

Orchid Island Capital, Inc.  
Form 10-Q  
November 04, 2013

---

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

.. 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  
(State or other jurisdiction of  
incorporation or organization)

27-3269228  
(I.R.S. Employer  
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

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

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

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 November 4, 2013: 3,341,665

---

ORCHID ISLAND CAPITAL, INC.

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements	
Balance Sheets as of September 30, 2013 (unaudited) and December 31, 2012	1
Statements of Operations (unaudited) for the nine and three months ended September 30, 2013 and 2012	2
Statement of Stockholders' Equity (unaudited) for the nine months ended September 30, 2013	3
Statements of Cash Flows (unaudited) for the nine months ended September 30, 2013 and 2012	4
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	17
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.	39
ITEM 4. Controls and Procedures.	40
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings.	41
ITEM 1A. Risk Factors.	41
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.	41
ITEM 3. Defaults Upon Senior Securities.	41
ITEM 4. Mine Safety Disclosures.	41
ITEM 5. Other Information.	41
ITEM 6. Exhibits.	42
SIGNATURES.	43

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

ORCHID ISLAND CAPITAL, INC.  
BALANCE SHEETS

	(Unaudited) September 30, 2013	December 31, 2012
<b>ASSETS:</b>		
Mortgage-backed securities, at fair value		
Pledged to counterparties	\$277,982,323	\$109,604,559
Unpledged	53,804,610	5,775,015
Total mortgage-backed securities	331,786,933	115,379,574
Cash and cash equivalents	7,900,956	2,537,257
Restricted cash	2,580,875	449,000
Accrued interest receivable	1,388,496	440,877
Due from affiliates	-	45,126
Receivable for securities sold, pledged to counterparties	41,150,840	-
Prepaid expenses and other assets	671,733	9,122
<b>Total Assets</b>	<b>\$385,479,833</b>	<b>\$118,860,956</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Repurchase agreements	\$301,656,523	\$103,941,174
Accrued interest payable	77,697	54,084
Due to affiliates	79,878	-
Payable for unsettled securities purchased	38,720,351	-
Accounts payable, accrued expenses and other	121,183	140,723
<b>Total Liabilities</b>	<b>340,655,632</b>	<b>104,135,981</b>
<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 September 30, 2013 and no shares authorized as of December 31, 2012	-	-
Common Stock, \$0.01 par value; 500,000,000 shares authorized, 3,341,665 shares issued and outstanding as of September 30, 2013 and 1,000,000 shares authorized,		
154,110 shares issued and outstanding as of December 31, 2012	33,417	1,541
Additional paid-in capital	47,619,710	15,409,459
Accumulated deficit	(2,828,926 )	(686,025 )
<b>Total Stockholders' Equity</b>	<b>44,824,201</b>	<b>14,724,975</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$385,479,833</b>	<b>\$118,860,956</b>
See Notes to Financial Statements		



ORCHID ISLAND CAPITAL, INC.  
STATEMENTS OF OPERATIONS  
(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2013	2012	2013	2012
Interest income	\$6,393,156	\$2,224,749	\$2,551,199	\$696,905
Interest expense	(817,219 )	(182,815 )	(293,913 )	(58,381 )
Net interest income	5,575,937	2,041,934	2,257,286	638,524
Realized (losses) gains on mortgage-backed securities	(1,490,712)	115,871	(667,182 )	(336 )
Unrealized (losses) gains on mortgage-backed securities	(9,072,712)	(758,405 )	86,070	156,014
Gains (losses) on Eurodollar futures contracts	4,095,788	(39,500 )	(2,271,875)	(14,250 )
Net portfolio (loss) income	(891,699 )	1,359,900	(595,701 )	779,952
<b>Expenses:</b>				
Management fees	489,700	185,000	179,500	64,600
Directors' fees and liability insurance	207,309	-	82,924	-
Audit, legal and other professional fees	321,436	133,237	70,949	72,301
Direct REIT operating expenses	137,177	149,923	36,550	49,781
Other administrative	95,580	90,184	31,483	47,862
Total expenses	1,251,202	558,344	401,406	234,544
Net (loss) income	\$(2,142,901)	\$801,556	\$(997,107 )	\$545,408
Basic and diluted net (loss) income per share	\$(0.74 )	\$0.82	\$(0.30 )	\$0.56
Weighted Average Shares Outstanding	2,900,786	981,665	3,341,665	981,665
Dividends Declared Per Common Share	\$0.945	\$-	\$0.405	\$-

See Notes to Financial Statements

ORCHID ISLAND CAPITAL, INC.  
STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
Nine Months Ended September 30, 2013

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
Balances, January 1, 2013	\$1,541	\$15,409,459	\$ (686,025 )	\$14,724,975
Net loss	-	-	(2,142,901 )	(2,142,901 )
Cash dividends declared, \$0.945 per share	-	(3,157,873 )	-	(3,157,873 )
Issuance of common stock pursuant to public offering	23,600	35,376,400	-	35,400,000
Issuance of common stock pursuant to stock dividend	8,276	(8,276 )	-	-
Balances, September 30, 2013	\$33,417	\$47,619,710	\$ (2,828,926 )	\$44,824,201
See Notes to Financial Statements				

ORCHID ISLAND CAPITAL, INC.  
STATEMENTS OF CASH FLOWS  
(Unaudited)

For the Nine Months Ended September 30, 2013 and 2012

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$(2,142,901 )	\$801,556
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Realized and unrealized losses on mortgage-backed securities	10,563,424	642,534
Changes in operating assets and liabilities:		
Accrued interest receivable	(907,884 )	36,708
Prepaid expenses and other assets	(118,425 )	(31,346 )
Accrued interest payable	23,613	19,961
Accounts payable, accrued expenses and other	(19,540 )	241
Due to affiliates	125,004	213,759
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>7,523,291</b>	<b>1,683,413</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
From mortgage-backed securities investments:		
Purchases	(489,923,917 )	(109,739,149)
Sales	237,375,025	91,041,151
Principal repayments	22,563,699	7,248,554
(Increase) decrease in restricted cash	(2,131,875 )	82,625
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(232,117,068 )</b>	<b>(11,366,819 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from repurchase agreements	2,423,975,175	389,050,234
Principal payments on repurchase agreements	(2,226,259,826)	(376,803,831)
Cash dividends	(3,157,873 )	-
Proceeds from issuance of common stock	35,400,000	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>229,957,476</b>	<b>12,246,403</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>5,363,699</b>	<b>2,562,997</b>
<b>CASH AND CASH EQUIVALENTS, beginning of the period</b>	<b>2,537,257</b>	<b>1,891,914</b>
<b>CASH AND CASH EQUIVALENTS, end of the period</b>	<b>\$7,900,956</b>	<b>\$4,454,911</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$793,606	\$162,854
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES:</b>		
Securities acquired settled in later period	\$38,720,351	\$-
Securities sold settled in later period	\$40,955,374	\$-
See Notes to Financial Statements		





ORCHID ISLAND CAPITAL, INC.  
NOTES TO FINANCIAL STATEMENTS  
UNAUDITED  
SEPTEMBER 30, 2013

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 through February 20, 2013 Orchid was a wholly owned subsidiary of Bimini Capital Management, Inc. (“Bimini”). Orchid began operations on November 24, 2010. 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 proceeds of \$35.4 million. Following the IPO, Bimini owns approximately 29.38% of Orchid’s outstanding common stock.

Basis of Presentation and Use of Estimates

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States (“GAAP”). 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 MBS and Eurodollar futures contracts.

Statement of Comprehensive Income (Loss)

In accordance with the Financial Accounting Standards Board’s Accounting Standards Codification (“FASB ASC”) Topic 220, Comprehensive Income, a statement of comprehensive income has not been included as the Company has no items of other comprehensive income. 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. Restricted cash, of approximately \$2,581,000 at September 30, 2013, represents cash held by a broker as margin on Eurodollar futures contracts. Restricted cash, totaling approximately \$449,000 at December 31, 2012, represents cash held on deposit as collateral with repurchase agreement counterparties.

The Company maintains cash balances at three banks, and, at times, balances may exceed federally insured limits. The Company has not experienced any losses related to these balances. All non-interest bearing cash balances were fully insured at December 31, 2012 due to a temporary federal program in effect from December 31, 2010 through December 31, 2012. Under the program, there was no limit to the amount of insurance for eligible accounts. Beginning January 1, 2013, insurance reverted to \$250,000 per depositor at each financial institution. At September 30, 2013, the Company's cash deposits exceeded federally insured limits by approximately \$7.4 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 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 mortgage-backed loans (collectively, "MBS"). These investments meet the requirements to be classified as available for sale under ASC 320-10-25, Debt and Equity Securities (which requires the securities to be carried at fair value on the balance sheet with changes in fair value charged to other comprehensive income, a component of stockholders' equity). However, the Company has elected to account for its investment in MBS under the fair value option. Electing the fair value option allows the Company to record changes in fair value in the 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 MBS transactions on the trade date. Security purchases that have not settled as of the balance sheet date are included in the MBS balance with an offsetting liability recorded, whereas securities sold that have not settled as of the balance sheet date are removed from the MBS balance with an offsetting receivable recorded.

The fair value of the Company's investments in MBS 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 MBS are based on the average of third-party broker quotes received and/or independent pricing sources when available.

Income on PT MBS securities is based on the stated interest rate of the security. Premiums or discounts present at the date of purchase are not amortized. 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 MBS during each reporting period are recorded in earnings and reported as unrealized gains or losses on mortgage-backed securities in the accompanying statements of operations.

### Derivative Financial Instruments

The Company has entered into Eurodollar futures contracts to manage interest rate risk, facilitate asset/liability strategies and manage other exposures, and it may continue to do so in the future. The Company has elected to not

treat any of its derivative financial instruments as hedges. 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.

-6-

---

## 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. MBS and Eurodollar futures contracts are accounted for at fair value in the balance sheets. The methods and assumptions used to estimate fair value for these instruments are presented in Note 11 of the financial statements.

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, prepaid expenses and other assets, due from/to affiliates, receivable for securities sold, repurchase agreements, accrued interest payable, payable for unsettled securities purchased, accounts payable, accrued expenses and others generally approximates their carrying values as of September 30, 2013 and December 31, 2012 due to the short-term nature of these financial instruments.

## Repurchase Agreements

The Company finances the acquisition of the majority of its PT MBS 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, a Maryland limited liability company and wholly-owned subsidiary of Bimini (“the Manager” or “Bimini Advisors”). The Company’s management agreement with the Manager provides for the 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 12 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 attributable to common stockholders divided by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is calculated using the “if converted” method 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

Bimini has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”). Until the closing of its IPO on February 20, 2013, Orchid was a “qualified REIT subsidiary” of Bimini under the Code. Beginning with its short tax period commencing on February 20, 2013 and ending December 31, 2013, Orchid expects to elect and intends to qualify to be taxed as a REIT. 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 July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the unrecognized tax benefits. The ASU is effective beginning January 1, 2014 on either a prospective or retrospective basis. The guidance represents a change in financial statement presentation only and the Company does not expect that this ASU will have a material impact on its financial results.

In July 2013, the FASB issued ASU 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The standard permits the Fed Funds Effective Swap Rate to be used as a benchmark interest rate for hedge accounting purposes. The new guidance is effective for hedging relationships entered into on or after July 17, 2013. The Company does not expect that this ASU will have a material impact on its financial statements.

In June 2013, the FASB issued ASU 2013-08, Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements. The amendments in this Update modify the guidance for determining whether an entity is an investment company, update the measurement requirements for noncontrolling interests in other investment companies and require additional disclosures for investment companies under US GAAP. The amendments in the Update develop a two-tiered approach for the assessment of whether an entity is an investment company which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. The amendments in this Update also revise the measurement guidance in Topic 946 such that investment companies must measure noncontrolling ownership interests in other investment companies at fair value, rather than applying the equity method of accounting to such interests. The new guidance is effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. The Company does not expect that this ASU will have a material impact on its financial statements.

