

Orchid Island Capital, Inc.  
Form 10-Q  
April 27, 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 March 31, 2018

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: 001-35236

Orchid Island Capital, Inc.  
(Exact name of registrant as specified in its charter)

Maryland 27-3269228  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

3305 Flamingo Drive, Vero Beach, Florida 32963  
(Address of principal executive offices) (Zip Code)

(772) 231-1400  
(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, 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. Check one:

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

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 Act). Yes  No

Number of shares outstanding at April 27, 2018: 53,098,115

---

ORCHID ISLAND CAPITAL, INC.

TABLE OF CONTENTS

	Page
<b>PART I. FINANCIAL INFORMATION</b>	
ITEM 1. Condensed Financial Statements	1
Condensed Consolidated Balance Sheets (unaudited)	1
Condensed Consolidated Statements of Operations (unaudited)	2
Condensed Consolidated Statement of Stockholders' Equity (unaudited)	3
Condensed Consolidated Statements of Cash Flows (unaudited)	4
Notes to Condensed Consolidated Financial Statements	5
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	24
ITEM 3. Quantitative and Qualitative Disclosures about Market Risk	43
ITEM 4. Controls and Procedures	47
<b>PART II. OTHER INFORMATION</b>	
ITEM 1. Legal Proceedings	48
ITEM 1A. Risk Factors	48
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	48
ITEM 3. Defaults upon Senior Securities	48
ITEM 4. Mine Safety Disclosures	48
ITEM 5. Other Information	48
ITEM 6. Exhibits	49
SIGNATURES	50



PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

---

ORCHID ISLAND CAPITAL, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (\$ in thousands, except per share data)

	(Unaudited)	
	March 31, 2018	December 31, 2017
<b>ASSETS:</b>		
Mortgage-backed securities, at fair value		
Pledged to counterparties	\$3,643,718	\$3,712,561
Unpledged	102,066	32,250
Total mortgage-backed securities	3,745,784	3,744,811
Cash and cash equivalents	127,168	214,363
Restricted cash	36,837	32,349
Accrued interest receivable	15,384	14,444
Derivative assets, at fair value	36,179	17,160
Receivable for securities sold, pledged to counterparties	160,919	-
Other assets	427	216
Total Assets	\$4,122,698	\$4,023,343
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Repurchase agreements	\$3,619,280	\$3,533,786
Payable for unsettled securities purchased	32,054	-
Dividends payable	4,776	7,429
Derivative liabilities, at fair value	2,582	2,038
Accrued interest payable	7,152	6,516
Due to affiliates	796	797
Other liabilities	26,607	10,566
Total Liabilities	3,693,247	3,561,132
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding as of March 31, 2018 and December 31, 2017	-	-
Common Stock, \$0.01 par value; 500,000,000 shares authorized, 53,072,169 shares issued and outstanding as of March 31, 2018 and 53,061,904 shares issued and outstanding as of December 31, 2017	531	531
Additional paid-in capital	445,297	461,680
Accumulated (deficit) retained earnings	(16,377 )	-
Total Stockholders' Equity	429,451	462,211
Total Liabilities and Stockholders' Equity	\$4,122,698	\$4,023,343
See Notes to Consolidated Financial Statements		

ORCHID ISLAND CAPITAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

For the Three Months Ended March 31, 2018 and 2017

(\$ in thousands, except per share data)

	2018	2017
Interest income	\$39,935	\$32,311
Interest expense	(15,149)	(6,715)
Net interest income	24,786	25,596
Realized losses on mortgage-backed securities	(8,338)	(1,350)
Unrealized losses on mortgage-backed securities	(71,712)	(14,958)
Gains (losses) on derivative instruments	41,994	(4,419)
Net portfolio (loss) income	(13,270)	4,869
Expenses:		
Management fees	1,712	1,302
Allocated overhead	382	368
Accrued incentive compensation	11	12
Directors' fees and liability insurance	252	276
Audit, legal and other professional fees	296	170
Direct REIT operating expenses	403	231
Other administrative	51	61
Total expenses	3,107	2,420
Net (loss) income	\$(16,377)	\$2,449
Basic and diluted net (loss) income per share	\$(0.31)	\$0.07
Weighted Average Shares Outstanding	53,065,845	33,069,064
Dividends declared per common share	\$0.31	\$0.42
See Notes to Consolidated Financial Statements		

