

CAPSTEAD MORTGAGE CORP

Form 10-Q

May 08, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-08896

CAPSTEAD MORTGAGE CORPORATION

(Exact name of Registrant as specified in its Charter)

Maryland

(State or other jurisdiction of incorporation or organization)

75-2027937

(I.R.S. Employer Identification No.)

8401 North Central Expressway, Suite 800, Dallas, TX 75225-4404

(Address of principal executive offices)

(Zip Code)

(214) 874-2323

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Edgar Filing: CAPSTEAD MORTGAGE CORP - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock (\$0.01 par value) 95,812,050 as of May 8, 2015

CAPSTEAD MORTGAGE CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2015

INDEX

PART I. $\frac{3}{4}$ FINANCIAL INFORMATION

	Page
ITEM 1. Financial Statements (unaudited)	
<u>Consolidated Balance Sheets $\frac{3}{4}$ March 31, 2015 and December 31, 2014</u>	3
<u>Consolidated Statements of Income $\frac{3}{4}$ Quarter Ended March 31, 2015 and 2014</u>	4
<u>Consolidated Statements of Comprehensive Income $\frac{3}{4}$ Quarter Ended March 31, 2015 and 2014</u>	5
<u>Consolidated Statements of Cash Flows $\frac{3}{4}$ Quarter Ended March 31, 2015 and 2014</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
ITEM 3. <u>Quantitative and Qualitative Disclosure of Market Risk</u>	46
ITEM 4. <u>Controls and Procedures</u>	46
PART II. $\frac{3}{4}$ OTHER INFORMATION	
ITEM 6. <u>Exhibits</u>	46
<u>SIGNATURES</u>	48
Computation of Ratio of Income from Continuing Operations	
Certification Pursuant to Section 302(a)	
Certification Pursuant to Section 302(a)	
Certification Pursuant to Section 906	

Index

ITEM 1. FINANCIAL STATEMENTS

PART I. ¾ FINANCIAL INFORMATION

CAPSTEAD MORTGAGE CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except pledged and per share amounts)

	March 31, 2015 (unaudited)	December 31, 2014
Assets		
Residential mortgage investments (\$13.59 and \$13.48 billion pledged under repurchase arrangements at March 31, 2015 and December 31, 2014, respectively)	\$ 14,150,084	\$ 13,908,104
Cash collateral receivable from interest rate swap counterparties	61,669	53,139
Interest rate swap agreements at fair value	285	1,657
Cash and cash equivalents	205,615	307,526
Receivables and other assets	114,229	118,643
	\$ 14,531,882	\$ 14,389,069
Liabilities		
Repurchase arrangements and similar borrowings	\$ 12,938,508	\$ 12,806,843
Interest rate swap agreements at fair value	37,791	27,034
Unsecured borrowings	100,000	100,000
Common stock dividend payable	30,701	34,054
Accounts payable and accrued expenses	28,583	30,367
	13,135,583	12,998,298
Stockholders' equity		
Preferred stock - \$0.10 par value; 100,000 shares authorized: 7.50% Cumulative Redeemable Preferred Stock, Series E, 8,050 and 7,618 shares issued and outstanding (\$201,247 and \$190,454 aggregate liquidation preferences) at March 31, 2015 and December 31, 2014, respectively	194,587	183,936
Common stock - \$0.01 par value; 250,000 shares authorized: 95,812 and 95,848 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	958	958
Paid-in capital	1,325,633	1,325,340
Accumulated deficit	(346,465)	(346,885)
Accumulated other comprehensive income	221,586	227,422
	1,396,299	1,390,771
	\$ 14,531,882	\$ 14,389,069

See accompanying notes to consolidated financial statements.

IndexCAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME(in thousands, except per share amounts)
(unaudited)

	Quarter Ended	
	March 31	
	2015	2014
Interest income:		
Residential mortgage investments	\$58,645	\$59,445
Other	94	61
	58,739	59,506
Interest expense:		
Repurchase arrangements and similar borrowings	(19,214)	(15,407)
Unsecured borrowings	(2,123)	(2,122)
	(21,337)	(17,529)
	37,402	41,977
Other revenue (expense):		
Salaries and benefits	(1,049)	(1,132)
Short-term incentive compensation	(692)	(540)
Long-term incentive compensation	(608)	(626)
Other general and administrative expense	(1,149)	(1,203)
Miscellaneous other revenue (expense)	53	(85)
	(3,445)	(3,586)
Net income	\$33,957	\$38,391
Net income available to common stockholders:		
Net income	\$33,957	\$38,391
Less preferred stock dividends	(3,742)	(3,238)
	\$30,215	\$35,153
Net income per common share:		
Basic and diluted	\$0.32	\$0.37
Weighted average common shares outstanding:		
Basic	95,469	95,349
Diluted	95,674	95,538
Cash dividends declared per share:		
Common	\$0.31	\$0.34
Series E Preferred	0.47	0.47

See accompanying notes to consolidated financial statements.

IndexCAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, unaudited)

	Quarter Ended	
	March 31	
	2015	2014
Net income	\$33,957	\$38,391
Other comprehensive income (loss)		
Amounts related to available-for-sale securities:		
Change in net unrealized gains	6,107	16,693
Amounts related to cash flow hedges:		
Change in net unrealized losses	(18,391)	(12,656)
Reclassification adjustment for amounts included in net income	6,448	4,722
	(5,836)	8,759
Comprehensive income	\$28,121	\$47,150

See accompanying notes to consolidated financial statements.

IndexCAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Quarter Ended March 31	
	2015	2014
Operating activities:		
Net income	\$33,957	\$38,391
Noncash items:		
Amortization of investment premiums	25,078	22,288
Amortization of equity-based awards	724	718
Other depreciation and amortization	33	37
Change in measurable hedge ineffectiveness related to interest rate swap agreements designated as cash flow hedges	185	–
Net change in receivables, other assets, accounts payable and accrued expenses	(1,131)	(37)
Net cash provided by operating activities	58,846	61,397
Investing activities:		
Purchases of residential mortgage investments	(959,548)	(669,003)
Interest receivable acquired with the purchase of residential mortgage investments	(1,534)	(1,121)
Principal collections on residential mortgage investments, including changes in mortgage securities principal remittance receivable	703,688	617,074
Net cash used in investing activities	(257,394)	(53,050)
Financing activities:		
Proceeds from repurchase arrangements and similar borrowings	29,887,321	31,981,126
Principal payments on repurchase arrangements and similar borrowings	(29,755,657)	(31,873,771)
Increase in cash collateral receivable from interest rate swap Counterparties	(8,530)	(10,494)
Proceeds from issuance of preferred shares	10,651	1,336
Other capital stock transactions	(429)	(512)
Dividends paid	(36,719)	(33,095)
Net cash provided by financing activities	96,637	64,590
Net change in cash and cash equivalents	(101,911)	72,937
Cash and cash equivalents at beginning of period	307,526	413,356
Cash and cash equivalents at end of period	\$205,615	\$486,293

See accompanying notes to consolidated financial statements.

Index

CAPSTEAD MORTGAGE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2015
(unaudited)

NOTE 1 ¾ BUSINESS

Capstead Mortgage Corporation operates as a self-managed real estate investment trust for federal income tax purposes (a “REIT”) and is based in Dallas, Texas. Unless the context otherwise indicates, Capstead Mortgage Corporation, together with its subsidiaries, is referred to as “Capstead” or the “Company.” Capstead earns income from investing in a leveraged portfolio of residential mortgage pass-through securities consisting almost exclusively of adjustable-rate mortgage (“ARM”) securities issued and guaranteed by government-sponsored enterprises, either Fannie Mae or Freddie Mac (together, the “GSEs”), or by an agency of the federal government, Ginnie Mae. Residential mortgage pass-through securities guaranteed by the GSEs or Ginnie Mae are referred to as “Agency Securities” and are considered to have limited, if any, credit risk.