In February 2013, the FASB issued ASU 2013-04, Liabilities (Topic 405) - Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date ("ASU 2013-04"). The objective of the amendments in this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing GAAP. The amendments in ASU 2013-04 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, and should be retrospectively applied to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU's scope that exist at the beginning of an entity's fiscal year of adoption. Early adoption is permitted. The Company does not expect that this ASU will have a material impact on its financial statements.





In January 2013, the FASB released ASU 2013-01 Balance Sheet: Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, which served solely to clarify the scope of financial instruments included in ASU 2011-11 as there was concern about diversity in practice. The objectives of ASU 2013-01 and ASU 2011-11 are to support further convergence of US GAAP and IFRS requirements. These updates are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this ASU had no effect on the Company's financial statements.

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities, requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with ASC 210-20-45 or ASC 815-10-45 or (2) subject to an enforceable master netting arrangement. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this ASU. The Company is required to apply the amendments for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. The disclosures required are to be provided retrospectively for all comparative periods presented. The adoption of this ASU had no effect on the Company's financial statements.

## NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's MBS portfolio as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013	December 31, 2012
Pass-Through Certificates:		
Hybrid Adjustable-rate Mortgages	\$ 120,205	\$ 59,485
Adjustable-rate Mortgages	6,150	6,531
Fixed-rate Mortgages	184,662	43,589
Total Pass-Through Certificates	311,017	109,605
Structured MBS Certificates:		
Interest-Only Securities	15,371	2,884
Inverse Interest-Only Securities	5,399	2,891
Total Structured MBS Certificates	20,770	5,775
Total	\$ 331,787	\$ 115,380

The following table summarizes the Company's MBS portfolio as of September 30, 2013 and December 31, 2012, according to the contractual maturities of the securities in the portfolio. Actual maturities of MBS 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)

	September 30, 2013	December 31, 2012
Greater than five years and less than ten years	\$ 1,662	\$ 12,980
Greater than or equal to ten years	330,125	102,400
Total	\$ 331,787	\$ 115,380

The Company generally pledges its MBS assets as collateral under repurchase agreements. At September 30, 2013 and December 31, 2012, the Company had unpledged securities totaling \$53.8 million and \$5.8 million, respectively. The unpledged balance at September 30, 2013 includes unsettled securities purchases with a fair value of approximately \$38.8 million that will be pledged as collateral under repurchase agreements on the settlement date in October 2013.

## NOTE 3. REPURCHASE AGREEMENTS

As of September 30, 2013, the Company had outstanding repurchase obligations of approximately \$301.7 million with a net weighted average borrowing rate of 0.37%. These agreements were collateralized by MBS with a fair value, including accrued interest and receivable for securities sold, of approximately \$320.0 million. As of December 31, 2012, the Company had outstanding repurchase obligations of approximately \$103.9 million with a net weighted average borrowing rate of 0.49%. These agreements were collateralized by MBS with a fair value, including accrued interest, of approximately \$109.9 million, and cash pledged to counterparties of approximately \$0.4 million.

As of September 30, 2013 and December 31, 2012, the Company's repurchase agreements had remaining maturities as summarized below:

(in thousands)

	OVERNIGHT (1 DAY OR LESS)	BETWEEN 2 AND 30 DAYS	BETWEEN 31 AND 90 DAYS	GREATER THAN 90 DAYS	TOTAL
<b>September 30, 2013</b>					
Fair market value of securities pledged, including accrued interest receivable and receivable for securities sold	\$ 25,386	\$ 192,889	\$ 101,706	\$ -	\$ 319,981
Repurchase agreement liabilities associated with these securities	\$ 25,067	\$ 181,002	\$ 95,588	\$ -	\$ 301,657
Net weighted average borrowing rate	0.35	% 0.38	% 0.34	% -	0.37 %
<b>December 31, 2012</b>					
Fair market value of securities pledged, including accrued interest receivable	\$ -	\$ 109,863	\$ -	\$ -	\$ 109,863
Repurchase agreement liabilities associated with these securities	\$ -	\$ 103,941	\$ -	\$ -	\$ 103,941
Net weighted average borrowing rate	-	0.49	% -	-	0.49 %

If, during the term of a repurchase agreement, a lender should file 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, receivable for securities sold and cash posted by the Company as collateral. At September 30, 2013, the Company had a maximum amount at risk (the difference between the amount loaned to the Company, including interest payable, and the fair value of securities pledged, including accrued interest on such securities and receivable for securities sold) of approximately \$18.2 million. Summary information regarding the Company's amounts at risk with individual counterparties greater than 10% of the Company's equity at September 30, 2013 and December 31, 2012 is as follows:

(in thousands)

	Amount at Risk(1)	Weighted Average Maturity (in Days)
Repurchase Agreement Counterparties		
September 30, 2013		
Citigroup Global Markets, Inc.	\$6,924	26
December 31, 2012		
Citigroup Global Markets, Inc.	\$3,714	18
South Street Securities, LLC	1,802	7

- (1) Equal to the fair value of securities sold, cash posted as collateral, receivable for securities sold, plus accrued interest receivable, minus the sum of repurchase agreement liabilities and accrued interest payable.

#### NOTE 4. DERIVATIVE FINANCIAL INSTRUMENTS

In connection with its interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. The Company has not elected hedging treatment under GAAP, and as such all gains and losses on these instruments are reflected in earnings for all periods presented.

As of September 30, 2013, such instruments were comprised entirely of Eurodollar futures contracts. Eurodollar futures are cash settled futures contracts on an interest rate, with gains and losses credited and charged to the Company's account on a daily basis. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. The Company is exposed to the changes in value of the futures by the amount of margin held by the broker. The table below presents information related to the Company's Eurodollar futures positions at September 30, 2013. As of December 31, 2012, the Company had no outstanding futures positions.

(in thousands)

Expiration Year	Weighted Average LIBOR Rate		Average Contract Notional Amount	Open Equity(1)
2014	0.47	%	262,500	(96 )
2015	0.89	%	275,000	95
2016	1.86	%	250,000	1,286

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

2017	2.83	%	250,000	1,794
2018	3.51	%	250,000	1,088
	1.95	%		\$4,167
Cash posted as collateral, included in restricted cash				\$2,581

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

The table below presents the effect of the Company's derivative financial instruments on the statements of operations for the nine and three months ended September 30, 2013 and 2012.

(in thousands)

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Eurodollar futures contracts (short positions)	\$4,096	\$(40)	\$(2,272)	\$(14)

#### NOTE 5. CAPITAL STOCK

At December 31, 2012, the Company had the authority to issue 1,000,000 shares of \$0.01 par value common stock. In connection with the Company's IPO in February 2013, the Company's charter was amended to increase the authorized capital stock to 600,000,000 shares of which (i) 500,000,000 shares are designated as common stock and (ii) 100,000,000 shares are designated as preferred stock, each with a par value of \$0.01 per share. Holders of shares of the common stock generally have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any securities of the Company. Subject to the provisions of our charter regarding restrictions on ownership and transfer of our stock, all holders of shares of the common stock will have equal liquidation and other rights.

#### Common Stock Issuances

During July 2012, Bimini acquired 4,110 additional shares of common stock of the Company in satisfaction of an amount due to Bimini at June 30, 2012 of approximately \$411,000 for prior management fees, overhead allocations and direct expense reimbursements.

On February 20, 2013, Orchid completed the IPO of its common stock in which it sold 2,360,000 shares of its common stock and raised proceeds of \$35,400,000.

#### Stock Dividend

On February 14, 2013, Orchid's Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed pursuant to this dividend were issued to Bimini on February 20, 2013, immediately prior to the Company's IPO.

#### Cash Dividends

The table below presents the cash dividends declared on the Company's common stock during 2013.

Declaration Date	Record Date	Payment Date	Per Share Amount	Total
March 8, 2013	March 25, 2013	March 27, 2013	\$0.135	\$451,125
April 10, 2013	April 25, 2013	April 30, 2013	0.135	451,125
May 9, 2013	May 28, 2013	May 31, 2013	0.135	451,125
June 10, 2013	June 25, 2013	June 28, 2013	0.135	451,125
July 9, 2013	July 25, 2013	July 31, 2013	0.135	451,125
August 12, 2013	August 26, 2013	August 30, 2013	0.135	451,125
September 10, 2013	September 25, 2013	September 30, 2013	0.135	451,125
October 10, 2013	October 25, 2013	October 31, 2013	0.135	451,125



## NOTE 6. EXPENSES

The table below presents the Company's operating expenses for the nine and three months ended September 30, 2013 and 2012.

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Directors fees and liability insurance	\$207,309	\$-	\$82,924	\$-
Legal fees	71,286	-	10,949	-
Other professional fees	250,150	133,237	60,000	72,301
Management fees	489,700	185,000	179,500	64,600
Other direct REIT operating expenses	137,177	149,923	36,550	49,781
Other administrative expenses	95,580	90,184	31,483	47,862
Total expenses	\$1,251,202	\$558,344	\$401,406	\$234,544

## NOTE 7. STOCK INCENTIVE PLAN

In October 2012, our Board of Directors adopted and Bimini, then the Company's sole stockholder, approved, the Orchid Island Capital, Inc. 2012 Equity Incentive Plan (the "Incentive Plan") to recruit and retain employees, directors and other service providers, including employees of the Manager and other affiliates. The Incentive Plan provides for the award of stock options, stock appreciation rights, stock award, performance units, other equity-based awards (and dividend equivalents with respect to awards of performance units and other equity-based awards) and incentive awards. The Incentive Plan is administered by the Compensation Committee of the Company's Board of Directors except that the Company's full Board of Directors will administer awards made to directors who are not employees of the Company or its affiliates. The Incentive Plan provides for awards of up to an aggregate of 10% of the issued and outstanding shares of our common stock (on a fully diluted basis) at the time of the awards, subject to a maximum aggregate 4,000,000 shares of the Company's common stock that may be issued under the Incentive Plan. To date, no awards have been made under the Incentive Plan.

## NOTE 8. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at September 30, 2013.

## NOTE 9. INCOME TAXES

The Company will generally not be subject to federal income tax on its REIT taxable income to the extent that it distributes its REIT taxable income to its stockholders and satisfies the ongoing REIT requirements, including meeting certain asset, income and stock ownership tests. A REIT must generally distribute at least 90% of its REIT taxable income to its stockholders, of which 85% generally must be distributed within the taxable year, in order to avoid the imposition of an excise tax. The remaining balance may be distributed up to the end of the following taxable year, provided the REIT elects to treat such amount as a prior year distribution and meets certain other requirements.



## NOTE 10. EARNINGS PER SHARE (EPS)

The table below reconciles the numerator and denominator of EPS for the nine and three months ended September 30, 2013 and 2012.

(in thousands, except per-share information)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2013	2012	2013	2012
Basic and diluted EPS per common share:				
Numerator for basic and diluted EPS per common share:				
Net (loss) income - Basic and diluted	\$(2,143	) \$802	\$(997	) \$545
Weighted average common shares:				
Common shares outstanding or to be				
issued at the balance sheet date	3,342	982	3,342	982
Effect of weighting	(441	) -	-	-
Weighted average shares-basic and diluted	2,901	982	3,342	982
(Loss) income per common share:				
Basic and diluted	\$(0.74	) \$0.82	\$(0.30	) \$0.56

On February 14, 2013, Orchid's Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed pursuant to the dividend were issued to Bimini on February 20, 2013, immediately prior to Orchid's IPO. For the nine and three months ended September 30, 2012, the 981,665 common shares, which includes the 154,110 shares of common stock outstanding at December 31, 2012 and the 827,555 shares distributed as a stock dividend, is used for the EPS computation, as Bimini was the sole stockholder during the entire period.