## ORCHID ISLAND CAPITAL, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

For the Three Months Ended March 31, 2018

(\$ in thousands, except per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Total
Balances, January 1, 2018	\$ 531	\$ 461,680	\$-	\$462,211
Net loss	-	-	(16,377)	(16,377)
Cash dividends declared, \$0.31 per share	-	(16,463 )	-	(16,463 )
Issuance of common stock pursuant to stock based compensation plan	-	35	-	35
Amortization of stock based compensation	-	45	-	45
Balances, March 31, 2018	\$ 531	\$ 445,297	\$(16,377)	\$429,451
See Notes to Consolidated Financial Statements				



ORCHID ISLAND CAPITAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)  
 For the Three Months Ended March 31, 2018 and 2017  
 (\$ in thousands)

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$(16,377	) \$2,449
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Stock based compensation	80	243
Realized and unrealized losses on mortgage-backed securities	80,050	16,308
Realized and unrealized gains on interest rate swaptions	(1,717	) -
Realized and unrealized gains on interest rate swaps	(11,576	) (1,534
Realized gains on forward settling to-be-announced securities	(8,407	) -
Changes in operating assets and liabilities:		
Accrued interest receivable	(1,105	) (1,676
Other assets	(251	) (417
Accrued interest payable	636	164
Other liabilities	218	1,819
Due (from) to affiliates	(1	) 262
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>41,550</b>	<b>17,618</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
From mortgage-backed securities investments:		
Purchases	(517,829	) (1,737,240
Sales	228,691	1,407,673
Principal repayments	78,720	73,298
Redemption of FHLB stock	-	3
Proceeds from net settlement of to-be-announced securities	9,161	1,119
Purchase of derivative financial instruments, net of margin cash received	10,622	-
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(190,635</b>	<b>) (255,147</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from repurchase agreements	13,098,449	11,947,907
Principal payments on repurchase agreements	(13,012,955)	(11,691,004)
Cash dividends	(19,116	) (13,869
Proceeds from issuance of common stock, net of issuance costs	-	12,793
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>66,378</b>	<b>255,827</b>
<b>NET (DECREASE) INCREASE IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH</b>	<b>(82,707</b>	<b>) 18,298</b>
<b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, beginning of the period</b>	<b>246,712</b>	<b>94,425</b>
<b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, end of the period</b>	<b>\$ 164,005</b>	<b>\$ 112,723</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$14,513	\$6,551
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:</b>		
Securities acquired settled in later period	\$32,054	\$-

Securities sold settled in later period	159,300	-
See Notes to Consolidated Financial Statements		

4

---

ORCHID ISLAND CAPITAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

MARCH 31, 2018

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Description

Orchid Island Capital, Inc. ("Orchid" or the "Company"), was incorporated in Maryland on August 17, 2010 for the purpose of creating and managing a leveraged investment portfolio consisting of residential mortgage-backed securities ("RMBS"). From incorporation to February 20, 2013 Orchid was a wholly owned subsidiary of Bimini Capital Management, Inc. ("Bimini"). Orchid began operations on November 24, 2010 (the date of commencement of operations). From incorporation through November 24, 2010, Orchid's only activity was the issuance of common stock to Bimini.

On February 20, 2013, Orchid completed the initial public offering ("IPO") of its common stock in which it sold approximately 2.4 million shares of its common stock and raised gross proceeds of \$35.4 million, which were invested in RMBS that were issued and the principal and interest of which were guaranteed by a federally chartered corporation or agency ("Agency RMBS") on a leveraged basis. Orchid is an "emerging growth company" as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act").

On July 29, 2016, Orchid entered into an equity distribution agreement (the "July 2016 Equity Distribution Agreement") with two sales agents pursuant to which the Company could offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of the Company's common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The Company issued a total of 10,174,992 shares under the July 2016 Equity Distribution Agreement for aggregate gross proceeds of \$110.0 million, and net proceeds of approximately \$108.2 million, net of commissions and fees, prior to its termination in February 2017.

On February 23, 2017, Orchid entered into another equity distribution agreement, as amended and restated on May 10, 2017, (the "May 2017 Equity Distribution Agreement") with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The Company issued a total of 12,299,032 shares under the May 2017 Equity Distribution Agreement for aggregate gross proceeds of \$125.0 million, and net proceeds of approximately \$122.9 million, net of commissions and fees, prior to its termination in August 2017.

