CAPSTEAD MORTGAGE CORP
Form 10-Q/A
January 27, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q/A
(Amendment No. 2)

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

For the quarterly period ended: September 30, 2008

OR

o **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	**75-2027937**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8401 North Central Expressway, Suite 800, Dallas, TX	**75225**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(214) 874-2323**

Indicate by check mark whether the Registrant (1) has filed all documents and 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 þ NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock ($0.01 par value)	58,780,175 as of October 30, 2008

CAPSTEAD MORTGAGE CORPORATION
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EXPLANATORY NOTE RECLASSIFYING RESTATEMENT

On January 12, 2009, Capstead Mortgage Corporation (the Company) filed its Amendment No. 1 to Form 10-Q, filed on Form 10-Q/A, to restate the Company s consolidated statements of income for the quarter and nine months ending September 30, 2008 to reflect (a) interest income from overnight investments and collateral deposits on interest rate swap agreements with interest income on mortgage securities and similar investments to arrive at total interest income and (b) interest expense from unsecured borrowings with interest expense from repurchase arrangements and similar borrowings in order to reflect a more all-inclusive measure of net interest margin. The reclassifications contained in this restatement do not change the Company s previously reported net income, earnings per share or stockholders equity for any of the aforementioned periods. In addition, the restatement does not impact the Company s consolidated balance sheets, statements of stockholders equity or cash flows for the indicated periods.

This Amendment No. 2 to Form 10-Q has been filed in order to conform Management s Discussion and Analysis more precisely to the revised presentation on the restated consolidated statements of income. This Amendment No. 2 does not amend or restate the financial statements included in Amendment No. 1.

The reclassifications contained in these restatements do not change the Company s previously reported net income, earnings per share or stockholders equity for any of the aforementioned periods. In addition, the restatements do not impact the Company s consolidated balance sheets, statements of stockholders equity or cash flows for the indicated periods.

Management and the Audit Committee of the Board of Directors have discussed these matters with the Company s independent registered public accounting firm, Ernst & Young, LLP.

For the convenience of the reader, this Amendment No. 2 to Form 10-Q/A sets forth the Company s original Form 10-Q as filed with the SEC on October 30, 2008 (the Original 10-Q) in its entirety, as amended by, and to reflect, the reclassifications required by this restatement. No other attempt has been made in this Form 10-Q/A to update other disclosures presented in the Original 10-Q, except as required to reflect the effects of the restatement. This Form 10-Q/A does not reflect events occurring after the filing of the Original 10-Q or modify or update those disclosures, including the exhibits to the Original 10-Q affected by subsequent events.

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ITEM 1. FINANCIAL STATEMENTS
PART I. FINANCIAL INFORMATION
CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

		September 30, 2008 (unaudited)		*December 31, 2007*
Assets:				
Mortgage securities and similar investments ($7.7 billion pledged under repurchase arrangements)	$	7,936,112	$	7,108,719
Investments in unconsolidated affiliates		3,117		3,117
Interest rate swap agreements at fair value		5,202		
Receivables and other assets		108,502		90,437
Cash and cash equivalents		137,475		6,653
	$	8,190,408	$	7,208,926
Liabilities:				
Repurchase arrangements and similar borrowings	$	7,242,848	$	6,500,362
Unsecured borrowings		103,095		103,095
Interest rate swap agreements at fair value		8,867		2,384
Common stock dividend payable		32,024		9,786
Accounts payable and accrued expenses		37,171		32,382
		7,424,005		6,648,009
Stockholders equity:				
Preferred stock $0.10 par value; 100,000 shares authorized:				
$1.60 Cumulative Preferred Stock, Series A, 197 and 202 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively ($3,232 aggregate liquidation preference)		2,755		2,828
$1.26 Cumulative Convertible Preferred Stock, Series B, 15,819 shares issued and outstanding at September 30, 2008 and December 31, 2007 ($180,025 aggregate liquidation preference)		176,705		176,705
Common stock $0.01 par value; 250,000 shares authorized: 58,226 and 40,819 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively		582		408
Paid-in capital		932,113		702,170
Accumulated deficit		(358,155)		(358,155)
Accumulated other comprehensive income		12,403		36,961
		766,403		560,917