## NOTE 11. FAIR VALUE

Authoritative accounting literature establishes a framework for using fair value to measure assets and liabilities and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of non-performance. Required disclosures include stratification of balance sheet amounts measured at fair value based on inputs the Company uses to derive fair value measurements. These stratifications are:

- Level 1 valuations, where the valuation is based on quoted market prices for identical assets or liabilities traded in active markets (which include exchanges and over-the-counter markets with sufficient volume),
- Level 2 valuations, where the valuation is based on quoted market prices for similar instruments traded in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market, and

- Level 3 valuations, where the valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect the Company's own estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include option pricing models, discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

Our MBS are valued using Level 2 valuations, and such valuations currently are determined by the Company based on the average of third-party broker quotes and/or by independent pricing sources when available. Because the price estimates may vary, the Company must make certain judgments and assumptions about the appropriate price to use to calculate the fair values. Alternatively, the Company could opt to have the value of all of our positions in MBS determined by either an independent third-party or do so internally.

MBS and Eurodollar futures contracts were recorded at fair value on a recurring basis during the nine months ended September 30, 2013 and 2012. When determining fair value measurements, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset. When possible, the Company looks to active and observable markets to price identical assets. When identical assets are not traded in active markets, the Company looks to market observable data for similar assets. The following table presents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012:

(in thousands)

	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013				
Mortgage-backed securities	\$ 331,787	\$-	\$331,787	\$ -
Eurodollar futures contracts	2,581	2,581	-	-
December 31, 2012				
Mortgage-backed securities	\$ 115,380	\$-	\$115,380	\$ -

During the nine and three months ended September 30, 2013 and 2012, there were no transfers of financial assets or liabilities between levels 1, 2 or 3.

#### NOTE 12. RELATED PARTY TRANSACTIONS

##### Management Agreement

The Company entered into a management agreement with Bimini, which provided for an initial term through December 31, 2011 with automatic one-year extension options. The agreement was extended under the option to December 31, 2013, but was terminated at the completion of the Company's IPO. At the completion of the IPO, the Company entered into a management agreement with the Manager, which provides for an initial term through February 20, 2016 with automatic one-year extensions and is subject to certain termination rights. Under the terms of

the management agreement, Bimini Advisors will be responsible for administering the business activities and day-to-day operations of the Company. Bimini Advisors will receive a monthly management fee in the amount of:

- One-twelfth of 1.5% of the first \$250 million of the Company's equity, as defined in the management agreement,
- One-twelfth of 1.25% of the Company's equity that is greater than \$250 million and less than or equal to \$500 million, and
  - One-twelfth of 1.00% of the Company's equity that is greater than \$500 million.

The Company is obligated to reimburse Bimini Advisors for any direct expenses incurred on its behalf. In addition, once the Company's Equity, as defined in the management agreement, equals \$100 million, Bimini Advisors will begin allocating to the Company, its pro rata portion of certain overhead costs as defined in the management agreement. Should the Company terminate the management agreement without cause, it shall pay to Bimini Advisors a termination fee equal to three times the average annual management fee, as defined in the management agreement, before or on the last day of the initial term or automatic renewal term.

The Company was obligated to reimburse Bimini for its costs incurred under the original management agreement. In addition, the Company was required to pay Bimini a monthly fee of \$7,200, which represents an allocation of overhead expenses for items that include, but are not limited to, occupancy costs, insurance and administrative expenses. These expenses were allocated based on the ratio of the Company's assets and Bimini's consolidated assets. Total expenses recorded during the nine and three months ended September 30, 2013 for the management fee and costs incurred was approximately \$504,000 and \$180,000, respectively, compared to \$250,000 and \$86,000, respectively, for the nine and three months ended September 30, 2012.

#### Payment of Certain Offering Expenses

Bimini Advisors has paid, or has agreed to reimburse Orchid for all offering expenses in connection with the Company's IPO. During the year ended December 31, 2012, these expenses were approximately \$247,000. During the nine months ended September 30, 2013, Bimini Advisors paid additional expenses related to this offering of approximately \$3,042,000. In addition, during the year ended December 31, 2012, Bimini Advisors paid certain expenses totaling approximately \$833,000 on behalf of the Company associated with a failed merger attempt. The Company has no obligation or intent to reimburse Bimini Advisors, either directly or indirectly, for the offering costs or attempted merger costs, therefore they are not included in the Company's financial statements. At September 30, 2013 and December 31, 2012, the net amount due (to) from affiliates was approximately (\$80,000) and \$45,000, respectively.

#### Board Memberships

John B. Van Heuvelen, one of the Company's independent directors, owns shares of common stock of Bimini. Robert Cauley, the Company's Chief Executive Officer and Chairman of the Company's Board of Directors, also serves as Chief Executive Officer and Chairman of the Board of Directors of Bimini and owns shares of common stock of Bimini. Hunter Haas, the Company's Chief Financial Officer, Chief Investment Officer, Secretary and a member of the Company's Board of Directors, also serves as the Chief Financial Officer, Chief Investment Officer and Treasurer of Bimini and owns shares of common stock of Bimini.

#### Consulting Agreement

In September 2010, the Company entered into a consulting agreement with W Coleman Bitting, who became one of the Company's independent directors in February 2013. The terms of the consulting agreement provided that Mr. Bitting would advise the Company with respect to financing alternatives, business strategies and related matters as requested during the term of the agreement. In exchange for his services, the consulting agreement provided that the Company pay Mr. Bitting an hourly fee of \$150 and reimburse him for all out-of-pocket expenses reasonably incurred in the performance of his services. During the nine months ended September 30, 2013 and 2012, the Company paid Mr. Bitting approximately \$3,800 and \$12,900, respectively, under this agreement. Mr. Bitting's consulting agreement was terminated upon completion of the Company's IPO. The total compensation Mr. Bitting received under the consulting agreement was approximately \$115,000.



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and notes to those statements included in Item 1 of this Form 10-Q. The discussion may contain certain forward-looking statements that involve risks and uncertainties. Forward-looking statements are those that are not historical in nature. As a result of many factors, such as those set forth under "Risk Factors" in our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q, our actual results may differ materially from those anticipated in such forward-looking statements.

### Overview

We are a specialty finance company that invests in Agency RMBS. Our investment strategy focuses on, and our portfolio consists of, two categories of Agency RMBS: (i) traditional pass-through Agency RMBS and (ii) structured Agency RMBS, such as CMOs, IOs, IIOs and POs, among other types of structured Agency RMBS. From inception through the closing of the initial public offering of our common stock, we were managed by Bimini. We are currently externally managed by Bimini Advisors, a registered investment adviser with the Securities and Exchange Commission ("SEC").

We were formed by Bimini in August 2010 and commenced operations on November 24, 2010. At December 31, 2012, Bimini was our sole stockholder. We completed our initial public offering on February 20, 2013. In that offering we raised \$35.4 million from the sale of 2,360,000 shares of our common stock.

Our business objective is to provide attractive risk-adjusted total returns over the long term through a combination of capital appreciation and the payment of regular monthly distributions. We intend to achieve this objective by investing in and strategically allocating capital between the two categories of Agency RMBS described above. We seek to generate income from (i) the net interest margin on our leveraged pass-through Agency RMBS portfolio and the leveraged portion of our structured Agency RMBS portfolio, and (ii) the interest income we generate from the unleveraged portion of our structured Agency RMBS portfolio. We intend to fund our pass-through Agency RMBS and certain of our structured Agency RMBS through short-term borrowings structured as repurchase agreements. Pass-through Agency RMBS and structured Agency RMBS typically exhibit materially different sensitivities to movements in interest rates. Declines in the value of one portfolio may be offset by appreciation in the other. The percentage of capital that we allocate to our two Agency RMBS asset categories will vary and will be actively managed in an effort to maintain the level of income generated by the combined portfolios, the stability of that income stream and the stability of the value of the combined portfolios. We believe that this strategy will enhance our liquidity, earnings, book value stability and asset selection opportunities in various interest rate environments.

We intend to qualify and will elect to be taxed as a REIT under the Code commencing with our short taxable year ending December 31, 2013. We generally will not be subject to U.S. federal income tax to the extent that we annually distribute all of our REIT taxable income to our stockholders and qualify as a REIT.

### Factors that Affect our Results of Operations and Financial Condition

A variety of industry and economic factors may impact our results of operations and financial condition. These factors include:

- interest rate trends;

-

prepayment rates on mortgages underlying our Agency RMBS, and credit trends insofar as they affect prepayment rates, borrowing rates and exposure to our lenders;

- the difference between Agency RMBS yields and our funding and hedging costs;
  - competition for investments in Agency RMBS;
- recent actions taken by the Federal Reserve and the U.S. Treasury; and
  - other market developments.

In addition, a variety of factors relating to our business may also impact our results of operations and financial condition. These factors include:

- our degree of leverage;
- our access to funding and borrowing capacity;
  - our borrowing costs;
  - our hedging activities;
- the market value of our investments; and
- the requirements to qualify as a REIT and the requirements to qualify for a registration exemption under the Investment Company Act.

We anticipate that, for any period during which changes in the interest rates for our adjustable rate assets do not coincide with interest rate changes on the corresponding liabilities, such assets will re-price more slowly than the corresponding liabilities. Consequently, changes in interest rates, particularly short term interest rates, may significantly influence our net income.

Our net income may be affected by a difference between actual prepayment rates and our projections. Prepayments on loans and securities may be influenced by changes in market interest rates and homeowners' ability and desire to refinance their mortgages.

#### Results of Operations

Described below are the Company's results of operations for the nine and three months ended September 30, 2013, as compared to the Company's results of operations for the nine and three months ended September 30, 2012.

#### Net (Loss) Income Summary

Net loss for the nine months ended September 30, 2013 was \$2.1 million, or \$0.74 per share. Net income for the nine months ended September 30, 2012 was \$0.8 million, or \$0.82 per share. Net loss for the three months ended September 30, 2013 was \$1.0 million, or \$0.30 per share. Net income for the three months ended September 30, 2012 was \$0.5 million, or \$0.56 per share.

The components of net (loss) income for the nine and three months ended September 30, 2013 and 2012, along with the changes in those components, are presented in the table below:

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2013	2012	Change	2013	2012	Change
Interest income	\$6,393	\$2,225	\$4,168	\$2,551	\$697	\$1,854
Interest expense	(817 )	(183 )	(634 )	(294 )	(58 )	(236 )
Net interest income	5,576	2,042	3,534	2,257	639	1,618
(Losses) gains on MBS and Eurodollar futures	(6,468 )	(682 )	(5,786 )	(2,853 )	141	(2,994 )
Net portfolio (deficiency) income	(892 )	1,360	(2,252 )	(596 )	780	(1,376 )
Expenses	(1,251 )	(558 )	(693 )	(401 )	(235 )	(166 )
Net (loss) income	\$(2,143 )	\$802	\$(2,945 )	\$(997 )	\$545	\$(1,542 )





## GAAP and Non-GAAP Reconciliation

To date, we have used derivatives, specifically Eurodollar futures contracts, to hedge the interest rate risk on repurchase agreements in a rising rate environment. We have not elected to designate our derivative holdings for hedge accounting treatment under the Financial Accounting Standards Board (the “FASB”) Accounting Standards Codification (“ASC”) Topic 815, Derivatives and Hedging. Changes in fair value of these instruments are presented in a separate line item in our Statements of Operations. As such, for financial reporting purposes, interest expense and cost of funds are not impacted by the fluctuation in value of the Eurodollar futures contracts. In the future, we may use other derivative instruments to hedge our interest expense and/or elect to designate our derivative holdings for hedge accounting treatment.