On August 2, 2017, Orchid entered into another equity distribution agreement (the "August 2017 Equity Distribution Agreement") with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. Through March 31, 2018, the Company issued a total of 7,746,052 shares under the August 2017 Equity Distribution Agreement for aggregate gross proceeds of approximately \$76.0 million, and net proceeds of approximately \$74.7 million, net of commissions and fees.

## Basis of Presentation and Use of Estimates

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 Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The consolidated financial statements include the accounts of our wholly-owned subsidiary, Orchid Island Casualty, LLC. Significant intercompany accounts and transactions have been eliminated. 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 three month period ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The balance sheet at December 31, 2017 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates affecting the accompanying financial statements are the fair values of RMBS and derivatives.

## Statement of Comprehensive Income (Loss)

In accordance with the Financial Accounting Standards Board (the "FASB") Accounting Standards Codification ("ASC") Topic 220, Comprehensive Income, a statement of comprehensive income (loss) has not been included as the Company has no items of other comprehensive income (loss). Comprehensive income (loss) is the same as net income (loss) for the periods presented.

## Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents include cash on deposit with financial institutions and highly liquid investments with original maturities of three months or less at the time of purchase. Restricted cash includes cash pledged as collateral for repurchase agreements and other borrowings, and interest rate swaps and other derivative instruments.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the statement of financial position that sum to the total of the same such amounts shown in the statement of cash flows.

(in thousands)

	March 31, 2018	December 31, 2017
Cash and cash equivalents	\$127,168	\$214,363
Restricted cash	36,837	32,349
Total cash, cash equivalents and restricted cash	\$164,005	\$246,712

The Company maintains cash balances at four banks and excess margin on account at derivative exchanges, and, at times, balances may exceed federally insured limits. The Company has not experienced any losses related to these balances. The Federal Deposit Insurance Corporation insures eligible accounts up to \$250,000 per depositor at each financial institution. At March 31, 2018, the Company's cash deposits exceeded federally insured limits by

approximately \$125.4 million. Restricted cash balances are uninsured, but are held in separate customer accounts that are segregated from the general funds of the counterparty. The Company limits uninsured balances to only large, well-known bank and derivative exchanges and believes that it is not exposed to any significant credit risk on cash and cash equivalents or restricted cash balances.

## Mortgage-Backed Securities

The Company invests primarily in mortgage pass-through ("PT") certificates, collateralized mortgage obligations, and interest-only ("IO") securities and inverse interest-only ("IIO") securities representing interest in or obligations backed by pools of RMBS. The Company has elected to account for its investment in RMBS under the fair value option. Electing the fair value option requires the Company to record changes in fair value in the consolidated statement of operations, which, in management's view, more appropriately reflects the results of our operations for a particular reporting period and is consistent with the underlying economics and how the portfolio is managed.

The Company records RMBS transactions on the trade date. Security purchases that have not settled as of the balance sheet date are included in the RMBS balance with an offsetting liability recorded, whereas securities sold that have not settled as of the balance sheet date are removed from the RMBS balance with an offsetting receivable recorded.

The fair value of the Company's investments in RMBS is governed by FASB ASC 820, Fair Value Measurement. The definition of fair value in FASB ASC 820 focuses on the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset or transfer the liability either occurs in the principal market for the asset or liability, or in the absence of a principal market, occurs in the most advantageous market for the asset or liability. Estimated fair values for RMBS are based on independent pricing sources and/or third party broker quotes, when available.

Income on PT RMBS securities is based on the stated interest rate of the security. Premiums or discounts present at the date of purchase are not amortized. Premium lost and discount accretion resulting from monthly principal repayments are reflected in unrealized gains (losses) on RMBS in the consolidated statements of operations. For IO securities, the income is accrued based on the carrying value and the effective yield. The difference between income accrued and the interest received on the security is characterized as a return of investment and serves to reduce the asset's carrying value. At each reporting date, the effective yield is adjusted prospectively from the reporting period based on the new estimate of prepayments and the contractual terms of the security. For IIO securities, effective yield and income recognition calculations also take into account the index value applicable to the security. Changes in fair value of RMBS during each reporting period are recorded in earnings and reported as unrealized gains or losses on mortgage-backed securities in the accompanying consolidated statements of operations.

## Derivative Financial Instruments

The Company uses derivative instruments to manage interest rate risk, facilitate asset/liability strategies and manage other exposures, and it may continue to do so in the future. The principal instruments that the Company has used to date are Treasury Note ("T-Note") and Eurodollar futures contracts, interest rate swaps, options to enter in interest rate swaps ("interest rate swaptions") and "to-be-announced" ("TBA") securities transactions, but may enter into other derivatives in the future.