	$	8,190,408	$	7,208,926

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Quarter Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
		(as Restated, see NOTE 13)		
Interest income:				
Mortgage securities and similar investments	$ 99,205	$ 74,949	$ 302,888	$ 222,886
Other	346	212	1,932	313
	99,551	75,161	304,820	223,199
Interest expense:				
Repurchase arrangements and similar borrowings	(60,032)	(66,478)	(184,357)	(197,174)
Unsecured borrowings	(2,186)	(2,186)	(6,560)	(6,560)
	(62,218)	(68,664)	(190,917)	(203,734)
	37,333	6,497	113,903	19,465
Other revenue (expense):				
Loss from portfolio restructuring		(8,276)	(1,408)	(8,276)
Other revenue (expense)	(45)	62	(61)	1,069
Incentive compensation	(300)		(4,820)	
Other operating expense	(2,306)	(1,678)	(6,187)	(4,891)
	(2,651)	(9,892)	(12,476)	(12,098)
Income (loss) before equity in earnings of unconsolidated affiliates	34,682	(3,395)	101,427	7,367
Equity in earnings of unconsolidated affiliates	64	247	194	1,486
Net income (loss)	$ 34,746	$ (3,148)	$ 101,621	$ 8,853
Net income available (loss attributable) to common stockholders:				
Net income (loss)	$ 34,746	$ (3,148)	$ 101,621	$ 8,853
Less cash dividends paid on preferred stock	(5,062)	(5,064)	(15,189)	(15,192)

	$ 29,684	$ (8,212)	$ 86,432	$ (6,339)
Net income (loss) per common share:				
Basic	$ 0.53	$ (0.43)	$ 1.66	$ (0.33)
Diluted	0.52	(0.43)	1.64	(0.33)
Cash dividends declared per share:				
Common	$ 0.550	$ 0.040	$ 1.660	$ 0.100
Series A Preferred	0.400	0.400	1.200	1.200
Series B Preferred	0.315	0.315	0.945	0.945

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	Nine Months Ended September 30	
	2008	2007
Operating activities:		
Net income	$ 101,621	$ 8,853
Noncash items:		
Amortization of investment premiums	23,208	17,855
Depreciation and other amortization	184	171
Equity-based compensation costs	948	673
Amounts related to interest rate swap agreements	528	
Loss from portfolio restructuring	1,408	8,276
Net change in receivables, other assets, accounts payable and accrued expenses	17,500	4,968
Net cash provided by operating activities	145,397	40,796
Investing activities:		
Purchases of mortgage securities and similar investments	(2,851,297)	(1,737,579)
Proceeds from sales of mortgage securities and similar investments	766,800	803,363
Principal collections on mortgage securities and similar investments	1,202,737	1,371,343
Investment in unconsolidated affiliates		8,952
Net cash (used in) provided by investing activities	(881,760)	446,079
Financing activities:		
Proceeds from repurchase arrangements and similar borrowings	49,296,731	34,888,670
Principal payments on repurchase arrangements and similar borrowings	(48,554,240)	(35,321,353)
Collateral deposits on interest rate swap agreements	(22,756)	
Payment on early termination of interest rate swap agreement	(2,275)	
Capital stock transactions	233,739	1,518
Dividends paid	(84,014)	(16,738)
Net cash provided by (used in) financing activities	867,185	(447,903)
Net change in cash and cash equivalents	130,822	38,972
Cash and cash equivalents at beginning of period	6,653	5,661
Cash and cash equivalents at end of period	$ 137,475	$ 44,633

See accompanying notes to consolidated financial statements.

CAPSTEAD MORTGAGE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(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 real estate-related assets on a leveraged basis. These investments currently consist primarily of a core portfolio of residential adjustable-rate mortgage (ARM) securities issued and guaranteed by government-sponsored entities, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae (collectively, Agency Securities).