For the purpose of computing net interest income and ratios relating to cost of funds measures throughout this Management’s Discussion and Analysis of Financial Condition and Results of Operations, interest expense has been adjusted to reflect the effect of our Eurodollar hedges on our interest expense for each period presented. The adjustment to reflect this effect includes only the gains or losses on our Eurodollar futures contracts in effect for the applicable period, whereas the gains or losses on Eurodollar futures contracts reflected in our statements of operations include gains or losses for all Eurodollar futures contracts in effect as of the end of each period in accordance with GAAP. As of September 30, 2013, we have Eurodollar futures contracts in place through 2018. Since we have taken short positions on these contracts, when interest rates move higher the value of our short position may increase in value. The opposite would be true if interest rates were to decrease. In fact, if the relevant portion of the yield curve for which we have employed funding hedges is positively sloped and rates remain unchanged, we would expect the value of the short position to decrease in value. Adjusting our interest expense for the periods presented by the gains on all Eurodollar futures would not accurately reflect our economic interest expense for these periods. Combining the effects of the Eurodollar positions in place for only the periods presented with the interest expense on repurchase agreements reflects total economic interest expense on these obligations and the economic effect of our hedging strategy for the applicable period. Interest expense, including the effect of Eurodollar futures contracts for the period, is referred to as economic interest expense. Net interest income, including the effect of Eurodollar futures contracts for the period, is referred to as economic net interest income.

We believe that economic interest expense and economic net interest income provides meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The non-GAAP measures help us to evaluate our financial position and performance without the effects of certain transactions and GAAP adjustments that are not necessarily indicative of our current investment portfolio or operations.

Our presentation of the economic value of our hedging strategy has important limitations. First, other market participants may calculate economic interest expense and economic net interest income differently than we calculate them. Second, while we believe that the calculation of the economic value of our hedging strategy described above helps to present our financial position and performance, it may be of limited usefulness as an analytical tool. Therefore, the economic value of our investment strategy should not be viewed in isolation and is not a substitute for interest expense and net interest income computed in accordance with GAAP.

The following table presents the effect of our hedging strategy on interest expense and net interest income for the nine and three months ended September 30, 2013 and 2012 and for each quarter during 2013 and 2012.

(dollars in thousands)

	GAAP Interest Expense	Effect of Eurodollar Hedges(1)	Economic Interest Expense(2)	GAAP Net Interest Income	Economic Net Interest Income(3)
Three Months Ended,					
September 30, 2013	\$294	\$(28 )	\$322	\$2,257	\$2,229
June 30, 2013	322	(4 )	326	2,107	2,103
March 31, 2013	201	(65 )	266	1,211	1,146
December 31, 2012	94	(62 )	156	379	317
September 30, 2012	58	(28 )	86	639	611
June 30, 2012	74	(10 )	84	695	685
March 31, 2012	51	(4 )	55	708	704
Nine Months Ended,					
September 30, 2013	\$817	\$(97 )	\$914	\$5,575	\$5,478
September 30, 2012	183	(42 )	225	2,042	2,000

(1) Reflects the effect of Eurodollar futures contract hedges for only the period presented. For the three month periods ended September 30, 2013 and 2012, total gains (losses) on Eurodollar contracts recognized in our statements of operations for GAAP purposes were \$(2,271,875) and \$(14,250), respectively. For the nine month periods ended September 30, 2013 and 2012, total gains (losses) on Eurodollar contracts recognized in our statements of operations for GAAP purposes were \$4,095,788 and \$(39,500), respectively.

(2) Calculated by subtracting the effect of Eurodollar hedges from GAAP interest expense.

(3) Calculated by adding the effect of Eurodollar hedges to GAAP net interest income.

#### Net Interest Income

During the nine months ended September 30, 2013, we generated \$5.5 million of economic net interest income, consisting of a combination of \$6.4 million of interest income from MBS assets and \$0.9 million of economic interest expense on repurchase liabilities. For the comparable period ended September 30, 2012, we generated \$2.0 million of economic net interest income, consisting of \$2.2 million of interest income from MBS assets offset by \$0.2 million of economic interest expense on repurchase liabilities.

During the three months ended September 30, 2013, we generated \$2.2 million of economic net interest income, consisting of a combination of \$2.6 million of interest income from MBS assets and \$0.3 million of economic interest expense on repurchase liabilities. For the three months ended September 30, 2012, we generated \$0.6 million of economic net interest income, consisting of \$0.7 million of interest income from MBS assets offset by \$0.1 million of economic interest expense on repurchase liabilities.

The table below provides information on our portfolio average balances, interest income, yield on assets, average repurchase agreement balances, economic interest expense, economic cost of funds, economic net interest income and economic net interest spread for the nine months ended September 30, 2013 and 2012 and for each quarter in 2013 and 2012.

(dollars in thousands)

	Average MBS Securities Held(1)	Interest Income(2)	Yield on Average MBS Securities		Average Repurchase Agreements(1)	Economic Interest Expense(3)	Average Economic Cost of Funds		Economic Net Interest Income(3)	Economic Net Interest Spread	
Three Months Ended,											
September 30, 2013	\$ 335,467	\$ 2,551	3.04 %	\$	305,196	\$ 322	0.42 %	\$	2,229	2.62 %	
June 30, 2013	349,704	2,429	2.78 %		312,591	326	0.42 %		2,103	2.36 %	
March 31, 2013	237,820	1,412	2.38 %		210,194	266	0.51 %		1,146	1.87 %	
December 31,											
2012	91,094	473	2.08 %		80,256	156	0.78 %		317	1.30 %	
September 30,											
2012	64,378	697	4.33 %		53,698	86	0.64 %		611	3.69 %	
June 30, 2012	73,559	769	4.18 %		62,407	84	0.54 %		685	3.64 %	
March 31, 2012	70,585	759	4.30 %		59,157	55	0.37 %		704	3.93 %	
Nine Months Ended,											
September 30, 2013	\$ 307,664	\$ 6,392	2.77 %	\$	275,993	\$ 914	0.44 %	\$	5,478	2.33 %	
September 30, 2012	69,507	2,225	4.27 %		58,421	225	0.51 %		2,000	3.76 %	

- (1) Portfolio yields and costs of borrowings presented in the table above and the tables on pages 22 and 23 are calculated based on the average balances of the underlying investment portfolio/repurchase agreement balances and are annualized for the quarterly periods presented. Average balances for quarterly periods are calculated using two data points, the beginning and ending balances. Average balances for the year to date periods are calculated as the average of the average quarterly periods.
- (2) Interest income presented in the table above includes only interest earned on the Company's MBS investments and excludes interest earned on cash balances, and excludes the impact of discounts or premiums on MBS investments, as discounts or premiums are not amortized under the fair value option. Interest income and net portfolio interest income may not agree with the information presented in the statements of operations.
- (3) Economic interest expense and economic net interest income presented in the table above and the table on page 23 includes the effect of Eurodollar futures contract hedges for only the period presented. For the three month periods ended September 30, 2013 and 2012, total gains (losses) on Eurodollar contracts recognized in our statements of operations for GAAP purposes were \$(2,271,875) and \$(14,250), respectively. For the nine month periods ended September 30, 2013 and 2012, total gains (losses) on Eurodollar contracts recognized in our statements of operations for GAAP purposes were \$4,095,788 and \$(39,500), respectively.

#### Interest Income and Average Earning Asset Yield

Our interest income for the nine months ended September 30, 2013 and 2012 was \$6.4 million and \$2.2 million, respectively. We had average MBS holdings of \$307.7 million and \$69.5 million for the nine months ended September 30, 2013 and 2012, respectively. The yield on our portfolio was 2.77% and 4.27% for the nine months ended September 30, 2013 and 2012, respectively. For the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012, there was a \$4.2 million increase in interest income due to a \$238.2 million increase in average MBS, partially offset by a 150 basis point decrease in the yield on average MBS for the nine months ended September 30, 2013 when compared to the nine months ended September 30, 2012.

Our interest income for the three months ended September 30, 2013 and 2012 was \$2.6 million and \$0.7 million, respectively. We had average MBS holdings of \$335.5 million and \$64.4 million for the three months ended September 30, 2013 and 2012, respectively. The yield on our portfolio was 3.04% and 4.33% for the three months ended September 30, 2013 and 2012, respectively. For the three months ended September 30, 2013 as compared to the three months ended September 30, 2012, there was a \$1.9 million increase in interest income due to a \$271.1 million increase in average MBS, partially offset by a 129 basis point decrease in the yield on average MBS for the three months ended September 30, 2013 when compared to the three months ended September 30, 2012.

The table below presents the average portfolio size, income and yields of our respective sub-portfolios, consisting of structured MBS and PT MBS.

(dollars in thousands)

	Average MBS Held			Interest Income			Realized Yield on Average MBS		
	PT MBS	Structured MBS	Total	PT MBS	Structured MBS	Total	PT MBS	Structured MBS	Total
Three Months Ended,									
September 30, 2013	\$ 314,096	\$ 21,371	\$ 335,467	\$ 2,412	\$ 139	\$ 2,551	3.07 %	2.60 %	3.04 %
June 30, 2013	326,977	22,727	349,704	2,514	(85 )	2,429	3.08 %	(1.51 )%	2.78 %
March 31, 2013	223,191	14,629	237,820	1,415	(3 )	1,412	2.54 %	(0.06 )%	2.38 %
December 31, 2012	84,617	6,477	91,094	597	(124 )	473	2.82 %	(7.66 )%	2.08 %
September 30, 2012	56,519	7,859	64,378	410	287	697	2.90 %	14.59 %	4.33 %
June 30, 2012	65,320	8,239	73,559	593	176	769	3.63 %	8.56 %	4.18 %
March 31, 2012	61,936	8,649	70,585	530	229	759	3.43 %	10.56 %	4.30 %
Years Ended,									
September 30, 2013	\$ 288,088	\$ 19,576	\$ 307,664	\$ 6,341	\$ 51	\$ 6,392	2.93 %	0.35 %	2.77 %
September 30, 2012	61,258	8,249	69,507	1,533	692	2,225	3.34 %	11.17 %	4.27 %

#### Interest Expense and the Cost of Funds

We had average outstanding repurchase agreements of \$276.0 million and \$58.4 million and total economic interest expense of \$0.9 million and \$0.2 million for the nine months ended September 30, 2013 and 2012, respectively. Our average economic cost of funds was 0.44% and 0.51% for nine months ended September 30, 2013 and 2012, respectively. There was a 7 basis point decrease in the average economic cost of funds and a \$217.6 million increase in average outstanding repurchase agreements during the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012.

We had average outstanding repurchase agreements of \$305.2 million and \$53.7 million and total economic interest expense of \$0.3 million and \$0.1 million for the three months ended September 30, 2013 and 2012, respectively. Our average economic cost of funds was 0.42% and 0.64% for three months ended September 30, 2013 and 2012, respectively. There was a 22 basis point decrease in the average economic cost of funds and a \$251.5 million increase in average outstanding repurchase agreements during the three months ended September 30, 2013 as compared to the three months ended September 30, 2012.

Since all of our repurchase agreements are short-term, changes in market rates directly affect our interest expense. Our average economic cost of funds was 23 basis points above average one-month LIBOR and 2 basis points above

average six-month LIBOR for the quarter ended September 30, 2013. The average term to maturity of the outstanding repurchase agreements increased from 15 days at December 31, 2012 to 24 days at September 30, 2013.

-22-

---

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

The table below presents the average repurchase agreements outstanding, economic interest expense and average economic cost of funds, and average one-month and six-month LIBOR rates for the nine months ended September 30, 2013 and 2012 and for each quarter in 2013 and 2012.

(dollars in thousands)

	Average Balance of Repurchase Agreements	Economic Interest Expense	Average Economic Cost of Funds		Average One-Month LIBOR		Average Six-Month LIBOR		Average Economic Cost of Funds Relative to Average One- Month LIBOR		Average Economic Cost of Funds Relative to Average Six- Month LIBOR	
Three Months Ended, September 30, 2013	\$305,196	\$322	0.42	%	0.19	%	0.40	%	0.23	%	0.02	%
June 30, 2013	312,591	326	0.42	%	0.20	%	0.43	%	0.22	%	(0.01)	)%
March 31, 2013	210,194	266	0.51	%	0.21	%	0.48	%	0.30	%	0.03	%
December 31, 2012	80,256	156	0.78	%	0.22	%	0.59	%	0.56	%	0.19	%
September 30, 2012	53,698	86	0.64	%	0.23	%	0.70	%	0.41	%	(0.06)	)%
June 30, 2012	62,407	84	0.54	%	0.24	%	0.74	%	0.30	%	(0.20)	)%
March 31, 2012	59,157	55	0.37	%	0.26	%	0.76	%	0.11	%	(0.39)	)%
Nine Months Ended, September 30, 2013	\$275,993	\$914	0.44	%	0.20	%	0.44	%	0.24	%	0.00	%
September 30, 2012	58,421	225	0.51	%	0.25	%	0.73	%	0.26	%	(0.22)	)%

Gains or Losses

The table below presents our gains or losses for the nine and three months ended September 30, 2013 and 2012.

