

CAPSTEAD MORTGAGE CORP
Form 10-Q
October 30, 2018

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: September 30, 2018

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)

8401 North Central Expressway, Suite 800, Dallas, TX

(Address of principal executive offices)

(214) 874-2323

75-2027937

(I.R.S.

Employer

Identification

No.)

75225-4404

(Zip Code)

(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 every Interactive Data File required to be submitted 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 such files). YES NO

Edgar Filing: CAPSTEAD MORTGAGE CORP - Form 10-Q

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

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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) 90,927,815 as of October 30, 2018

CAPSTEAD MORTGAGE CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2018

INDEX

PART I. — FINANCIAL INFORMATION

	Page
ITEM 1. <u>Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets — September 30, 2018 and December 31, 2017</u>	3
<u>Consolidated Statements of Income — Quarter and Nine Months Ended September 30, 2018 and 2017</u>	4
<u>Consolidated Statements of Comprehensive Income — Quarter and Nine Months Ended September 30, 2018 and 2017</u>	5
<u>Consolidated Statements of Cash Flows — Nine Months Ended September 30, 2018 and 2017</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>	37
ITEM 4. <u>Controls and Procedures</u>	37
<u>PART II. — OTHER INFORMATION</u>	
ITEM 1A. <u>Risk Factors</u>	38
ITEM 6. <u>Exhibits</u>	38
<u>SIGNATURES</u>	40

ITEM 1. FINANCIAL STATEMENTS

PART I. — FINANCIAL INFORMATION

CAPSTEAD MORTGAGE CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except pledged and per share amounts)

	September 30, 2018	December 31, 2017
	(unaudited)	
Assets		
Residential mortgage investments (\$12.25 and \$12.98 billion pledged at September 30, 2018 and December 31, 2017, respectively)	\$ 12,681,791	\$ 13,454,098
Cash collateral receivable from interest rate swap counterparties	26,293	42,506
Cash and cash equivalents	31,725	103,907
Receivables and other assets	152,216	132,938
	\$ 12,892,025	\$ 13,733,449
Liabilities		
Secured borrowings	\$ 11,619,966	\$ 12,331,060
Interest rate swap agreements at fair value	13,012	23,772
Unsecured borrowings	98,266	98,191
Common stock dividend payable	10,365	18,487
Accounts payable and accrued expenses	29,323	23,063
	11,770,932	12,494,573
Stockholders' equity		
Preferred stock - \$0.10 par value; 100,000 shares authorized: 7.50% Cumulative Redeemable Preferred Stock, Series E, 10,329 shares issued and outstanding (\$258,226 aggregate liquidation preference) at September 30, 2018 and December 31, 2017	250,946	250,946
Common stock - \$0.01 par value; 250,000 shares authorized: 91,068 and 95,698 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	911	957
Paid-in capital	1,220,415	1,271,425
Accumulated deficit	(346,570)	(346,570)
Accumulated other comprehensive (loss) income	(4,609)	62,118
	1,121,093	1,238,876
	\$ 12,892,025	\$ 13,733,449

See accompanying notes to consolidated financial statements.

-3-

CAPSTEAD MORTGAGE CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	Quarter Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Interest income:				
Residential mortgage investments	\$67,649	\$57,073	\$201,989	\$168,017
Other	350	366	1,063	757
	67,999	57,439	203,052	168,774
Interest expense:				
Secured borrowings	(54,393)	(36,655)	(147,655)	(98,745)
Unsecured borrowings	(1,910)	(1,910)	(5,701)	(5,701)
	(56,303)	(38,565)	(153,356)	(104,446)
	11,696	18,874	49,696	64,328
Other revenue (expense):				
Compensation-related expense	(1,913)	(1,073)	(5,521)	(4,021)
Other general and administrative expense	(1,184)	(1,097)	(3,320)	(3,435)
Miscellaneous other revenue	81	48	233	130
	(3,016)	(2,122)	(8,608)	(7,326)
Net income	\$8,680	\$16,752	\$41,088	\$57,002
Net income available to common stockholders:				
Net income	\$8,680	\$16,752	\$41,088	\$57,002
Less preferred stock dividends	(4,842)	(4,718)	(14,526)	(12,600)
	\$3,838	\$12,034	\$26,562	\$44,402
Net income per common share:				
Basic and diluted	\$0.04	\$0.13	\$0.29	\$0.46
Weighted average common shares outstanding:				
Basic	91,206	95,792	92,202	95,768
Diluted	91,346	95,923	92,317	95,905
Cash dividends declared per share:				
Common	\$0.11	\$0.19	\$0.41	\$0.61
Series E preferred	0.47	0.47	1.41	1.41

See accompanying notes to consolidated financial statements.