The Company purchases a portion of its Agency RMBS through forward settling transactions, including TBA securities transactions. At times when market conditions are conducive, the Company may choose to move the settlement of these TBA securities transactions out to a later date by entering into an offsetting short position, which is then net settled for cash, and simultaneously entering into a substantially similar TBA securities trade for a later settlement date. Such a set of transactions is referred to as a TBA "dollar roll" transaction. The TBA securities purchased at the later settlement date are typically priced at a discount to securities for settlement in the current month. This difference is referred to as the "price drop." The price drop represents compensation to the Company for foregoing net interest margin and is referred to as TBA "dollar roll income."



The Company accounts for TBA securities as derivative instruments if either the TBA securities do not settle in the shortest period of time possible or if the Company cannot assert that it is probable at inception of the TBA transaction, or throughout its term, that it will take physical delivery of the Agency RMBS for a long position, or make delivery of the Agency RMBS for a short position, upon settlement of the trade. The Company accounts for TBA dollar roll transactions as a series of derivative transactions. Gains, losses and dollar roll income associated with TBA securities transactions and dollar roll transactions are reported in gain (loss) on derivative instruments in the accompanying consolidated statements of operations. The fair value of TBA securities is estimated based on similar methods used to value RMBS securities.

The Company has elected not to treat any of its derivative financial instruments as hedges in order to align the accounting treatment of its derivative instruments with the treatment of its portfolio assets under the fair value option election. FASB ASC Topic 815, Derivatives and Hedging, requires that all derivative instruments be carried at fair value. Changes in fair value are recorded in earnings for each period.

Holding derivatives creates exposure to credit risk related to the potential for failure on the part of counterparties and exchanges to honor their commitments. In addition, the Company may be required to post collateral based on any declines in the market value of the derivatives. In the event of default by a counterparty, the Company may have difficulty recovering its collateral and may not receive payments provided for under the terms of the agreement. To mitigate this risk, the Company uses only well-established commercial banks and exchanges as counterparties.

#### Financial Instruments

FASB ASC 825, Financial Instruments, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value, either in the body of the financial statements or in the accompanying notes. RMBS, Eurodollar and T-Note futures contracts, interest rate swaps, interest rate swaptions and TBA securities are accounted for at fair value in the consolidated balance sheets. The methods and assumptions used to estimate fair value for these instruments are presented in Note 12 of the consolidated financial statements.

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, receivable for securities sold, other assets, due to affiliates, repurchase agreements, payable for unsettled securities purchased, accrued interest payable and other liabilities generally approximates their carrying values as of March 31, 2018 and December 31, 2017 due to the short-term nature of these financial instruments.

#### Repurchase Agreements

The Company finances the acquisition of the majority of its RMBS through the use of repurchase agreements under master repurchase agreements. Pursuant to ASC Topic 860, Transfers and Servicing, the Company accounts for repurchase transactions as collateralized financing transactions, which are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

#### Manager Compensation

The Company is externally managed by Bimini Advisors, LLC (the "Manager" or "Bimini Advisors"), a Maryland limited liability company and wholly-owned subsidiary of Bimini. The Company's management agreement with the Manager provides for payment to the Manager of a management fee and reimbursement of certain operating expenses, which are accrued and expensed during the period for which they are earned or incurred. Refer to Note 13 for the terms of the management agreement.



## Earnings Per Share

The Company follows the provisions of FASB ASC 260, Earnings Per Share. Basic earnings per share ("EPS") is calculated as net income or loss attributable to common stockholders divided by the weighted average number of shares of common stock outstanding or subscribed during the period. Diluted EPS is calculated using the treasury stock or two-class method, as applicable, for common stock equivalents, if any. However, the common stock equivalents are not included in computing diluted EPS if the result is anti-dilutive.

## Income Taxes

Orchid has qualified and elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). REITs are generally not subject to federal income tax on their REIT taxable income provided that they distribute to their stockholders at least 90% of their REIT taxable income on an annual basis. In addition, a REIT must meet other provisions of the Code to retain its tax status.