NOTE 2 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 and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2008. For further information refer to the consolidated financial statements and footnotes thereto incorporated by reference in the Company s annual report on Form 10-K for the year ended December 31, 2007. Certain prior year amounts have been reclassified to conform to the current year presentation.

Accounting for Seller-financed Acquisitions of Mortgage Securities

Capstead generally pledges its *Mortgage securities and similar investments* as collateral under repurchase arrangements and a portion of the Company s acquisitions may initially be financed with sellers. The Company records such assets and the related borrowings gross on its balance sheet, and the corresponding interest income and interest expense gross on its income statement. In addition, the asset is typically a security held available-for-sale, and any change in fair value of the asset is recorded as a component of *Accumulated other comprehensive income.* In February 2008 the Financial Accounting Standards Board (FASB) issued Staff Position 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP140-3). Under FSP140-3, certain seller-financed acquisitions entered into after December 31, 2008 will not qualify as acquisitions if the related financing is considered sufficiently linked to the acquisition transaction. Any such seller-financed acquisitions that are deemed to be sufficiently linked will be reported net of related financings at fair value with related changes in fair value reported in earnings until such time as the assets are no longer financed with the sellers. Because such linkage does not exist for the Company s typical acquisition transactions and related financings, management does not believe implementing FSP140-3 will have a material effect on Capstead s results of operations, taxable income or financial condition. Also, it is not expected to affect the Company s status as a REIT or cause it to fail to qualify for its exemption under Investment Company Act of 1940 which requires that the Company must, among other things, maintain at least 55% of its assets directly in qualifying real estate interests.

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Accounting for Variable Interests

The FASB recently issued an exposure draft that would amend FASB Interpretation No. 46(R) "*Consolidation of Variable Interest Entities* (FIN46(R)), to address concerns raised about FIN46(R) s complexity and reliance on quantitative analyses and to require a greater scope of entities to be evaluated for consolidation using FIN46(R) s provisions. The potential amendments, which would be effective for fiscal years beginning after November 15, 2009, would require an enterprise (including its related party and de facto agents) to determine whether it is the primary beneficiary of an entity primarily through a qualitative assessment, considering if it has both the power to direct matters that significantly affect the entity and the right to receive potentially significant benefits or the obligation to absorb potentially significant losses of the entity. The proposed amendment is not expected to have a material impact on the Company.

Fair Value Measurements

In September 2006 the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS157). SFAS157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS157 s valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs are internally derived, reflecting what the reporting entity believes to be market assumptions. SFAS157 classifies these inputs into the following hierarchy:

Level One Inputs Quoted prices for identical instruments in active markets.

Level Two Inputs Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level Three Inputs Instruments with primarily unobservable value drivers.

In February 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS159). This statement permits, but does not require, entities to measure many financial instruments, including liabilities and certain other items, at fair value with resulting changes in fair value reported in earnings. In adopting SFAS157 and SFAS159 on January 1, 2008, the Company determined that it was not necessary to make any substantive changes to its valuation practices and that currently it will not report changes in fair value of any of its financial assets or liabilities in earnings as allowed under SFAS159. Therefore, the adoption of these standards did not have any impact on the Company s consolidated financial statements.

The Company s holdings of mortgage securities, nearly all of which are classified as held available-for-sale, are measured at fair value on a recurring basis using Level Two Inputs. See NOTE 10 for a discussion of fair value methodology utilized and other related fair value disclosures. The Company s interest rate swap agreements are also measured at fair value on a recurring basis primarily using Level Two Inputs that utilize the standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts based on expected future interest rates derived from observable market interest rate curves. The Company also incorporates both its own nonperformance risk and its counterparties nonperformance risk in determining the fair value of its interest rate swap agreements. In considering the effect of nonperformance risk, the Company considered the impact of netting and credit enhancements, such as collateral postings and guarantees, and has concluded that counterparty risk is not significant to the overall valuation of these agreements. See NOTE 6 for additional fair value disclosures related to these agreements.