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2013	2012	Change	2013	2012	Change
Realized (losses) gains on sales of MBS	\$(1,491 )	\$116	\$(1,607 )	\$(667 )	\$-	\$(667 )
Unrealized (losses) gains on MBS	(9,073 )	(758 )	(8,315 )	86	156	(70 )
Total (losses) gains on MBS	(10,564 )	(642 )	(9,922 )	(581 )	156	(737 )
Gains (losses) on Eurodollar futures	4,096	(40 )	4,136	(2,272 )	(14 )	(2,258 )



During the nine months ended September 30, 2013 and 2012, the Company received proceeds of \$237.4 million and \$91.0 million, respectively, from the sales of MBS. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns or to manage our balance sheet as part of our asset/liability management strategy.

In May and again in June of 2013, the Federal Reserve hinted to the markets that it would begin to taper its quantitative easing program, possibly as soon as Fall 2013. The quantitative easing program involves the purchase of \$40 billion Agency MBS and \$45 billion US Treasury securities per month by the Federal Reserve. The US Treasury and Agency MBS markets reacted strongly to this news and interest rates rose by approximately 100 basis points from early May levels in the case of the 10 year US Treasury note.

With the release of improving economic data during the third quarter, interest rates continued to rise, with the yield on the 10 year US Treasury reaching 3.0% in early September 2013. However data later in the quarter was less robust and the Federal Reserve did not taper their asset purchases as expected. Subsequently, the treasury market rallied into quarter end, and the benchmark interest rates at the end of the third quarter were not materially different from levels at the end of the second quarter.

This market activity initially had an adverse effect on our pass-through portfolio since the prices of MBS assets generally move in an inverse relationship to interest rates. Conversely, our interest only structured securities rose in price as the market anticipated slower prepayment rates as a result of higher mortgage rates. By the end of the quarter, when interest rates ended essentially unchanged from the second quarter, the value of our MBS assets were not materially different than where they were at the beginning of the quarter. The table below presents historical interest rate data for each quarter end during 2013 and 2012.

As of,	10 Year Treasury Rate(1)		15 Year Fixed-Rate Mortgage Rate(2)		30 Year Fixed-Rate Mortgage Rate(2)	
September 30, 2013	2.62	%	3.52	%	4.49	%
June 30, 2013	2.48	%	3.17	%	4.07	%
March 31, 2013	1.85	%	2.76	%	3.57	%
December 31, 2012	1.76	%	2.66	%	3.35	%
September 30, 2012	1.64	%	2.78	%	3.47	%
June 30, 2012	1.66	%	2.95	%	3.68	%
March 31, 2012	2.22	%	3.20	%	3.95	%

(1) Historical 10 Year Treasury Rates are obtained from quoted end of day prices on the CBOE.

(2) Historical 30 Year and 15 Year Fixed Rate Mortgage Rates are obtained from Freddie Mac's Primary Mortgage Market Survey.

#### Expenses

Total operating expenses were \$1.3 million and \$0.6 million for the nine months ended September 30, 2013 and 2012, respectively, and \$0.4 million and \$0.2 million for the three months ended September 30, 2013 and 2012, respectively. The table below provides a breakdown of operating expenses for the nine and three months ended September 30, 2013 and 2012.

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2013	2012	Change	2013	2012	Change
Directors fees and liability insurance	\$207	\$-	\$207	\$83	\$-	\$83
Legal fees	71	-	71	11	-	11
Other professional fees	250	133	117	60	72	(12)
Management fees	490	185	305	180	65	115
Other direct REIT operating expenses	137	150	(13)	37	50	(13)
Other expenses	96	90	6	31	48	(17)
Total expenses	\$1,251	\$558	\$693	\$402	\$235	\$167

Under the terms of a management agreement that was in effect during all of 2012 and through the date of the IPO, the Company paid Bimini a monthly management fee equal to 1/12 of 1.50% per annum of the Stockholders' Equity (as defined in the management agreement) of the Company. In addition, the Company paid Bimini a monthly fee of \$7,200, which represented an allocation of overhead expenses for items that include, but are not limited to, occupancy costs, insurance and administrative expenses. These expenses were allocated based on the ratio of the Company's assets and Bimini's consolidated assets. At the completion of the IPO, the Company entered into a management

agreement with Bimini Advisors, LLC, a wholly owned subsidiary of Bimini, which provides for an initial term through February 20, 2016 with automatic one-year extensions and is subject to certain termination rights. Under the terms of the new management agreement, overhead costs will not be allocated to the Company until its Equity, as defined, equals or exceeds \$100 million for the first time.

## Financial Condition:

## Mortgage-Backed Securities

As of September 30, 2013, our MBS portfolio consisted of \$331.8 million of agency or government MBS at fair value and had a weighted average coupon on assets of 3.31%. During the nine months ended September 30, 2013, we received principal repayments of \$22.6 million compared to \$7.2 million for the nine months ended September 30, 2012. The average prepayment speeds for the quarters ended September 30, 2013 and 2012 were 12.6% and 25.0%, respectively.

The following table presents the constant prepayment rate (“CPR”) experienced on our structured and PT MBS sub-portfolios, on an annualized basis, for the quarterly periods presented. Assets that were not owned for the entire quarter have been excluded from the calculation. The exclusion of certain assets during periods of high trading activity can create a very high, and often volatile, reliance on a small sample of underlying loans.

Three Months Ended,	PT MBS Portfolio (%)	Structured MBS Portfolio (%)	Total Portfolio (%)
September 30, 2013	6.5	28.2	12.6
June 30, 2013	6.5	29.8	16.3
March 31, 2013	9.2	33.0	20.0
December 31, 2012	1.1	42.3	28.6
September 30, 2012	4.2	38.7	25.0
June 30, 2012	0.2	41.4	38.7
March 31, 2012	11.0	31.2	23.8

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

The following tables summarize certain characteristics of the Company's agency and government mortgage related securities as of September 30, 2013 and December 31, 2012:

(in thousands)

Asset Category	Fair Value	Percentage of Entire Portfolio	Weighted Average Coupon	Weighted Average Maturity in Months	Longest Maturity	Weighted Average Coupon Reset in Months	Weighted Average Lifetime Cap	Weighted Average Periodic Cap
September 30, 2013								
Adjustable Rate MBS	\$ 6,150	1.9%	4.04%	248	1-Sep-35	4.71	10.05%	2.00%
Fixed Rate MBS	184,662	55.7%	3.62%	310	1-Sep-43	NA	NA	NA
Hybrid Adjustable Rate MBS	120,205	36.2%	2.56%	352	1-Aug-43	111.61	7.56%	2.00%
Total Mortgage-backed Pass-through	311,017	93.8%	3.22%	325	1-Sep-43	106.41	7.68%	2.00%
Interest-Only Securities	15,371	4.6%	4.32%	236	20-Oct-42	NA	NA	NA
Inverse Interest-Only Securities	5,399	1.6%	5.91%	319	15-Dec-40	NA	6.09%	NA
Total Structured MBS	20,770	6.2%	4.73%	258	20-Oct-42	NA	NA	NA
Total Mortgage Assets	\$ 331,787	100.0%	3.31%	321	1-Sep-43	NA	NA	NA
December 31, 2012								
Adjustable Rate MBS	\$ 6,531	5.7%	4.20%	258	1-Sep-35	3.46	10.04%	2.00%
Fixed Rate MBS	43,589	37.8%	3.24%	181	1-Dec-40	NA	NA	NA
Hybrid Adjustable Rate MBS	59,485	51.5%	2.69%	357	1-Nov-42	100.51	7.69%	2.00%
Total Mortgage-backed Pass-through	109,605	95.0%	3.00%	281	1-Nov-42	90.91	7.93%	2.00%
Interest-Only Securities	2,884	2.5%	3.52%	151	25-Dec-39	NA	NA	NA
Inverse Interest-Only Securities	2,891	2.5%	6.13%	309	25-Nov-40	NA	6.34%	NA
Total Structured MBS	5,775	5.0%	4.83%	230	25-Nov-40	NA	NA	NA
Total Mortgage Assets	\$ 115,380	100.0%	3.09%	278	1-Nov-42	NA	NA	NA

(in thousands)

Agency	September 30, 2013			December 31, 2012		
	Fair Value	Percentage of Entire Portfolio		Fair Value	Percentage of Entire Portfolio	
Fannie Mae	\$203,477	61.33	%	\$113,235	98.14	%
Freddie Mac	107,876	32.51	%	2,145	1.86	%
Ginnie Mae	20,434	6.16	%	-	-	%
Total Portfolio	\$331,787	100.00	%	\$115,380	100.00	%

	September 30, 2013	December 31, 2012
Weighted Average Pass Through Purchase Price	\$ 104.71	\$ 105.65

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

Weighted Average Structured Purchase Price	\$	11.77	\$	9.91
Weighted Average Pass Through Current Price	\$	101.87	\$	105.81
Weighted Average Structured Current Price	\$	13.37	\$	7.84
Effective Duration (1)		4.614		1.209

(1) Effective duration of 4.614 indicates that an interest rate increase of 1.0% would be expected to cause a 4.614% decrease in the value of the MBS in the Company's investment portfolio at September 30, 2013. An effective duration of 1.209 indicates that an interest rate increase of 1.0% would be expected to cause a 1.209% decrease in the value of the MBS in the Company's investment portfolio at December 31, 2012. These figures include the structured securities in the portfolio but not the effect of the Company's funding cost hedges.

The following table presents details related to portfolio assets acquired during the nine months ended September 30, 2013 and 2012. We account for our securities transactions on a trade-date basis, and as such, the amounts presented for the nine months ended September 30, 2013 includes \$38.7 million on asset acquisitions that settled subsequent to the balance sheet date.

(in thousands)

	2013			2012		
	Total Cost	Average Price	Weighted Average Yield	Total Cost	Average Price	Weighted Average Yield
Pass-through MBS	\$494,357	104.39	2.25 %	\$106,610	104.95	1.76 %
Structured MBS	34,248	15.60	4.21 %	3,129	9.43	17.27 %

Our portfolio of PT MBS will typically be comprised of adjustable-rate MBS, fixed-rate MBS and hybrid adjustable-rate MBS. We generally seek to acquire low duration assets that offer high levels of protection from mortgage prepayments provided it is reasonably priced by the market. Although the duration of an individual asset can change as a result of changes in interest rates, we strive to maintain a hedged PT MBS portfolio with an effective duration of less than 2.0. The stated contractual final maturity of the mortgage loans underlying our portfolio of PT MBS generally ranges up to 30 years. However, the effect of prepayments of the underlying mortgage loans tends to shorten the resulting cash flows from our investments substantially. Prepayments occur for various reasons, including refinancing of underlying mortgages and loan payoffs in connection with home sales.

The duration of our IO and inverse interest only IIO portfolios will vary greatly depending on the structural features of the securities. While prepayment activity will always affect the cash flows associated with the securities, the interest only nature of IO's may cause their durations to become extremely negative when prepayments are high, and less negative when prepayments are low. With respect to IIO's, prepayments affect their durations in a similar fashion to that of IO's, but the floating rate nature of their coupon (which is inversely related to the level of one month LIBOR) cause their price movements - and model duration - to be affected by changes in both prepayments and one month LIBOR - both current and anticipated levels. As a result, the duration of IIO securities will also vary greatly.