Orchid measures, recognizes and presents its uncertain tax positions in accordance with FASB ASC 740, Income Taxes. Under that guidance, Orchid assesses the likelihood, based on their technical merit, that tax positions will be sustained upon examination based on the facts, circumstances and information available at the end of each period. All of Orchid's tax positions are categorized as highly certain. There is no accrual for any tax, interest or penalties related to Orchid's tax position assessment. The measurement of uncertain tax positions is adjusted when new information is available, or when an event occurs that requires a change.

## Recent Accounting Pronouncements

In November 2016, the FASB issued Accounting Standards Update ("ASU") 2016-18, Statement of Cash Flows – (Topic 230): Restricted Cash. ASU 2016-18 requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. ASU 2016-18 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2017. Early application is permitted. The Company early adopted the ASU beginning with the first quarter of 2017.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows – (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2017. The Company's adoption of this ASU did not have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss model). ASU 2016-13 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2019. Early application is permitted for fiscal periods beginning after December 15, 2018. The Company is currently evaluating the potential effect of this ASU on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 provides guidance for the recognition, measurement, presentation and disclosure of financial assets and financial liabilities. ASU 2016-01 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2017 and, for most provisions, is effective using the cumulative-effect transition approach. The Company's adoption of this ASU did not have a material impact on its consolidated financial statements.



## NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's RMBS portfolio as of March 31, 2018 and December 31, 2017:

(in thousands)

	March 31, 2018	December 31, 2017
Pass-Through RMBS Certificates:		
Hybrid Adjustable-rate Mortgages	\$26,482	\$27,398
Adjustable-rate Mortgages	1,754	1,754
Fixed-rate Mortgages	3,569,133	3,594,533
Total Pass-Through Certificates	3,597,369	3,623,685
Structured RMBS Certificates:		
Interest-Only Securities	120,199	86,918
Inverse Interest-Only Securities	28,216	34,208
Total Structured RMBS Certificates	148,415	121,126
Total	\$3,745,784	\$3,744,811

The following table summarizes the Company's RMBS portfolio as of March 31, 2018 and December 31, 2017, according to the contractual maturities of the securities in the portfolio. Actual maturities of RMBS investments are generally shorter than stated contractual maturities and are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal.

(in thousands)

	March 31, 2018	December 31, 2017
Greater than one year and less than five years	\$15	\$29
Greater than five years and less than ten years	3,049	3,281
Greater than or equal to ten years	3,742,720	3,741,501
Total	\$3,745,784	\$3,744,811

The Company generally pledges its RMBS assets as collateral under repurchase agreements. At March 31, 2018 and December 31, 2017, the Company had unpledged securities totaling \$102.1 million and \$32.3 million, respectively. The unpledged balance at March 31, 2018 includes unsettled security purchases with a fair value of approximately \$14.6 million that will be pledged as collateral under repurchase agreements on their respective settlement dates in April 2018.

## NOTE 3. REPURCHASE AGREEMENTS AND OTHER BORROWINGS

The Company pledges certain of its RMBS as collateral under repurchase agreements with financial institutions. Interest rates are generally fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is generally paid at the termination of a borrowing. If the fair value of the pledged securities declines, lenders will typically require the Company to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of the pledged securities increases, lenders may release collateral back to the Company. As of March 31, 2018, the Company had met all margin call requirements.

As of March 31, 2018, the Company had outstanding repurchase obligations of approximately \$3,619.3 million with a net weighted average borrowing rate of 1.86%. These agreements were collateralized by RMBS with a fair value, including accrued interest and securities pledged related to securities sold but not yet settled, of approximately

\$3,818.6 million, and cash pledged to the counterparties of approximately \$28.6 million. As of December 31, 2017, the Company had outstanding repurchase obligations of approximately \$3,533.8 million with a net weighted average borrowing rate of 1.54%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$3,726.5 million, and cash pledged to the counterparties of approximately \$25.3 million.

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

As of March 31, 2018 and 2017, the Company's repurchase agreements had remaining maturities as summarized below:

(\$ in thousands)

	OVERNIGHT2 (1 DAY OR LESS)	BETWEEN AND 30 DAYS	BETWEEN 31 AND 90 DAYS	GREATER THAN 90 DAYS	TOTAL
March 31, 2018					
Fair market value of securities pledged, including					
accrued interest receivable	\$ -	\$ 2,263,087	\$ 1,096,463	\$ 459,040	\$ 3,818,590
Repurchase agreement liabilities associated with					
these securities	\$ -	\$ 2,127,683	\$ 1,038,162	\$ 453,435	\$ 3,619,280
Net weighted average borrowing rate	-	1.91 %	1.88 %	1.57 %	1.86 %
December 31, 2017					
Fair market value of securities pledged, including					
accrued interest receivable	\$ -	\$ 1,983,958	\$ 1,266,590	\$ 475,975	\$ 3,726,523
Repurchase agreement liabilities associated with					
these securities	\$ -	\$ 1,871,833	\$ 1,208,518	\$ 453,435	\$ 3,533,786
Net weighted average borrowing rate	-	1.53 %	1.53 %	1.57 %	1.54 %

