Golden West Financial Corp. (GDW)

BUY (1)
Low Risk (L)

GDW: 1Q06 - Solid Quarter

Mkt Cap: **$22,185 mil.**

April 20, 2006

United States

BANKS

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SUMMARY

- Golden West reported 1Q06 EPS of $1.25, versus consensus of $1.26 and versus 4Q05 EPS of $1.27. In our view, it was a solid quarter, with (a) typical seasonal weakness and (b) atypical low-originations-with-very-high-runoff. If originations remain at these levels, we expect runoff to slow.
- Golden West's 1Q06 quarterly earnings resulted from: (a) an 8% increase in average earning assets (linked-quarter annualized); (b) a modestly wider net interest margin (2.84% versus 2.82% in 4Q05) and (b) efficient operations (efficiency ratio of 29%, a bit higher than 4Q05, but with options expensing).
- March data was consistent with 1Q06; we expect slower runoff/better portfolio growth in the rest of 2006, and expect core NIM to expand when the Fed stops.
- Based on 1Q06 results and on an expectation of the end of Fed rate hikes in 2Q06, we are keeping our 2006 EPS estimate at $5.38 and our 2007 EPS estimate at $6.17. We reiterate our Buy rating.

FUNDAMENTALS

P/E (12/06E)	13.4x
P/E (12/07E)	11.7x
TEV/EBITDA (12/06E)	NA
TEV/EBITDA (12/07E)	NA
Book Value/Share (12/06E)	$33.06
Price/Book Value	2.2x
Revenue (12/06E)	$3,893.5 mil.
Proj. Long-Term EPS Growth	12%
ROE (12/06E)	17.8%
Long-Term Debt to Capital(a)	NA

GDW is in the S&P 500® Index.

(a) Data as of most recent quarter

SHARE DATA

Price (4/20/06)	$71.89
52-Week Range	$73.41-$55.40
Shares Outstanding(a)	308.6 mil.
Div(E) (Cur/Prev)	**$0.24**/$0.24

RECOMMENDATION

Rating (Cur/Prev)	**1L**/1L
Target Price (Cur/Prev)	**$75.00**/$75.00
Expected Share Price Return	4.3%
Expected Dividend Yield	0.3%
Expected Total Return	4.7%

EARNINGS PER SHARE

FY ends		1Q	2Q	3Q	4Q	Full Year
12/05A	**Actual**	**$1.12A**	**$1.16A**	**$1.22A**	**$1.27A**	**$4.77A**
12/06E	**Current**	**$1.25A**	**$1.33E**	**$1.38E**	**$1.42E**	**$5.38E**
	Previous	$1.29E	$1.32E	$1.36E	$1.41E	$5.38E
12/07E	**Current**	**NA**	**NA**	**NA**	**NA**	**$6.17E**
	Previous	NA	NA	NA	NA	$6.17E
12/08E	**Current**	**NA**	**NA**	**NA**	**NA**	**$6.96E**
	Previous	NA	NA	NA	NA	$6.85E

First Call Consensus EPS: 12/06E $5.36; 12/07E $6.05; 12/08E $6.78

OPINION

Golden West reported 1Q06 EPS of $1.25, versus consensus of $1.26 and versus 4Q05 EPS of $1.27. In our view, it was a solid quarter, with (a) typical seasonal weakness and (b) atypical low-originations-with-very-high-runoff. If originations remain at these levels, we expect runoff to slow, and the loan portfolio/earning assets to grow faster. Based on 1Q06 results and on an expectation of the end of Fed rate hikes in 2Q06, we are keeping our 2006 EPS estimate at $5.38 and our 2007 EPS estimate at $6.17. We reiterate our Buy rating.

Golden West's 1Q06 quarterly earnings resulted from: (a) an 8% increase in average earning assets (linked-quarter annualized), with ARM originations ($11.5 billion) exceeding runoff ($8.9 billion), though by a lesser amount than in previous quarters; (b) a modestly wider net interest margin (2.84% versus 2.82% in 4Q05) and (b) efficient operations (efficiency ratio of 29%, slightly higher than in 4Q05, but with stock options expensing now included).