NOTE 2 ¾ BASIS OF PRESENTATION

Interim Financial Reporting and Reclassifications

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended March 31, 2015 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2015. For further information refer to the audited consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2014.

Recent Accounting Pronouncements

In June 2014 the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) 2014-11, Transfers and Servicing: Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures (“ASU 2014-11”). ASU 2014-11 requires repurchase-to-maturity transactions to be accounted for as financings and eliminates existing guidance regarding so-called “linked transactions” between a buyer of securities and a seller that also provides related repurchase financings. ASU 2014-11 also introduces new disclosure requirements and is effective for periods beginning after December 15, 2014. The Company adopted ASU 2014-11 in the current quarter. As the Company has not entered into any repurchase-to-maturity or linked transactions, the provisions of this ASU had no effect on the Company’s results of operations, financial condition, or cash flows.

NOTE 3 ¾ NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income, after deducting dividends paid or accrued on preferred stock and allocating earnings to equity awards deemed to be participating securities pursuant to the two-class method, by the weighted average number of shares of common stock outstanding, calculated excluding unvested stock awards. Participating securities include any unvested equity awards that contain non-forfeitable rights to dividends prior to vesting.

Index

Diluted net income per common share is computed by dividing the numerator used to compute basic net income per common share by the denominator used to compute basic net income per common share, further adjusted for the dilutive effect, if any, of equity awards and shares of preferred stock when and if convertible into shares of common stock. Shares of the Company's 7.50% Series E Cumulative Redeemable Preferred Stock are contingently convertible into shares of common stock only upon the occurrence of a change in control and therefore are not considered dilutive securities absent such an occurrence. Any unvested equity awards that are deemed participating securities are included in the calculation of diluted net income per common share, if dilutive, under either the two-class method or the treasury stock method, depending upon which method produces the more dilutive result.

Components of the computation of basic and diluted net income per common share were as follows for the indicated periods (dollars in thousands, except per share amounts):

	Quarter Ended	
	March 31	
	2015	2014
Basic net income per common share		
Numerator for basic net income per common share:		
Net income	\$33,957	\$38,391
Preferred stock dividends	(3,742)	(3,238)
Earnings participation of unvested equity awards	(34)	(24)
	\$30,181	\$35,129
Denominator for basic net income per common share:		
Weighted average common stock outstanding	95,825	95,777
Average unvested stock awards outstanding	(356)	(428)
	95,469	95,349
	\$0.32	\$0.37
Diluted net income per common share		
Numerator for diluted net income per common share:		
Numerator for basic net income per common share	\$30,181	\$35,129
Denominator for diluted net income per common share:		
Denominator for basic net income per common share	95,469	95,349
Net effect of dilutive equity awards	205	189
	95,674	95,538
	\$0.32	\$0.37

Index

NOTE 4 ¾ RESIDENTIAL MORTGAGE INVESTMENTS

Residential mortgage investments classified by collateral type and interest rate characteristics as of the indicated dates were as follows (dollars in thousands):

	Unpaid Principal Balance	Investment Premiums	Amortized Cost Basis	Carrying Amount ^(a)	Net WAC ^(b)	Average Yield ^(b)	
March 31, 2015							
Agency Securities:							
Fannie Mae/Freddie Mac:							
Fixed-rate	\$1,335	\$4	\$1,339	\$1,340	6.64 %	6.02	%
ARMs	10,381,104	334,577	10,715,681	10,958,273	2.51	1.76	
Ginnie Mae ARMs	3,061,079	106,549	3,167,628	3,183,873	2.60	1.45	
	13,443,518	441,130	13,884,648	14,143,486	2.53	1.69	
Residential mortgage loans:							
Fixed-rate	1,701	1	1,702	1,702	6.92	5.67	
ARMs	2,891	12	2,903	2,903	3.73	3.22	
	4,592	13	4,605	4,605	4.91	4.12	
Collateral for structured financings	1,961	32	1,993	1,993	8.11	7.75	
	\$13,450,071	\$441,175	\$13,891,246	\$14,150,084	2.53	1.70	
December 31, 2014							