If, during the term of a repurchase agreement, a lender files for bankruptcy, the Company might experience difficulty recovering its pledged assets, which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged to such lender, including the accrued interest receivable and cash posted by the Company as collateral. At March 31, 2018, the Company had an aggregate amount at risk (the difference between the amount loaned to the Company, including interest payable and securities posted by the counterparty (if any), and the fair value of securities and cash pledged (if any), including accrued interest on such securities) with all counterparties of approximately \$220.7 million. The Company did not have an amount at risk with any individual counterparty greater than 10% of the Company's equity at March 31, 2018 and December 31, 2017.

NOTE 4. DERIVATIVE FINANCIAL INSTRUMENTS

In connection with its interest rate risk management strategy, the Company economically hedges a portion of the cost of its repurchase agreement funding by entering into derivatives and other hedging contracts. To date, the Company has entered into Eurodollar and T-Note futures contracts, interest rate swaps, and interest rate swaptions, but may enter into other contracts in the future. The Company has not elected hedging treatment under GAAP, and as such all gains or losses (realized and unrealized) on these instruments are reflected in earnings for all periods presented.

In addition, the Company utilizes TBA securities as a means of investing in and financing Agency RMBS or as a means of reducing its exposure to Agency RMBS. The Company accounts for TBA securities as derivative instruments if either the TBA securities do not settle in the shortest period of time possible or if the Company cannot assert that it is probable at inception and throughout the term of the TBA securities that it will take physical delivery of the Agency RMBS for a long position, or make delivery of the Agency RMBS for a short position, upon settlement of the trade.



Derivative Assets (Liabilities), at Fair Value

The table below summarizes fair value information about our derivative assets and liabilities as of March 31, 2018 and December 31, 2017.

(in thousands)

Derivative Instruments and Related Accounts	Balance Sheet Location	March	
		31, 2018	December 31, 2017
<b>Assets</b>			
Interest rate swaps	Derivative assets, at fair value	\$25,107	\$ 13,745
Payer swaptions	Derivative assets, at fair value	10,296	3,405
Receiver swaptions	Derivative assets, at fair value	760	-
TBA securities	Derivative assets, at fair value	16	10
Total derivative assets, at fair value		\$36,179	\$ 17,160
<b>Liabilities</b>			
Interest rate swaps	Derivative liabilities, at fair value	\$-	\$ 215
TBA securities	Derivative liabilities, at fair value	2,582	1,823
Total derivative liabilities, at fair value		\$2,582	\$ 2,038
<b>Margin Balances Posted to (from) Counterparties</b>			
Futures contracts	Restricted cash	\$5,415	\$ 5,545
TBA securities	Restricted cash	2,857	1,508
TBA securities	Other liabilities	-	(59 )
Interest rate swaption contracts	Other liabilities	(7,169 )	(3,505 )
Total margin balances on derivative contracts		\$1,103	\$ 3,489

Eurodollar and T-Note futures are cash settled futures contracts on an interest rate, with gains and losses credited or charged to the Company's cash accounts on a daily basis. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. The tables below present information related to the Company's Eurodollar and T-Note futures positions at March 31, 2018 and December 31, 2017.

(\$ in thousands)

Expiration Year	March 31, 2018				Open Equity <sup>(1)</sup>
	Average Contract Notional Amount	Weighted Average Entry Rate	Weighted Average Effective Rate	Weighted Average	
<b>Eurodollar Futures Contracts (Short Positions)</b>					
2018	\$1,333,333	1.92	% 2.40	%	\$4,743
2019	1,500,000	2.16	% 2.69	%	8,060
2020	1,500,000	2.64	% 2.81	%	2,480
Total / Weighted Average	\$1,454,545	2.28	% 2.66	%	\$15,283
<b>Treasury Note Futures Contracts (Short Position)<sup>(2)</sup></b>					
June 2018 5-year T-Note futures (June 2018 - June 2023 Hedge Period)	\$165,000	2.94	% 2.87	%	\$(472 )