We note that, due to a change in regulatory reporting, Golden West's net interest margin (NIM) now includes prepayment penalties and late charges, which previously were included in noninterest income as "Fees". In 1Q06, it appears to us that Golden West's NIM, computed the "old" way (excluding prepayment penalties and late charges), was up versus 4Q05. We do not expect a consistent, upward core NIM trend until the Fed stops tightening, at which time we expect Golden West's core NIM to widen for the next 13 months; see "2006/2007" below. Nor do we expect Golden West to experience any problems with so-called payment option ARMs, Golden West's flagship product (see "No Danger from Payment Option ARMs" below) or from new mortgage guidelines (see "New Proposed Interagency Mortgage Guidelines" below).

Our Thesis : In our view, Golden West's core NIM will go down so long as the Fed hikes the fed funds rate, but that does not prevent EPS from going up, if, as we project: (a) Golden West's runoffs slow materially as mortgage rates rise; (b) originations slow less, because higher rates favor Golden West's monthly-adjustable ARMs; (c) thereby producing continued, strong earning asset growth; (d) which we expect to overpower continued NIM compression; (e) with the help of efficient operations. For full-year 2005, for example, EPS was up 16%, in spite of Fed interest rate hikes of 200 bps in 2005 (and 325 bps cumulatively).

2006/2007 : Importantly, as soon as the Fed interest rate hikes stop, Golden West's core NIM should widen for the next 13 months, due to the one-month reporting lag and 12-month repricing lag in Golden West's CODI index. CODI (Certificate of Deposit Index) is the 12-month moving average of 3-month CD rates, and is the index off which about one-half of Golden West's earning assets are priced. Assuming the end of Fed rate hikes in 2Q06, we are keeping our 2006 EPS estimate at $5.38 and our 2007 EPS estimate at $6.17.

March 2006 Portfolio/Spread Data : Golden West's March numbers were consistent with 1Q06 results, and slightly different from February's numbers. In March, Golden West's loan portfolio grew at an annualized rate of 8% (about 2% slower than February), and the net interest rate spread was down 2 bps (versus down 1 bp in February). ARM originations were up 27% from February's levels, but runoffs were up more (producing slower portfolio growth). In the remainder of 2006, we expect less runoff relative to originations. Because of the different lags in Golden West's ARM indices, it is not appropriate to extrapolate monthly changes in spreads, in our view. In 2Q06, we expect the net interest spread to stabilize, and we expect runoffs to slow, thus aiding portfolio growth. When the Fed stops tightening, we expect Golden West's core spread/NIM to recapture a good part of what it lost in the tightening cycle (Golden West's core NIM is currently down about 60 bps from its peak of 3.14% pre-Fed tightening, computed the "old" way).

Golden West Is Not A One-Month Story : Though Golden West reports various balance sheet and mortgage activity data on a monthly basis, Golden West is a long-term story – and arguably the best such story in financial services. The long-term earnings driver is net interest income (assisted by strong credit risk management and strong expense management), which in turn is driven by portfolio growth and the NIM. In the falling rate environment of 2001-2003 and in the rising rate environment of 2004-2005, Golden West has demonstrated that it can generate strong portfolio growth. Golden West's NIM was helped by falling rates in 2001-2003, and was hurt by rising rates in 2004-2005 – but EPS grew significantly in each of these years (16% in 2004 and in 2005). Our point is that one strong month is not sufficient reason to be enthused over GDW shares, just as one weaker month is not sufficient reason to be unenthused. Interest rate environments change, sometimes rapidly, and sometimes adverse to Golden West. We expect Golden West to stick to its proven reaction to adverse markets: maintain credit discipline and pricing discipline, regardless of what competitors are doing.

The Competitive ARM Environment : The 1Q06 mortgage market was generally characterized by tough competition for adjustable-rate mortgages (ARMs). Despite the competitive ARM environment, Golden West produced solid portfolio growth (8% linked-quarter annualized), though below the levels of previous quarters. And 99% of Golden West's originations in 1Q06 (as in every month since June 2004) were monthly-adjustable ARMs, demonstrating once again that Golden West is capable of producing strong ARM volumes in almost any interest rate environment.

As mentioned, competition for ARMs remained intense in 1Q06; based on discussions with Golden West management, we are comfortable that Golden West offers ARM payment options flexible enough, and has relationships with mortgage brokers strong enough, to be able to remain competitive with less rational competitors without giving up required profitability/rates of return. In other words, even in periods (such as recently) when competitors are more interested than usual in ARMs, Golden West has products/ARMs that offer prospective borrowers (and the mortgage brokers that typically have the face-to-face contact with these borrowers) competitive payments (not "teaser" rates) in initial periods, but that still generate attractive returns for Golden West. See discussion below of so-called payment option ARMs. Part of the reason that Golden West has more flexibility than its competitors is that Golden West retains all of its loans for its own portfolio; therefore, Golden West can customize its products to fit its needs and the needs of its borrowers. Golden West's competitors, on the other hand, typically sell many of their loans, and therefore must structure the loans to fit the (less flexible) needs of the buyer of the loans.