Prepayments on the loans underlying our MBS can alter the timing of the cash flows from the underlying loans to us. As a result, we gauge the interest rate sensitivity of its assets by measuring their effective duration. While modified duration measures the price sensitivity of a bond to movements in interest rates, effective duration captures both the movement in interest rates and the fact that cash flows to a mortgage related security are altered when interest rates move. Accordingly, when the contract interest rate on a mortgage loan is substantially above prevailing interest rates in the market, the effective duration of securities collateralized by such loans can be quite low because of expected prepayments.

We face the risk that the market value of our PT MBS assets will increase or decrease at different rates than that of our structured MBS or liabilities, including our hedging instruments. Accordingly, we assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. We generally calculate duration using various third party models. However, empirical results and various third party models may produce different duration numbers for the same securities.

The following sensitivity analysis shows the estimated impact on the fair value of our interest rate-sensitive investments and hedge positions as of September 30, 2013, assuming rates instantaneously fall 100 basis points (“bps”), rise 100 bps and rise 200 bps, adjusted to reflect the impact of convexity, which is the measure of the sensitivity of our hedge positions and Agency RMBS’s effective duration to movements in interest rates.

(in thousands)

MBS Portfolio	Fair Value	\$ Change in Fair Value			% Change in Fair Value		
		-100BPS	+100BPS	+200BPS	-100BPS	+100BPS	+200BPS
Adjustable Rate MBS	\$6,150	\$98	\$(153 )	\$(315 )	1.60 %	(2.49 )%	(5.12 )%
Hybrid Adjustable Rate MBS	120,205	4,364	(6,578 )	(13,378 )	3.63 %	(5.47 )%	(11.13 )%
Fixed Rate MBS	184,662	8,414	(11,159 )	(22,058 )	4.56 %	(6.04 )%	(11.95 )%
Interest-Only MBS	15,371	(2,548 )	1,541	2,007	(16.58 )%	10.03 %	13.06 %
Inverse Interest-Only MBS	5,399	(3 )	(598 )	(1,482 )	(0.05 )%	(11.08 )%	(27.45 )%
Total MBS Portfolio	\$331,787	\$10,325	\$(16,947 )	\$(35,226 )	3.11 %	(5.11 )%	(10.62 )%

(in thousands)

Repurchase Agreement Hedges	Notional Amount(1)	\$ Change in Fair Value			% Change in Fair Value		
		-100BPS	+100BPS	+200BPS	-100BPS	+100BPS	+200BPS
Eurodollar Futures Contracts	\$4,375,000	\$(8,921 )	\$10,938	\$21,875	(0.83 )%	1.02 %	2.04 %

(1) Represents the total cumulative contract/notional amount of Eurodollar futures contracts outstanding.

In addition to changes in interest rates, other factors impact the fair value of our interest rate-sensitive investments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above and such difference might be material and adverse to our stockholders.

#### Repurchase Agreements

As of September 30, 2013, we had established borrowing facilities in the repurchase agreement market with nine counterparties which we believe provide borrowing capacity in excess of our needs. None of these lenders are affiliated with the Company. As of September 30, 2013, we had funding in place with all nine counterparties. These borrowings are secured by the Company’s MBS and bear interest rates that are based on a spread to LIBOR.

As of September 30, 2013, we had obligations outstanding under the repurchase agreements of approximately \$301.7 million with a net weighted average borrowing cost of 0.37%. The remaining maturity of our outstanding repurchase agreements obligations ranged from 1 to 53 days, with a weighted average remaining maturity of 24 days. Securing the repurchase agreement obligations as of September 30, 2013, are MBS with an estimated fair value, including



accrued interest, of approximately \$320.0 million and a weighted average maturity of 315 months. Through November 4, 2013, we have been able to maintain our repurchase facilities with comparable terms to those that existed at September 30, 2013 with maturities through January 10, 2014.

-28-

---

The table below presents information about our period end and average repurchase agreement obligations for each quarter in 2013 and 2012.

(dollars in thousands)

Three Months Ended,	Ending Balance of Repurchase Agreements	Average Balance of Repurchase Agreements	Difference Between Ending Repurchase Agreements and Average Repurchase Agreements		
			Amount	Percent	
September 30, 2013	\$ 301,657	\$ 305,196	\$(3,539 )	(1.16 )%	
June 30, 2013	308,735	312,591	(3,856 )	(1.23 )%	
March 31, 2013	316,446	210,194	106,252	50.55	%(a)
December 31, 2012	103,941	80,256	23,685	29.51	%(b)
September 30, 2012	56,571	53,698	2,873	5.35	%
June 30, 2012	50,825	62,407	(11,582 )	(18.56 )%	%(c)
March 31, 2012	73,988	59,157	14,831	25.07	%(d)

- (a) The higher ending balance relative to the average balance during the quarter ended March 31, 2013 reflects the deployment of the proceeds of the Company's IPO. During the quarter ended March 31, 2013, the Company's investment in PT MBS increased \$227.2 million.
- (b) The higher ending balance relative to the average balance reflects a shift in the portfolio allocation towards PT MBS that the Company funds through the repo market. During the quarter ended December 31, 2012, the Company's investment in PT MBS increased \$50.0 million.
- (c) The lower ending balance relative to the average balance reflects a shift in the portfolio allocation towards Structured MBS that were not funded through the repo market. During the quarter ended June 30, 2012, the Company's investment in PT MBS decreased \$23.8 million.
- (d) The higher ending balance relative to the average balance reflects a shift in the portfolio allocation towards assets that the Company funds through the repo market. During the quarter ended March 31, 2012, the Company's investment in PT MBS increased \$30.6 million.

#### Liquidity and Capital Resources

Liquidity is our ability to turn non-cash assets into cash, purchase additional investments, repay principal and interest on borrowings, fund overhead, fulfill margin calls and pay dividends. Our principal immediate sources of liquidity include cash balances, unencumbered assets and borrowings under repurchase agreements. Our borrowing capacity will vary over time as the market value of our interest earning assets varies. Our balance sheet also generates liquidity on an on-going basis through payments of principal and interest we receive on our MBS portfolio. Management believes that we currently have sufficient liquidity and capital resources available for (a) the acquisition of additional investments consistent with the size and nature of our existing MBS portfolio, (b) the repayments on borrowings and (c) the payment of dividends to the extent required for our continued qualification as a REIT.

Because our PT MBS portfolio consists entirely of government and agency securities, we do not anticipate having difficulty converting our assets to cash should our liquidity needs ever exceed our immediately available sources of cash. Our structured MBS portfolio also consists entirely of governmental agency securities, although they typically do not trade with comparable bid / ask spreads as PT MBS. However, we anticipate that we would be able to liquidate such securities readily, even in distressed markets, albeit with potential haircuts. To enhance our liquidity even further, we may pledge a portion of our structured MBS as part of a repurchase agreement funding but retain the cash in lieu of acquiring additional assets. In this way we can, at a modest cost, retain higher levels of cash on hand and

decrease the likelihood we will have to sell assets in a distressed market in order to raise cash.

-29-

---

Our master repurchase agreements have no stated expiration, but can be terminated at any time at our option or at the option of the counterparty. However, once a definitive repurchase agreement under a master repurchase agreement has been entered into, it generally may not be terminated by either party. A negotiated termination can occur, but may involve a fee to be paid by the party seeking to terminate the repurchase agreement transaction.

Under our repurchase agreement funding arrangements, we are required to post margin at the initiation of the borrowing. The margin posted represents the haircut, which is a percentage of the market value of the collateral pledged. To the extent the market value of the asset collateralizing the financing transaction declines, the market value of our posted margin will be insufficient and we will be required to post additional collateral. Conversely, if the market value of the asset pledged increases in value, we would be over collateralized and we could then call our repo counterparty and have excess margin returned to us. Our lenders typically value our pledged securities daily to ensure the adequacy of our margin and make margin calls as needed, as do we. Typically, but not always, the parties agree to a minimum threshold amount for margin calls so as to avoid the need for nuisance margin calls on a daily basis. At September 30, 2013, the weighted average haircut our repurchase agreement counterparties required us to hold was approximately 5.45% of the estimated fair value of the underlying collateral.

As discussed earlier, we invest a portion of our capital in structured Agency RMBS. We do not fund these investments in the repurchase market but instead purchase directly, thus reducing – but not eliminating - the Company's reliance on access to repurchase agreement funding. The leverage inherent in structured securities replaces the leverage obtained by acquiring PT securities and funding them in the repurchase market. This structured MBS strategy has been a core element of the Company's overall investment strategy since inception. However, we have and may continue to pledge a portion of our structured MBS in order to raise our cash levels.

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements and interest expense on repurchase agreements.

(in thousands)

	Obligations Maturing				Total
	Within One Year	One to Three Years	Three to Five Years	More than Five Years	
Repurchase agreements	\$301,657	\$-	\$-	\$-	\$301,657
Interest expense on repurchase agreements(1)	146	-	-	-	146
Totals	\$301,803	\$-	\$-	\$-	\$301,803

(1) Interest expense on repurchase agreements is based on current interest rates as of September 30, 2013 and the remaining term of the liabilities existing at that date.

In the coming periods, we expect to continue to finance our activities in a manner that is consistent with our current operations via repurchase agreements. As of September 30, 2013, we had cash and cash equivalents of \$7.9 million. We generated cash flows of \$28.0 million from principal and interest payments on our MBS and had average repurchase agreements outstanding of \$276.0 million during the nine months ended September 30, 2013.

## Stockholders' Equity

On February 13, 2013, we announced the sale of 2,360,000 shares of common stock at a price of \$15.00 per share in a public offering. The proceeds we received before expenses in this sale were \$35.4 million. The offering was completed on February 20, 2013. On February 14, 2013, our Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed pursuant to the dividend were issued to Bimini on February 20, 2013, immediately prior to our initial public offering. For the nine months ended September 30, 2012, the 981,665 common shares, which includes the 154,110 shares of common stock outstanding at December 31, 2012 and the 827,555 shares distributed as a stock dividend, is used for our earnings per share computations, as Bimini has been the sole stockholder during the entire period.

## Outlook

### Regulatory Developments with Respect to Fannie Mae and Freddie Mac and the Dodd-Frank Act

In response to the credit market disruption and the deteriorating financial conditions of Fannie Mae and Freddie Mac, Congress and the U.S. Treasury undertook a series of actions that culminated with putting Fannie Mae and Freddie Mac in conservatorship in September 2008. The Federal Housing Finance Agency ("FHFA") now operates Fannie Mae and Freddie Mac as conservator, in an effort to stabilize the entities. The FHFA also noted that during the conservatorship period, it would work to enact new regulations for minimum capital standards, prudent safety and soundness standards and portfolio limits of Fannie Mae and Freddie Mac.

Although the U.S. Government has committed significant resources to Fannie Mae and Freddie Mac, Agency RMBS guaranteed by either Fannie Mae or Freddie Mac are not backed by the full faith and credit of the United States. Moreover, the Secretary of the U.S. Treasury noted that the guarantee structure of Fannie Mae and Freddie Mac required examination and that changes in the structures of the entities were necessary to reduce risk to the financial system. Such changes may involve an explicit U.S. Government backing of Fannie Mae and Freddie Mac Agency RMBS or the express elimination of any implied U.S. Government guarantee and, therefore, creation of credit risk with respect to Fannie Mae and Freddie Mac Agency RMBS. Additionally, on February 11, 2011, the U.S. Treasury issued a White Paper titled "Reforming America's Housing Finance Market" that lays out, among other things, proposals to limit or potentially wind down the role that Fannie Mae and Freddie Mac play in the mortgage market.

On October 4, 2012, the FHFA released a white paper entitled Building a New Infrastructure for the Secondary Mortgage Market (the "FHFA White Paper"). This release follows up on the FHFA's February 21, 2012 Strategic Plan for Enterprise Conservatorships, which set forth three goals for the next phase of the Fannie Mae and Freddie Mac conservatorships. These three goals are to (i) build a new infrastructure for the secondary mortgage market, (ii) gradually contract Fannie Mae and Freddie Mac's presence in the marketplace while simplifying and shrinking their operations, and (iii) maintain foreclosure prevention activities and credit availability for new and refinanced mortgages. The FHFA White Paper proposes a new infrastructure for Fannie Mae and Freddie Mac that has two basic goals.