(\$ in thousands)

Expiration Year	December 31, 2017				
	Average Contract Notional Amount	Weighted Average Entry Rate	Weighted Average Effective Rate	Open Equity <sup>(1)</sup>	
Eurodollar Futures Contracts (Short Positions)					
2018	\$1,212,500	1.86	% 1.98	% \$1,418	
2019	1,350,000	2.11	% 2.27	% 2,152	
2020	987,500	2.59	% 2.36	% (2,360 )	
Total / Weighted Average	\$1,183,333	2.16	% 2.20	% \$1,210	

Treasury Note Futures Contracts (Short Position)<sup>(2)</sup>

March 2018 10 year T-Note futures (Mar 2018 - Mar 2028 Hedge Period)	\$140,000	2.23	% 2.33	% \$755
---	-----------	------	--------	---------

(1) Open equity represents the cumulative gains (losses) recorded on open futures positions from inception.

T-Note futures contracts were valued at a price of \$114.46 at March 31, 2018 and \$124.05 at December 31, 2017.

(2) The notional contract values of the short positions were \$188.9 million and \$173.7 million at March 31, 2018 and December 31, 2017, respectively.

Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on the London Interbank Offered Rate ("LIBOR") ("payer swaps"). The floating rate we receive under our swap agreements has the effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. We are typically required to post collateral on our interest rate swap agreements. The table below presents information related to the Company's interest rate swap positions at March 31, 2018 and December 31, 2017.

(\$ in thousands)

	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Net Estimated Fair Value	Average Maturity (Years)
March 31, 2018					
Expiration > 1 to ≤ 3 years	\$650,000	1.09	% 1.81	% \$17,232	1.8
Expiration > 3 to ≤ 5 years	360,000	2.05	% 2.03	% 7,875	4.0
	\$1,010,000	1.43	% 1.89	% \$25,107	2.6
December 31, 2017					
Expiration > 1 to ≤ 3 years	\$650,000	1.09	% 1.31	% \$10,318	2.1
Expiration > 3 to ≤ 5 years	360,000	2.05	% 1.32	% (2,216 )	4.3
	\$1,010,000	1.43	% 1.31	% \$8,102	2.8

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The table below presents information related to the Company's interest rate swaption positions at March 31, 2018 and December 31, 2017.

(\$ in thousands)

Expiration	Option Cost	Fair Value	Weighted Average Months to Expiration	Underlying Swap			
				Notional Amount	Average Fixed Rate	Average Adjustable Rate (LIBOR)	Weighted Average Term (Years)
March 31, 2018							
≤ 1 year							
Payer Swaptions	\$11,062	\$10,296	9.3	\$750,000	3.00%	3 Month	9.2
Receiver Swaptions	820	760	10.4	100,000	2.60%	3 Month	5.0
December 31, 2017							
≤ 1 year							
Payer Swaptions	\$2,367	\$3,405	8.0	\$200,000	2.16%	3 Month	6.0

The following table summarizes our contracts to purchase and sell TBA securities as of March 31, 2018 and December 31, 2017.

(\$ in thousands)

	Notional Amount Long (Short) <sup>(1)</sup>	Cost Basis <sup>(2)</sup>	Market Value <sup>(3)</sup>	Net Carrying Value <sup>(4)</sup>
March 31, 2018				
30-Year TBA securities:				
3.0%	\$(400,000)	\$(387,621)	\$(390,187)	\$(2,566)
December 31, 2017				
30-Year TBA securities:				
3.0%	\$(300,000)	\$(299,371)	\$(300,153)	\$(782)
4.0%	(357,000)	(373,403)	(373,477)	(74)
4.5%	356,556	380,371	379,414	(957)
Total	\$(300,444)	\$(292,403)	\$(294,216)	\$(1,813)

- (1) Notional amount represents the par value (or principal balance) of the underlying Agency RMBS.
- (2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.
- (3) Market value represents the current market value of the TBA securities (or of the underlying Agency RMBS) as of period-end.
- (4) Net carrying value represents the difference between the market value and the cost basis of the TBA securities as of period-end and is reported in derivative assets (liabilities), at fair value in our consolidated balance sheets.



## Gain (Loss) From Derivative Instruments, Net

The table below presents the effect of the Company's derivative financial instruments on the consolidated statements of operations for the three months ended March 31, 2018 and 2017.