Originations/Runoff : Golden West's ARM origination volume in 1Q06 ($11.5 billion) was down 12% from its ARM origination volume in 4Q05 ($13.0 billion). We note, however, that our EPS estimates are not dependent upon a certain level of originations. A primary driver of Golden West's net interest income is the size of its ARM portfolio, which in turn is driven by both origination volume and runoff volume; lower originations and lower runoff work as well as higher originations and higher runoff. The ideal environment for Golden West is one of higher interest rates that both slow runoff and favor originations of ARMs (Golden West's niche) over fixed-rate mortgages; that environment prevailed for part of 2004, and it is possible that that environment could prevail sometime in the later part of 2006.

Efficient Operations : In general, Golden West's expense base is dependent upon the level of originations. As just explained, Golden West's growth in its ARM portfolio is indifferent between high originations/high runoff and lower originations/lower runoff. But Golden West's expense base is not indifferent: it favors lower volumes. If originations slow materially, we expect expenses to follow (due to less incentive pay and attrition), thereby contributing to EPS growth.

Net Interest Margin : Since mid-2004, investors in financial services stocks have been fixated on the impact of changing interest rates on earnings, and, in the case of depository institutions (banks and thrifts), the impact of changing interest rates on net interest margins. And with good reason. It is unreasonable, however, to assume that lower NIMs automatically mean lower earnings. Golden West derives some benefits from both higher rates and lower rates; as in the just-completed 1Q06, we forecast that, for the remainder of 2006, Golden West will benefit more than it is hurt.

Funding : Golden West's funding costs, of course, impact its net interest margin. Currently, deposits (generally the most desirable funding) constitute about 53% of Golden West's funding: this percentage has generally been declining as loan growth has exceeded deposit growth. In 1Q06, Golden West's loan/MBS growth was $2.9 billion; this loan/MBS growth of $2.9 billion was funded by deposits ($1.4 billion), reverse repos ($0.9 billion) and bank notes ($0.6 billion). While not optimal, that does not trouble us, because one of the main indices off which Golden West prices its monthly-adjustable ARMs is tied in varying degrees to Golden West's non-deposit sources of funding.

Valuation : In our view, Golden West's record performance in the 2001-2003 refi boom, defying conventional wisdom (that ARM originations are weak in refi booms), has made a strong case for multiple expansion for GDW shares, especially given Golden West's impressive transition in 2004/2005 to a non-refi-boom environment, its demonstrated ability to do well in a rising-rate environment and its relatively low risk profile; note that our risk rating for Golden West is Low Risk. See "Valuation" below.

NO DANGER FROM PAYMENT OPTION ARMS

So-called payment option ARMs, Golden West's flagship product, are monthly adjustable-rate mortgages (ARMs) that, during at least the first year, give the borrower the option of choosing a monthly payment that is below the payment that would fully amortize/pay off remaining principal and interest on the mortgage over its remaining life. Consequently, in a period of stable or rising rates, payment option ARMs can result in "negative amortization", that is, the unpaid interest is added to principal, producing a bigger mortgage/increased debt for the borrower. The perceived danger is that these mortgages appeal to borrowers trying to stretch to qualify for the largest mortgage possible, and encourage/allow them to become more extended (more in debt), and more prone to default.

In our view, payment option ARMs are not a danger to Golden West. The reasons are conservative underwriting and common-sense management; the proof is Golden West's exceptional track record in the 20-plus years that Golden West has been making these loans.

Consevative Underwriting : Unlike its competitors, Golden West has been making payment option ARM loans for a long time, and has a proprietary data base of past performance to guide its future underwriting. Unlike its competitors, Golden West does not use automated underwriting or rely on single-decision factors such as FICO scores. Instead, Golden West takes all factors into account, including those that its proprietary data base has identified as particularly relevant, and makes a reasoned decision. Factors include job history and income-based ratios, as well as loan-to-values (LTVs). Unlike some of its competitors, Golden West uses income-based ratios to qualify the borrower at the fully-amortizing payment, regardless of the payment option chosen. Unlike most of its competitors, Golden West uses appraisals by its own staff appraisers. LTVs at time of origination average about 72% (and go down if/as the house appreciates in value). In addition, Golden West does no mortgages of the types that we consider inherently more risky: subprime mortgages, 100% LTV mortgages, mortgages on high-end homes and mortgages for speculators/flippers.