The first such goal is to replace the current, outdated infrastructures of Fannie Mae and Freddie Mac with a common, more efficient infrastructure that aligns the standards and practices of the two entities, beginning with core functions performed by both entities such as issuance, master servicing, bond administration, collateral management and data integration. The second goal is to establish an operating framework for Fannie Mae and Freddie Mac that is consistent with the progress of housing finance reform and encourages and accommodates the increased participation of private capital in assuming credit risk associated with the secondary mortgage market. The FHFA recognizes that there are a number of impediments to their goals which may or may not be surmountable, such as the absence of any significant secondary mortgage market mechanisms beyond Fannie Mae, Freddie Mac and Ginnie Mae, and that their proposals are in the formative stages. As a result, it is unclear if the proposals will be enacted. If such proposals are enacted, it is unclear how closely what is enacted will resemble the proposals from the FHFA White Paper or what the effects of the enactment will be. As the economy has slowly recovered home prices have increased off the low levels seen in the aftermath of the financial crisis and a significant portion of the shadow inventory of homes that resulted from foreclosures are slowly being worked off. The combination of recovering home prices, attractive financing levels – albeit with still tight lending standards - and decreasing liquidations of home via foreclosures have resulted in an acceleration in refinancing activity. See “Risk Factors — Risks Related to Our Business — We cannot predict the impact, if any, on our earnings or cash available for distribution to our stockholders of the FHFA’s proposed revisions to Fannie Mae’s, Freddie Mac’s and Ginnie Mae’s existing infrastructures to align the standards and practices of the three entities” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed on March 22, 2013.

On June 25, 2013, Senators Bob Corker (R-TN) and Mark Warner (D-VA), with Senators Mike Johanns (R-NE), Jon Tester (D-MT), Dean Heller (R-NV), Heidi Heitkamp (D-ND), Jerry Moran (R-KS) and Kay Hagan (D-NC), formally introduced the Housing Finance Reform and Taxpayer Protection Act of 2013 (the “Corker-Warner Bill”) into the U.S. Senate. While the current draft of the Corker-Warner Bill will likely undergo significant changes as it is debated, it is expected to serve as a basis of discussion for congressional efforts to reform Fannie Mae and Freddie Mac.

As currently drafted, the Corker-Warner Bill has three key provisions:

- i. the establishment of the Federal Mortgage Insurance Corporation (the “FMIC”);
- ii. the creation of a Mortgage Insurance Fund (the “Fund”); and
- iii. the wind-down of Fannie Mae and Freddie Mac.

The FMIC would be a government guarantor modeled after the Federal Deposit Insurance Corporation (the “FDIC”) in that it would collect insurance premiums and maintain a deposit fund on all outstanding obligations. Every mortgage-backed security issued through the FMIC would have a private investor bearing the first risk of loss and holding at least \$0.10 in equity capital for every dollar of risk. This private capital buffer would serve to protect taxpayers from the risk of default on the mortgages underlying securities issued by the FMIC. Thus, the ultimate purpose of the FMIC would be to bring in credit investors to bear the risk of default while providing liquidity, transparency and access to mortgage credit for the housing finance system.

The FHFA would be abolished after the establishment of the FMIC, and all current responsibilities of the FHFA, as well as its resources, would be transferred to the FMIC. In particular, the Corker-Warner Bill specifies that the FMIC would maintain a database of uniform loan-level information on eligible mortgages, develop standard uniform securitization agreements and oversee the common securitization platform currently being developed by the FHFA.

In the event losses due to default on underlying mortgages exceed the first position losses of private credit investors in securities issued by the FMIC, the FMIC would cover such losses out of the Fund. The Corker-Warner Bill specifies that the FMIC would endeavor to attain a reserve balance of 1.25% of the aggregate outstanding principal balance of covered securities within five years of the establishment of the FMIC and 2.50% of such amount within ten years of

the establishment of the FMIC. The Fund would be paid with insurance premiums, akin to user fees, paid by private investors with various reporting and transparency requirements.

-32-

---

As currently proposed, the Corker-Warner Bill would revoke the charters of Fannie Mae and Freddie Mac upon the establishment of the FMIC. Fannie Mae and Freddie Mac would wind down as expeditiously as possible while maximizing returns to taxpayers as their assets are sold off.

On July 11, 2013, members of the U.S. House of Representatives introduced the Protecting American Taxpayers and Homeowners Act (“PATH”), a broad financing reform bill that serves as a counterpart to the Corker-Warner Bill. PATH would also revoke the charters of Fannie Mae and Freddie Mac and remove barriers to private investment. However, PATH would maintain the FHFA and give it oversight over a new non-government, not-for-profit National Mortgage Market Utility whose mission would be to develop best practices standards for the private origination, servicing, pooling and securitizing of mortgages and operate a publicly accessible securitization outlet to match loan originators with investors. Additional provisions of PATH include the reduction in size and scope of the Federal Housing Administration (“FHA”), targeting its mission specifically to first-time borrowers and low- and moderate- income borrowers except in periods of significant credit contraction.

There is no way to know if either proposal will become law or, should one of the proposals become law, if or how the enacted law will differ from the current draft of the bill. It is unclear how this proposal would impact housing finance, and what impact, if any, it would have on mortgage REITs.

The effect of the actions taken and to be taken by the U.S. Treasury, Congress or FHFA remains uncertain. Given the public reaction to the substantial funds made available to Fannie Mae and Freddie Mac, future funding for both is likely to face increased scrutiny. New and recently enacted laws, regulations and programs related to Fannie Mae and Freddie Mac may adversely affect the pricing, supply, liquidity and value of Agency RMBS and otherwise materially harm our business and operations. See “Risk Factors — Risks Related to Our Business — The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. Government, may materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed on March 22, 2013.

The Dodd-Frank Act provides for new regulations on financial institutions and creates new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. Because a significant number of regulations under the Dodd-Frank Act have either not yet been proposed or not yet been adopted in final form, it is not possible for us to predict how the Dodd-Frank Act will impact our business. See “Risk Factors — Risks Related to Our Business — Actions of the U.S. Government for the purpose of stabilizing the financial markets may adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed on March 22, 2013.

#### Interest Rates

The Federal Reserve has taken a number of steps over the last few years to lower both short and long-term interest rates. In August 2011, the Federal Reserve announced that it expected to maintain the Federal Funds Rate at a low level at least through mid-2013, and on January 25, 2012 it extended that outlook through late 2014. Additionally, on September 21, 2011, the Federal Reserve announced the extension of the maturities of its U.S. Treasury securities portfolio by selling approximately \$400 billion in short-term U.S. Treasury securities and purchasing an equivalent amount of longer-term U.S. Treasury securities. This program, known as “Operation Twist,” lasted through December 2012. The goal of Operation Twist was to lower the yields on longer-term U.S. Treasury securities, which in turn should lower interest rates that are tied to such yields, such as mortgage rates and interest rates on commercial loans.





In September 2012, the Federal Reserve announced an open-ended program to expand its holdings of long-term securities by purchasing an additional \$40 billion of Agency RMBS per month until key economic indicators, such as the unemployment rate, showed signs of improvement. This program, known as “QE3”, when combined with other programs to extend the average maturity of the Federal Reserve’s holdings of securities and reinvest principal payments from the Federal Reserve’s holdings of agency debt and Agency RMBS into Agency RMBS, was expected to increase the Federal Reserve’s holdings of long-term securities by \$85 billion each month. The Federal Reserve also announced that it would keep the target range for the Federal Funds Rate between zero and 0.25% through at least mid-2015, which is six months longer than previously expected.

The Federal Reserve provided further guidance to the market in December 2012 by stating that it intended to keep the Federal Funds Rate close to zero while the unemployment rate is above 6.5% and as long as inflation does not rise above 2.5%. In December 2012, the Federal Reserve also announced that it would initially begin buying \$45 billion of long-term Treasury bonds each month and noted that such amount may increase in the future. This bond purchase program replaced the program known as “Operation Twist,” in which the Federal Reserve repurchased approximately \$45 billion of long-term Treasury bonds each month and sold approximately the same amount of short-term Treasury bonds. The Federal Reserve expects these measures to put downward pressure on long-term interest rates.

The Federal Reserve Open Market Committee (the “FOMC”) meeting minutes released on April 10, 2013 revealed that the FOMC had begun considering when the Federal Reserve should begin tapering the pace of Agency RMBS purchases set in September 2012. The FOMC meeting minutes released on May 22, 2013 announced that the Federal Reserve was considering beginning to taper such purchase as early as June 2013. In minutes released on June 25, 2013, the FOMC stated that the Federal Reserve would begin to scale back Agency RMBS purchases later in 2013 and that such purchases would cease entirely when the unemployment rate reached 7%. On October 30, 2013, the FOMC announced that it would continue reinvesting principal payments from its holdings of agency debt and Agency RMBS into Agency RMBS and U.S. Treasury securities at the current pace indefinitely. The FOMC believes that these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help control the rate of inflation. The October 30, 2013 announcement provided no additional guidance as to when tapering might begin.

Although historically correlated with movements in the Federal Funds Rate, European inter-bank lending rates, specifically LIBOR, are independently affected by the fiscal and budgetary problems of the member countries of the European Union. In recent years, the European Central Bank, International Monetary Fund and member countries have provided emergency funding mechanisms to support members facing the inability to raise new debt at acceptable levels (such as Greece, Ireland, Portugal and Spain). To the extent this crisis persists or worsens, LIBOR may increase substantially.

Although, long-term interest rates are currently at historically low levels, they are still high relative to short-term interest rates. We believe that the relationship between long and short-term interest rates will remain relatively unchanged so long as the U.S. economic recovery and inflation rates remain tepid. If the economic recovery were to strengthen or inflation rates increase, the Federal Reserve may decide to abandon its current low-interest rate policies and/or increase interest rates. Although an increase in the Federal Funds Rate would most likely result in an increase in LIBOR, other European-specific factors, such as a credit disruption in the European inter-bank credit market, could cause an increase in LIBOR independent of movements in the Federal Funds Rate.

### Prepayment Rates, Refinancings and Loan Modification Programs

As a result of the Federal Reserve's interest rate policy and global economic conditions, prevailing interest rates, especially mortgage interest rates, are at historically low levels. Generally, lower mortgage interest rates leads to increased refinancings and, consequently, prepayments on mortgages and RMBS. In addition to the proposed reforms and/or changes of Fannie Mae and Freddie Mac suggested by the U.S. Treasury and the FHFA, Congress has to date introduced three legislative proposals that seek to provide changes to the current housing finance infrastructure. However, as a result of the continuing depressed levels of home prices (due in part to the supply of new and existing homes for sale, plus the "shadow" inventory of homes expected to be on the market as a result of future foreclosures) and the tighter underwriting standards of lenders, refinancing activity has yet to react to prevailing interest rate incentives available to borrowers as market participants expected.

To further stimulate the level of refinancing activity, the Obama administration has instituted programs to assist borrowers struggling with their mortgage payments or unable to refinance. For example, the government has expanded the HARP program, which is a program whereby eligible borrowers who owe more money on their mortgage loans than the value of their homes (commonly known as being "underwater" on a mortgage loan) can receive assistance refinancing their mortgage loans by loosening the eligibility requirements for refinancing. On April 11, 2013, the FHFA extended the HARP program by two years to December 31, 2015. In response to the expanded HARP program, Fannie Mae and Freddie Mac have announced guidelines for compliance with the expanded program.

Current programs such as the Home Affordable Modification Program, or HAMP, and the Principal Reduction Alternative, or the PRA, are designed to assist borrowers in modifying their mortgage loans.