(in thousands)

	Three Months Ended March 31,	
	2018	2017
Eurodollar futures contracts (short positions)	\$ 14,541	\$(571 )
T-Note futures contracts (short position)	6,821	(3,851)
Interest rate swaps	10,508	3
Receiver swaptions	(349 )	-
Payer swaptions	2,066	-
Net TBA securities	8,407	-
Total	\$41,994	\$(4,419)

## Credit Risk-Related Contingent Features

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We minimize this risk by limiting our counterparties for instruments which are not centrally cleared on a registered exchange to major financial institutions with acceptable credit ratings and monitoring positions with individual counterparties. In addition, we may be required to pledge assets as collateral for our derivatives, whose amounts vary over time based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our derivative agreements, and may have difficulty obtaining our assets pledged as collateral for our derivatives. The cash and cash equivalents pledged as collateral for our derivative instruments are included in restricted cash on our consolidated balance sheets.

## NOTE 5. PLEDGED ASSETS

## Assets Pledged to Counterparties

The table below summarizes our assets pledged as collateral under our repurchase agreements and derivative agreements by type, including securities pledged related to securities sold but not yet settled, as of March 31, 2018 and December 31, 2017.

(in thousands)

	March 31, 2018			December 31, 2017		
	Repurchase Agreements	Derivative Agreements	Total	Repurchase Agreements	Derivative Agreements	Total
Assets Pledged to Counterparties						
PT RMBS - fair value	\$3,529,357	\$ -	\$3,529,357	\$3,612,244	\$ -	\$3,612,244
Structured RMBS - fair value	114,361	-	114,361	100,317	-	100,317
Accrued interest on pledged securities	14,568	-	14,568	13,962	-	13,962
Receivable for securities sold	160,304	-	160,304	-	-	-
Restricted cash	28,565	8,272	36,837	25,296	7,053	32,349
Total	\$3,847,155	\$ 8,272	\$3,855,427	\$3,751,819	\$ 7,053	\$3,758,872

Assets Pledged from Counterparties

The table below summarizes our assets pledged to us from counterparties under our repurchase agreements as of March 31, 2018 and December 31, 2017.

(in thousands)

Assets Pledged to Orchid	March 31, 2018			December 31, 2017		
	Repurchase Agreements	Derivative Agreements	Total	Repurchase Agreements	Derivative Agreements	Total
Cash	\$ 1,146	\$ 7,169	\$ 8,315	\$ 67	\$ 3,564	\$ 3,631
PT RMBS - fair value	548	-	548	-	-	-
U.S. Treasury securities - fair value	1,077	-	1,077	-	-	-
Total	\$ 2,771	\$ 7,169	\$ 9,940	\$ 67	\$ 3,564	\$ 3,631

PT RMBS and U.S. Treasury securities received as margin under our repurchase agreements are not recorded in the consolidated balance sheets because the counterparty retains ownership of the security. Cash received as margin is recognized in cash and cash equivalents with a corresponding amount recognized as an increase in repurchase agreements or other liabilities in the consolidated balance sheets.

NOTE 6. OFFSETTING ASSETS AND LIABILITIES

The Company's derivatives and repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its assets and liabilities subject to these arrangements on a gross basis.

The following table presents information regarding those assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of March 31, 2018 and December 31, 2017.

(in thousands)

Offsetting of Assets

	Gross Amount of Recognized Assets	Offset in the Consolidated Balance Sheet	Net Amount Presented in the Consolidated Balance Sheet	Gross Amount Not Offset in the Consolidated Balance Sheet		
				Collateral Received	Inst. Cash Received	Net Amount
March 31, 2018						
Interest rate swaps	\$ 25,107	\$ -	\$ 25,107	\$-	\$-	\$ 25,107
Interest rate swaptions	11,056	-	11,056	-	(7,169 )	3,887
TBA securities	16	-	16	-	-	16
	\$ 36,179	\$ -	\$ 36,179	\$-	\$(7,169 )	\$ 29,010
December 31, 2017						

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

Interest rate swaps	\$ 13,745	\$ -	\$ 13,745	\$-	\$-	\$13,745
Interest rate swaptions	3,405	-	3,405	-	(3,405 )	-
TBA securities	10	-	10	-	(10 )	-
	\$ 17,160	\$ -	\$ 17,160	\$-	\$(3,415 )	\$13,745

16

---

(in thousands)