Exceptional Track Record : Golden West has been making payment option ARM loans for more than 20 years, in periods including recessions, layoffs, falling housing markets and rising interest rates, and losses have been very low, usually nominal (almost no net losses in the past eight years). In 1994, with California in an economic recession (caused by end-of-Cold-War defense/aerospace layoffs) and in a real estate depression, Golden West had its worst year ever for net chargeoffs, a relatively low 18 bps of average loans.

Negative Amortization : We note that negative amortization has been present on numerous occasions during the exceptional track record just described. Golden West's mortgage portfolio has been subject to negative amortization in each extended period of rising rates, because the payment options set at the beginning of the year become insufficient to cover the pro-forma fully-amortizing payment as rates rise (payments options are set only once per year, based on rates at that time). This occurs even if all borrowers opt to make the fully-amortizing payment set at the beginning of the year. These amounts of deferred interest have always been very small relative to the size of Golden West's total mortgage portfolio (0.54% at the end of 1Q06). We also note that, conversely, accelerated (as opposed to negative) amortization has been present in each extended period of falling rates.

Non-Cash Income : Because the lender is permitted under GAAP to book as income the stated contract amount of interest (as opposed to the lower optional payment), periods of negative amortization produce some non-cash income (and periods of accelerated amortization produce some above-cash income). In 1Q06, this amounted to about 11% of interest income.

Common-Sense Management : The mortgage business is a cyclical business, with interest rates (including the shape of the yield curve) causing ebbs and flows in mortgage origination volumes and in the profitability environment. One of the mantras of Golden West co-CEOs Herb and Marion Sandler and their management team is not to do anything stupid/irrational in the toughest part (or any part) of the cycle. This means (among other things) not reducing underwriting standards. However, even retaining high standards, certain parts of the cycle produce some arguably less-than-optimal metrics (such as negative amortization). What Golden West's track record of credit quality and earnings (EPS growth rate of 19% over the past 35 years, 17% over the past 15 years, 21% over the past 10 years and 23% over the past 5 years, all compounded) says to us is that Golden West has always managed to navigate successfully through the tougher parts of the cycle, and to take advantage of the easier parts of the cycle, always staying disciplined and focused.

NEW PROPOSED INTERAGENCY MORTGAGE GUIDELINES

The much-anticipated interagency mortgage guidelines (see our First Call note dated September 23, 2005) were issued on December 20,2005, in proposed form (subject to a 60-day comment period, since extended). The title, and the focus, of the guidelines is "Nontraditional Mortgage Products", defined as "payment option" ARMs and "interest-only" mortgages (which are characterized by possible negative principal amortization and by no principal amortization, respectively). Inasmuch as payment option ARMs are Golden West's flagship (and only) product, one might expect these guidelines to contain nothing but bad news for Golden West. Instead, in our view, the guidelines could help Golden West, by (a) validating its flagship product, (b) validating its underwriting and disclosure policies and procedures (all of which appear to us to be consistent with the guidelines), and (c) eliminating some elements of irrational competition (thereby possibly increasing Golden West's market share and/or profitability).

Previous Guidelines : In May 2005, interagency guidelines on home equity (second mortgage) lending were issued jointly by the five regulators of U.S. depository institutions: the Fed (which supervises bank holding companies), the Federal Deposit Insurance Corporation (FDIC, which governs deposit insurance), the Office of the Comptroller of the Currency (OCC, which supervises national banks), the Office of Thrift Supervision (OTS, which supervises savings and loans/thrifts) and the National Credit Union Administration (which supervises credit unions). These guidelines encouraged more vigilant risk management practices for "higher risk" home equity products, such as those with high loan-to-collateral-values (LTVs), limited documentation or no documentation of income or net worth (low doc/no doc), interest-only payments (IOs) and third-party originations.