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NOTE 3 EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share is computed by dividing net income (loss), after deducting preferred share dividends, by the weighted average number of common shares outstanding. Diluted earnings (loss) per common share is computed by dividing net income (loss), after deducting dividends on convertible preferred shares when such shares are antidilutive, by the weighted average number of common shares and common share equivalents outstanding, giving effect to equity awards and convertible preferred shares, when such awards and shares are dilutive. For calculation purposes the Series A and B preferred shares are considered dilutive whenever basic earnings per common share exceeds each Series dividend divided by the conversion rate applicable for that period. Components of the computation of basic and diluted earnings (loss) per common share were as follows (in thousands, except per share amounts):

	Quarter Ended September 30		*Nine Months Ended September 30*	
	2008	*2007*	*2008*	*2007*
Numerators for basic earnings (loss) per common share:				
Net income (loss)	$ 34,746	$ (3,148)	$ 101,621	$ 8,853
Less Series A and B preferred share dividends	(5,062)	(5,064)	(15,189)	(15,192)
Income available (loss attributable) to common stockholders	$ 29,684	$ (8,212)	$ 86,432	$ (6,339)
Weighted average common shares outstanding	56,318	19,108	51,991	19,017
Basic earnings (loss) per common share	$ 0.53	$ (0.43)	$ 1.66	$ (0.33)
Numerators for diluted earnings (loss) per common share:				
Net income (loss)	$ 34,746	$ (3,148)	$ 101,621	$ 8,853
Less dividends on antidilutive convertible preferred shares		(5,064)		(15,192)
Income available (loss attributable) to common stockholders	$ 34,746	$ (8,212)	$ 101,621	$ (6,339)
Denominator for diluted earnings (loss) per common share:				
Weighted average common shares outstanding	56,318	19,108	51,991	19,017
Net effect of dilutive equity awards	192		316	
Net effect of dilutive convertible preferred shares	9,842		9,830	
	66,352	19,108	62,137	19,017
Diluted earnings (loss) per common share	$ 0.52	$ (0.43)	$ 1.64	$ (0.33)

Potentially dilutive securities excluded from the calculation of diluted earnings (loss) per common share were as follows (in thousands):

	Quarter Ended September 30		*Nine Months Ended September 30*	
	2008	***2007***	***2008***	***2007***
Equity awards:				
Shares issuable under option awards	40	1,020	10	1,020
Nonvested stock awards	148	281		281
Convertible preferred shares:				
Series A shares		202		202
Series B shares		15,819		15,819

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NOTE 4 MORTGAGE SECURITIES AND SIMILAR INVESTMENTS

Mortgage securities and similar investments and related weighted average rates classified by collateral type and interest rate characteristics were as follows (dollars in thousands):

	Principal Balance	*Investment Premiums (Discounts)*	*Basis*	*Carrying Amount* [(a)]	*Net WAC* [(b)]	*Average Yield* [(b)]
September 30, 2008						
Agency Securities:						
Fannie Mae/Freddie Mac:						
Fixed-rate	$ 10,762	$ 29	$ 10,791	$ 10,812	6.65%	6.50%
ARMs	7,331,953	98,264	7,430,217	7,445,344	5.48	4.97
Ginnie Mae ARMs	411,779	2,117	413,896	416,635	5.21	5.04
	7,754,494	100,410	7,854,904	7,872,791	5.47	4.98
Residential mortgage loans:						
Fixed-rate	6,028	(8)	6,020	6,020	7.14	6.89
ARMs	9,176	80	9,256	9,256	5.87	5.79
	15,204	72	15,276	15,276	6.37	6.23
Commercial real estate loans	43,233	(12)	43,221	43,221	8.12	9.48
Collateral for structured financings	4,746	78	4,824	4,824	8.11	7.82
	$ 7,817,677	$ 100,548	$ 7,918,225	$ 7,936,112	5.49	5.00
December 31, 2007						
Agency Securitie						