### Effect on Us

Regulatory developments, movements in interest rates and prepayment rates as well as loan modification programs affect us in many ways, including the following:

#### Effects on our Assets

A change in or elimination of the guarantee structure of Agency RMBS may increase our costs (if, for example, guarantee fees increase) or require us to change our investment strategy altogether. For example, the elimination of the guarantee structure of Agency RMBS may cause us to change our investment strategy to focus on non-Agency RMBS, which in turn would require us to significantly increase our monitoring of the credit risks of our investments in addition to interest rate and prepayment risks.

Lower long-term interest rates can affect the value of our Agency RMBS in a number of ways. If prepayment rates are relatively low (due, in part, to the refinancing problems described above), lower long-term interest rates can increase the value of higher-coupon Agency RMBS. This is because investors typically place a premium on assets with yields that are higher than market yields. Although lower long-term interest rates may increase asset values in our portfolio, we may not be able to invest new funds in similarly-yielding assets.

If prepayment levels increase, the value of our Agency RMBS affected by such prepayments may decline. This is because a principal prepayment accelerates the effective term of an Agency RMBS, which would shorten the period during which an investor would receive above-market returns (assuming the yield on the prepaid asset is higher than market yields). Also, prepayment proceeds may not be able to be reinvested in similar-yielding assets. Agency RMBS backed by mortgages with high interest rates are more susceptible to prepayment risk because holders of those mortgages are most likely to refinance to a lower rate. IOs and IIOs, however, may be the types of Agency RMBS most sensitive to increased prepayment rates. Because the holder of an IO or IIO receives no principal payments, the values of IOs and IIOs are entirely dependent on the existence of a principal balance on the underlying mortgages. If the principal balance is eliminated due to prepayment, IOs and IIOs essentially become worthless. Although increased prepayment rates can negatively affect the value of our IOs and IIOs, they have the opposite effect on POs. Because POs act like zero-coupon bonds, meaning they are purchased at a discount to their par value and have an effective interest rate based on the discount and the term of the underlying loan, an increase in prepayment rates would reduce the effective term of our POs and accelerate the yields earned on those assets, which would increase our net income.

Because we base our investment decisions on risk management principles rather than anticipated movements in interest rates, in a volatile interest rate environment we may allocate more capital to structured Agency RMBS with shorter durations, such as short-term fixed and floating rate CMOs. We believe these securities have a lower sensitivity to changes in long-term interest rates than other asset classes. We may always attempt to mitigate our exposure to changes in long-term interest rates by investing in IOs and IIOs, which typically have different sensitivities to changes in long-term interest rates than pass-through Agency RMBS, particularly pass-through Agency RMBS backed by fixed-rate mortgages.

We do not believe our investment portfolio will be materially affected by loan modification programs because Agency RMBS backed by loans that would qualify for such programs (i.e. seriously delinquent loans) will be purchased by Fannie Mae and Freddie Mac at their par value prior to the implementation of such programs. However, if Fannie Mae and Freddie Mac were to modify or end their repurchase programs or if the U.S. Government modified its loan modification programs to modify non-delinquent mortgage loans, our investment portfolio could be negatively impacted.

#### Effects on our borrowing costs

We leverage our pass-through Agency RMBS portfolio and a portion of our structured Agency RMBS with principal balances through the use of short-term repurchase agreement transactions. The interest rates on our debt are determined by market levels of both the Federal Funds Rate and LIBOR. An increase in the U.S. Federal Funds Rate or LIBOR would increase our borrowing costs, which could affect our interest rate spread if there is no corresponding increase in the interest we earn on our assets. This would be most prevalent with respect to our Agency RMBS backed by fixed rate mortgage loans because the interest rate on a fixed-rate mortgage loan does not change even though market rates may change.

In order to protect our net interest margin against increases in short-term interest rates, we may enter into interest rate swaps, which effectively convert our floating-rate repurchase agreement debt to fixed-rate debt.

#### Summary

The relatively large spread between short and long-term interest rates has positively affected our net interest margin. However, changes in prepayment rates could negatively affect our net interest margin and the value of our assets. Furthermore, increases in the Federal Funds Rate and LIBOR could significantly increase our financing costs, which could lower our net interest margin.



## Critical Accounting Policies

Our financial statements are prepared in accordance with GAAP. GAAP requires our management to make some complex and subjective decisions and assessments. Our most critical accounting policies involve decisions and assessments which could significantly affect reported assets, liabilities, revenues and expenses. Management has identified its most critical accounting policies:

### Mortgage-Backed Securities

Our investments in Agency RMBS are accounted for under the fair value option. We acquire our Agency RMBS for the purpose of generating long-term returns, and not for the short-term investment of idle capital. Changes in the fair value of securities accounted for under the fair value option are reflected as part of our net income or loss in our statement of operations, as opposed to a component of other comprehensive income in our statement of stockholders' equity if they were instead reclassified as available-for-sale securities. We elected to account for all of our Agency RMBS under the fair value option in order to reflect changes in the fair value of our Agency RMBS in our statement of operations, which we believe more appropriately reflects the results of our operations for a particular reporting period. GAAP requires the use of a three-level valuation hierarchy to disclose the classification of fair value measurements used for determining the fair value of our Agency RMBS. These levels include:

- Level 1 valuations, where the valuation is based on quoted market prices for identical assets or liabilities traded in active markets (which include exchanges and over-the-counter markets with sufficient volume),
- Level 2 valuations, where the valuation is based on quoted market prices for similar instruments traded in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market, and
- Level 3 valuations, where the valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company- specific data. These unobservable assumptions reflect the Company's own estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include option pricing models, discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

Our Agency RMBS are valued using Level 2 valuations, and such valuations currently are determined by our manager based on the average of third-party broker quotes and/or by independent pricing sources when available. Because the price estimates may vary, our manager must make certain judgments and assumptions about the appropriate price to use to calculate the fair values. Alternatively, our manager could opt to have the value of all of our positions in Agency RMBS determined by either an independent third-party or do so internally.

In managing our portfolio, Bimini Advisors employs the following four-step process at each valuation date to determine the fair value of our Agency RMBS:

- First, our Manager obtains fair values from subscription-based independent pricing sources. These prices are used by both our Manager as well as many of our repurchase agreement counterparty on a daily basis to establish margin requirements for our borrowings.
  - Second, our Manager requests non-binding quotes from one to four broker-dealers for each of its Agency RMBS in order to validate the values obtained by the pricing service. Our Manager requests these quotes from broker-dealers that actively trade and make markets in the respective asset class for which the quote is requested.
-

Third, our Manager reviews the values obtained by the pricing source and the broker-dealers for consistency across similar assets.

- Finally, if the data from the pricing services and broker-dealers is not homogenous or if the data obtained is inconsistent with our Manager's market observations, our Manager makes a judgment to determine which price appears the most consistent with observed prices from similar assets and selects that price. To the extent our Manager believes that none of the prices are consistent with observed prices for similar assets, which is typically the case for only an immaterial portion of our portfolio each quarter, our Manager may use a third price that is consistent with observed prices for identical or similar assets. In the case of assets that have quoted prices such as Agency RMBS backed by fixed-rate mortgages, our Manager generally uses the quoted or observed market price. For assets such as Agency RMBS backed by ARMs or structured Agency RMBS, our Manager may determine the price based on the yield or spread that is identical to an observed transaction or a similar asset for which a dealer mark or subscription-based price has been obtained.

Management believes its pricing methodology to be consistent with the definition of fair value described in FASB ASC 820, Fair Value Measurements.

#### Repurchase Agreements

We finance the acquisition of a portion of our Agency RMBS through repurchase transactions under master repurchase agreements. Repurchase transactions are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest.

In instances where we acquire Agency RMBS through repurchase agreements with the same counterparty from whom the Agency RMBS were purchased, we account for the purchase commitment and repurchase agreement on a net basis and record a forward commitment to purchase Agency RMBS as a derivative instrument if the transaction does not comply with the criteria in FASB ASC 860, Transfers and Servicing, for gross presentation. If the transaction complies with the criteria for gross presentation, we present the assets and the related financing on a gross basis in our statements of financial condition, and the corresponding interest income and interest expense in our statement of operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, we record the cash portion of our investment in Agency RMBS as a mortgage related receivable from the counterparty on our balance sheet.

#### Income Recognition

Since we commenced operations, we have elected to account for all of our Agency RMBS under the fair value option.

All of our Agency RMBS are either pass-through securities or structured Agency RMBS, including CMOs, IOs, IIOs or POs. Income on pass-through securities, POs and CMOs that contain principal balances is based on the stated interest rate of the security. As a result of accounting for our MBS under the fair value option, premium or discount present at the date of purchase is not amortized. For IOs, IIOs and CMOs that do not contain principal balances, 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, current interest rates and current asset prices. The new effective yield is calculated based on the carrying value at the end of the previous reporting period, the new prepayment estimates and the contractual terms of the security. Changes in fair value of all of our Agency RMBS during the period are recorded in earnings and reported as unrealized gains (losses) on mortgage-backed securities in the accompanying statements of operations. For IIO securities, effective yield and income recognition calculations also take into account the index value applicable to the security.



### Capital Expenditures

At September 30, 2013, we had no material commitments for capital expenditures.

### Off-Balance Sheet Arrangements

As of September 30, 2013, we did not have any off-balance sheet arrangements.

### Dividends

To qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gains. We intend to pay regular monthly dividends to our stockholders and have declared the following dividends during 2013.

Declaration Date	Record Date	Payment Date	Per Share	
			Amount	Total
March 8, 2013	March 25, 2013	March 27, 2013	\$0.135	\$451,125
April 10, 2013	April 25, 2013	April 30, 2013	0.135	451,125
May 9, 2013	May 28, 2013	May 31, 2013	0.135	451,125
June 10, 2013	June 25, 2013	June 28, 2013	0.135	451,125
July 9, 2013	July 25, 2013	July 31, 2013	0.135	451,125
August 12, 2013	August 26, 2013	August 30, 2013	0.135	451,125
September 10, 2013	September 25, 2013	September 30, 2013	0.135	451,125
October 10, 2013	October 25, 2013	October 31, 2013	0.135	451,125

### Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

### Jumpstart Our Business Startups Act of 2012

We are an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). The JOBS Act permits emerging growth companies to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. We have elected to “opt out” of this provision and, as a result, we will be required to comply with new or revised accounting standards as required when they are adopted. The decision to opt out of the extended transition period under the JOBS Act is irrevocable.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.



ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report (the “evaluation date”), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (“the CEO”) and Chief Financial Officer (“the CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”). Based on this evaluation, the CEO and CFO concluded our disclosure controls and procedures, as designed and implemented, were effective as of the evaluation date (1) in ensuring that information regarding the Company and its subsidiaries is accumulated and communicated to our management, including our CEO and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) in providing reasonable assurance that information we must disclose in its periodic reports under the Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC’s rules and forms.

Changes in Internal Controls over Financial Reporting

There were no significant changes in the Company’s internal control over financial reporting that occurred during the Company’s most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are not party to any material pending legal proceedings.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the “Risk Factors” section of our Annual Report on Form 10-K filed on March 22, 2013 with the SEC.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. Exhibits.

Exhibit No.

- 31.1\* Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\*\* Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS XBRL	Instance Document †
Exhibit 101.SCH XBRL	Taxonomy Extension Schema Document †
Exhibit 101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document †
Exhibit 101.DEF XBRL	Additional Taxonomy Extension Definition Linkbase Document Created†
Exhibit 101.LAB XBRL	Taxonomy Extension Label Linkbase Document †
Exhibit 101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document †

\* Filed herewith.  
 \*\* Furnished herewith.

§Submitted electronically herewith. Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed as part of a registration statement or prospectus for purposes of sections 11 and 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934 and otherwise is not subject to liability under these sections

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 4, 2013 By: /s/ Robert E. Cauley

Robert E. Cauley  
Chief Executive Officer, President and Chairman of the Board

Date: November 4, 2013 By: /s/ G. Hunter Haas

G. Hunter Haas IV  
Secretary, Chief Financial Officer, Chief Investment Officer and Director  
(Principal Financial Officer and Principal Accounting Officer)