In June 2005, the OTS issued an appendix to its Examination Handbook dealing with negatively amortizing (NegAm) mortgages. As explained above, all of Golden West's mortgages are potentially negatively amortizing. According to the OTS: "If lenders carefully underwrite NegAm loans with prudent LTVs and monitor the loans closely, the added credit risk they face may be small and manageable." We submit that this describes Golden West. "However, aggressively underwritten NegAm loans without adequate controls raise supervisory concerns."

New Proposed Guidelines : The new proposed guidelines pick up where the previous guidelines left off, identifying practices and (lack of) controls that concern regulators in regard to nontraditional mortgage products (payment option ARMs and interest-only mortgages) . The main such practices appear to be: (1) establishing an introductory interest rate well below the fully-indexed rate; (2) qualifying potential borrowers at less than the fully-indexed payment (for mortgages with lower initial payments); (3) relying on reduced documentation to verify income and/or assets; (4) risk layering, that is, combining two or more of the just-mentioned practices, and/or combining nontraditional mortgage products with subprime borrowers and/or high loan-to-value mortgages; (5) ceding underwriting authority to a third party (such as so-called correspondent lenders); and (6) inadequate disclosure of payment shock, negative amortization and prepayment penalties. These practices have permitted marginal buyers and speculators to qualify for mortgages that they could not afford under prudent underwriting standards, thus creating "froth" (Fed ex-Chairman Greenspan's characterization) in the housing markets, as well as increasing the probability of default when the fully-indexed payments begin. We note that none of these practices occur at Golden West.

Impact of Guidelines : It is too soon to tell whether the guidelines will have a broad impact; the guidelines need to be finalized, and then it remains to be seen how much they will be publicized and how strictly they will be implemented. Judging by how GDW shares traded in the day following release of the proposed guidelines (up more than 2%), the market appears to agree with us that the proposed guidelines are benign at worst for Golden West.

More broadly, it is possible that: (a) once speculators (especially condo "flippers") consider the guidelines, the supply of housing for sale at the margin could increase (as speculators conclude that the music has just stopped in their game of musical chairs, causing them to liquidate their holdings); (b) once the guidelines take hold, the demand for housing at the margin could decrease (as potential marginal buyers are priced out of the market because they can qualify for only a much smaller mortgage than pre-guidelines); (c) higher marginal supply and lower marginal demand could combine to produce a cooling of the hottest housing markets (the very result that Chairman Greenspan presumably desires); and (d) that could lead to more dire predictions of a bursting bubble, causing a sell-off in the more risky mortgage-related stocks.

EARNINGS OUTLOOK

Our general economic outlook for 2006 is positive (real GDP growth of 3.4%), and our current interest rate outlook for short-term rates calls for the Fed to tighten an additional 25 bps in 2Q06. Our earnings outlook for Golden West in 2006 is also positive, though tempered by our expectation that national mortgage origination volumes in 2006 could be lower than 2005 levels; MBA is predicting a 14% decline, while Fannie Mae is predicting a 23% decline. For Golden West, we estimate 2006 ARM origination volume of $46 billion, down 10% from $51 billion in 2005 (but we also expect slower runoff). Based upon these factors, upon all of the factors already discussed and upon Golden West's 1Q06 results, we are keeping our 2006 EPS estimate at $5.38.

Net Interest Income: For 2006, we expect 15% growth in average earning assets/loans, through a combination of Golden West's increasing its national mortgage market share in "pure"/not-hybrid monthly-adjustable ARMs and of slower runoff / fewer refinancings. We expect Golden West's NIM to be stable (to 2.83% in 2006, versus 2.82% in 2005, both computed including prepayment penalties and late charges) as reporting/repricing lags in Golden West's ARM indices catch up with increases in short-term interest rates. Putting these two factors together, we expect 2006 net interest income to grow by 15% over 2005.

Provision / Credit Quality: Golden West's credit quality remained exceptionally strong in 2005: Golden West's net chargeoffs were 0.00% of loans, for the eighth consecutive year. And Golden West's credit quality should remain exceptionally strong in 2006; accordingly, a case could be made for no provisioning in 2006 (that is, no additions to the loan loss reserve), but we expect a provision of about $3 million per quarter.

Noninterest Income/Noninterest Expense: We expect Golden West's noninterest income in 2006 to be flat with the level of 2005, now that prepayment fees are included in interest income. With increased spending on infrastructure and expensing of stock options, we expect Golden West's core efficiency ratio to increase from 28%in 2005 to 29% in 2006.