-4-

CAPSTEAD MORTGAGE CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, unaudited)

	Quarter Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Net income	\$8,680	\$16,752	\$41,088	\$57,002
Other comprehensive (loss) income				
Amounts related to available-for-sale securities:				
Change in net unrealized losses	(26,771)	(7,072)	(87,336)	(14,496)
Amounts related to cash flow hedges:				
Change in net unrealized gains	7,580	1,827	46,385	3,541
Reclassification adjustment for amounts				
included in net income	(11,162)	(3,213)	(25,776)	(2,207)
Comprehensive (loss) income	(30,353)	(8,458)	(66,727)	(13,162)
	\$(21,673)	\$8,294	\$(25,639)	\$43,840

See accompanying notes to consolidated financial statements.

CAPSTEAD MORTGAGE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Nine Months Ended September 30	
	2018	2017
Operating activities:		
Net income	\$41,088	\$57,002
Noncash items:		
Amortization of investment premiums	88,293	98,996
Amortization of equity-based awards	1,477	1,671
Other depreciation and amortization	79	89
Change in recorded measureable hedge ineffectiveness on		
interest rate swap agreements designated as cash flow hedges	–	36
Net change in receivables, other assets, accounts payable and		
accrued expenses	6,461	1,877
Net cash provided by operating activities	137,398	159,671
Investing activities:		
Purchases of residential mortgage investments	(2,158,970)	(3,380,199)
Interest receivable acquired with the purchase of residential		
mortgage investments	(4,167)	(5,410)
Principal collections on residential mortgage investments,		
including changes in mortgage securities principal remittance		
receivable	2,739,267	2,972,002
Net cash provided by (used in) investing activities	576,130	(413,607)
Financing activities:		
Proceeds from repurchase arrangements and similar		
borrowings	137,810,441	126,991,975
Principal payments on repurchase arrangements and similar		
borrowings	(138,521,532)	(126,669,933)
Increase (decrease) in cash collateral receivable from interest rate		
swap counterparties	16,213	(17,590)
Net proceeds from interest rate swap settlements	10,906	8,842
Proceeds from issuance of preferred shares	–	52,051
Common stock repurchases	(41,313)	–
Other capital stock transactions	(72)	(261)

Edgar Filing: CAPSTEAD MORTGAGE CORP - Form 10-Q

Dividends paid	(60,353)	(74,426)
Net cash (used in) provided by financing activities	(785,710)	290,658)
Net change in cash and cash equivalents	(72,182)	36,722)
Cash and cash equivalents at beginning of period	103,907		56,732	
Cash and cash equivalents at end of period	\$31,725		\$93,454	

See accompanying notes to consolidated financial statements.

CAPSTEAD MORTGAGE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018

(unaudited)

NOTE 1 — 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, Freddie Mac, or by an agency of the federal government, Ginnie Mae. Residential mortgage pass-through securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae are referred to as “Agency Securities” and are considered to have limited, if any, credit risk.

NOTE 2 — BASIS OF PRESENTATION

Interim Financial Reporting

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 and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2018. 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, 2017.

Recent Accounting Pronouncements

In November 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-18, Statement of Cash Flows: Restricted Cash (“ASU 2016-18”) which clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company adopted ASU 2016-18 on January 1, 2018, which had no effect on the Company’s results of operations, financial condition or cash flows.

In May 2017, the FASB issued Accounting Standards Update No. 2017-09, Compensation-Stock Compensation: Scope of Modification Accounting (“ASU 2017-09”) which allows companies to make certain changes to stock awards without accounting for them as modifications. It does not change the accounting for modifications. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company adopted ASU 2017-09 on January 1, 2018, which had no effect on the Company’s results of operations,

financial condition or cash flows.

-7-

NOTE 3 — 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 average number of shares of common stock outstanding, calculated excluding unvested stock awards. Participating securities include unvested equity awards that contain non-forfeitable rights to dividends prior to vesting.

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 September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Basic net income per common share				
Numerator for basic net income per common share:				
Net income	\$8,680	\$16,752	\$41,088	\$57,002
Preferred stock dividends	(4,842)	(4,718)	(14,526)	(12,600)
Earnings participation of unvested equity awards	(24)	(36)	(84)	(116)
	\$3,814	\$11,998	\$26,478	\$44,286
Denominator for basic net income per common share:				
Average number of shares of common stock outstanding	91,659	96,094	92,649	96,073
Average unvested stock awards outstanding	(453)	(302)	(447)	(305)
	91,206	95,792		