VALUATION

In our view, it is easy to conclude that Golden West is an exceptional company; that it is considered exceptional, however, also makes valuation a difficult issue. In deriving our $75 target price, we have considered a book value/residual value analysis, an historical P/E analysis and a comparable company P/E analysis.

Our book value/residual value analysis assumes a 5.5% yield on the 10-year Treasury note (well above current levels) and a 17% ROE (well below recent performance), and, importantly, implies a 9% long-term growth rate in EPS at our target price of $75. While this 9% EPS growth rate is greater than the top end of our projected range (6%-8%) for the growth rate for the U.S. mortgage market, it is well, well below the company's historical EPS growth rate (19% over the past 35 years, 17% over the past 15 years, 21% over the past 10 years and 23% over the past 5 years, all compounded). By our analysis, based upon historical EPS growth rates alone, Golden West would appear to be materially undervalued.

However, Golden West has typically traded below its book value/residual value valuation. Over the past 10 years, GDW shares have typically traded at a forward P/E multiple of between 9x and 14x, averaging about 12x. We note, however, that GDW shares traded at 16x-17x in 2Q98 and in 4Q00; what both of those periods had in common was a rising interest rate environment, similar to the environment that we believe will prevail in at least part of 2006.

The only large financial institution that has a 15-year EPS compounded-growth-rate record comparable to Golden West's is Fifth Third Bancorp, whose 15-year EPS compounded growth rate is also 17%. However, in 2004, Golden West held its form (EPS up 16%), while Fifth Third stumbled (EPS down 7%), and continued to stumble in 2005: therefore, GDW shares deserve a premium P/E multiple to FITB shares, in our view. The only large financial institution that has an 18-year record of uninterrupted growth in EPS and dividends is Marshall & Ilsley Corporation. However, Marshall & Ilsley's 20-year EPS compounded growth rate is 10%, well below Golden West's: therefore, GDW shares also deserve a premium P/E multiple to MI shares, in our view. Our target-price 2006E P/E multiple of 13.9x is below the 2006E P/E multiple of Fifth Third (14.7x) and in-line with the 2006E P/E multiple of Marshall & Ilsley (13.8x), and below Golden West's forward P/E multiple in 2Q98 and in 4Q00 (16x-17x).

In a comparison between our target price 2006E P/E multiple for Golden West (13.9x) and a composite 2006E P/E multiple comprised of related multiples from Countrywide Financial, and IndyMac Bancorp - using First Call consensus estimates (the composite multiple is 9.0x), the relative premium is well justified, in our view, because of Golden West's superior execution and overall performance over a sustained period.

In our view, Golden West's record performance in the most recent refi boom, defying conventional wisdom (that ARM originations are weak in refi booms), has made a strong case for multiple expansion for GDW shares, especially given Golden West's impressive transition to a non-refi-boom environment, its demonstrated ability to do well in a rising-rate environment (see above) and its relatively low risk profile; note our Low Risk rating below.

RISKS

We rate Golden West Financial Low Risk based on its high earnings stability, larger market capitalization, strong debt rating and average share price volatility.

The major risk we see at present is rising interest rates: Golden West is liability-sensitive, and thus subject to more interest rate risk from rising interest rates than depository institutions that are asset-sensitive.

About 65% of Golden West's borrowers are situated in California; if the economy of California fares poorly or worse than the national economy, this would have a negative impact on Golden West's credit quality. We also note that some commentators believe there is currently a "housing bubble" (characterized by inflated home prices) in certain housing markets in the United States. A steep fall in home prices could have a negative impact on Golden West's credit quality, since homes are collateral for almost all of Golden West's loans. Also, with the end of the refi boom, Golden West has been subject to greater competition for ARMs from major mortgage lenders. In addition, Golden West, like all of its mortgage-centric peers, is subject to prepayment risk and mortgage cyclicality, which can produce earnings volatility, as mortgage origination volumes fluctuate with interest rates.

If the negative impact upon the company's earnings from any of these factors proves to be greater than we anticipate, then GDW shares will likely have difficulty achieving our target price.

INVESTMENT THESIS

We rate the shares of Golden West Financial Corp. Buy/ Low Risk (1L). Under the leadership of the husband and wife team of Herbert and Marion Sandler, Golden West has produced a nearly 40-year earnings growth record that has established the company, not only as the nation's leading thrift, but also as one the nation's leading depository institutions. Golden West has grown EPS at a compounded rate over the past 35 years, 15 years, 10 years, and five years of 19%, 17%, 22%, and 23%, respectively. The company's business model is built around its disciplined strategy of focusing on the origination, (for its own on-balance-sheet portfolio), of prime, pure (not hybrid) monthly adjustable-rate mortgages (ARMs). This is a strategy that minimizes credit risk (almost no net charge-offs in the past eight years), interest rate risk, and operating risk (efficiency ratio of 28%). The strategy has also enabled the company to prosper throughout mortgage finance/interest rate cycles. As such, we view this as a unique company that deserves a unique valuation.

COMPANY DESCRIPTION

Golden West Financial Corp. (GDW) is the holding company for World Savings Bank FSB, the nation's second largest thrift, and is headquartered in Oakland, California. Golden West has 283 branches in 10 states, and lending operations in 39 states throughout the United States. The company is a leading national originator of monthly adjustable-rate mortgages, which Golden West holds on its balance sheet. As of March 31, 2006, the company had $128 billion in assets.

ANALYST CERTIFICATION

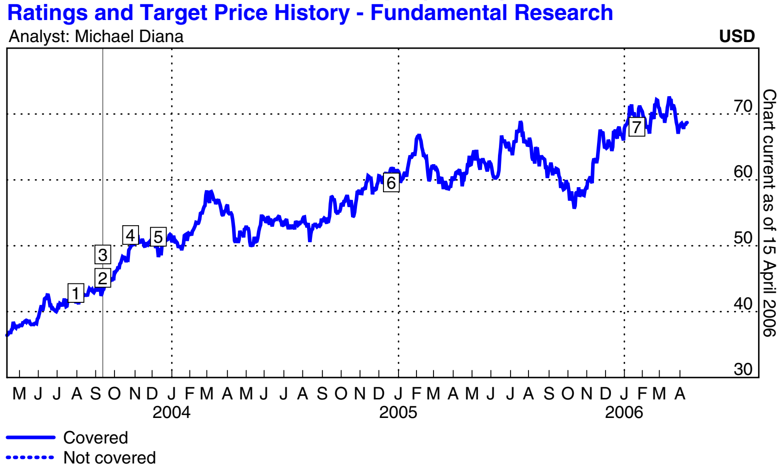
APPENDIX A-1

I, Michael Diana, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Golden West Financial Corp. (GDW)

Ratings and Target Price History - Fundamental Research



#	Date	Rating	Target Price	Closing Price
1:	31 Jul 03	2M	*45.00	41.30
2:	12 Sep 03	Stock rating system changed		
3:	12 Sep 03	*1L	*48.50	43.34
4:	27 Oct 03	1L	*55.00	49.81
5:	10 Dec 03	1L	*65.00	48.29
6:	21 Dec 04	1L	*70.00	61.85
7:	24 Jan 06	1L	*75.00	68.06

*Indicates change.

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Data current as of 31 March 2006	**Buy**	**Hold**	**Sell**
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% of companies in each rating category that are investment banking clients	46%	43%	32%
Banks -- North America (42)	33%	60%	7%
% of companies in each rating category that are investment banking clients	86%	44%	0%

Guide to Fundamental Research Investment Ratings:

Citigroup Investment Research's stock recommendations include a risk rating and an investment rating.

Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).

Investment ratings are a function of Citigroup Investment Research's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings are: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

Between September 9, 2002, and September 12, 2003, Citigroup Investment Research's stock ratings were based upon expected performance over the following 12 to 18 months relative to the analyst's industry coverage universe at such time. An Outperform (1) rating indicated that we expected the stock to outperform the analyst's industry coverage universe over the coming 12-18 months. An In-line (2) rating indicated that we expected the stock to perform approximately in line with the analyst's coverage universe. An Underperform (3) rating indicated that we expected the stock to underperform the analyst's coverage universe. In emerging markets, the same ratings classifications were used, but the stocks were rated based upon expected performance relative to the primary market index in the region or country. Our complementary Risk rating system -- Low (L), Medium (M), High (H), and Speculative (S) -- took into account predictability of financial results and stock price volatility. Risk ratings for Asia Pacific were determined by a quantitative screen which classified stocks into the same four risk categories. In the major markets, our Industry rating system -- Overweight, Marketweight, and Underweight -- took into account each analyst's evaluation of their industry coverage as compared to the primary market index in their region over the following 12 to 18 months.

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