

TWO HARBORS INVESTMENT CORP.

Form 10-Q

August 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended: June 30, 2018

Commission File Number 001-34506

TWO HARBORS INVESTMENT CORP.

(Exact Name of Registrant as Specified in Its Charter)

Maryland 27-0312904
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

575 Lexington Avenue, Suite 2930 10022
New York, New York

(Address of Principal Executive Offices) (Zip Code)

(612) 629-2500

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

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

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

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

As of August 7, 2018 there were 248,072,557 shares of outstanding common stock, par value \$.01 per share, issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWO HARBORS INVESTMENT CORP.

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)

ASSETS	June 30, 2018	December 31, 2017
Available-for-sale securities, at fair value	\$19,293,354	\$21,220,819
Mortgage servicing rights, at fair value	1,450,261	1,086,717
Residential mortgage loans held-for-sale, at fair value	28,813	30,414
Cash and cash equivalents	417,515	419,159
Restricted cash	564,705	635,836
Accrued interest receivable	61,108	68,309
Due from counterparties	35,385	842,303
Derivative assets, at fair value	257,917	309,918
Other assets	166,930	175,838
Total Assets	\$22,275,988	\$24,789,313
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	\$17,205,823	\$19,451,207
Federal Home Loan Bank advances	865,024	1,215,024
Revolving credit facilities	170,000	20,000
Convertible senior notes	283,268	282,827
Derivative liabilities, at fair value	39,429	31,903
Due to counterparties	25,957	88,898
Dividends payable	96,219	12,552
Accrued interest payable	84,296	87,698
Other liabilities	25,727	27,780
Total Liabilities	18,795,743	21,217,889
Stockholders' Equity		
Preferred stock, par value \$0.01 per share; 50,000,000 shares authorized:		
8.125% Series A cumulative redeemable: 5,750,000 and 5,750,000 shares issued and outstanding, respectively (\$143,750 liquidation preference)	138,872	138,872
7.625% Series B cumulative redeemable: 11,500,000 and 11,500,000 shares issued and outstanding, respectively (\$287,500 liquidation preference)	278,094	278,094
7.25% Series C cumulative redeemable: 11,800,000 and 11,800,000 shares issued and outstanding, respectively (\$295,000 liquidation preference)	285,584	285,571
Common stock, par value \$0.01 per share; 450,000,000 shares authorized and 175,470,398 and 174,496,587 shares issued and outstanding, respectively	1,755	1,745
Additional paid-in capital	3,678,586	3,672,003
Accumulated other comprehensive (loss) income	(34,933)) 334,813
Cumulative earnings	2,850,985	2,386,604
Cumulative distributions to stockholders	(3,718,698)) (3,526,278)
Total Stockholders' Equity	3,480,245	3,571,424
Total Liabilities and Stockholders' Equity	\$22,275,988	\$24,789,313

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)
(in thousands, except share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Interest income:				
Available-for-sale securities	\$183,467	\$149,910	\$374,183	\$285,237
Residential mortgage loans held-for-investment in securitization trusts	—	30,826	—	62,454
Residential mortgage loans held-for-sale	349	503	656	901
Other	3,544	3,502	6,540	5,303
Total interest income	187,360	184,741	381,379	353,895
Interest expense:				
Repurchase agreements	97,812	43,806	184,392	76,062
Collateralized borrowings in securitization trusts	—	24,843	—	50,229
Federal Home Loan Bank advances	4,896	11,444	9,354	20,237
Revolving credit facilities	999	597	1,803	1,026
Convertible senior notes	4,707	4,591	9,425	8,412
Total interest expense	108,414	85,281	204,974	155,966
Net interest income	78,946	99,460	176,405	197,929
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(174)	(429)	(268)	(429)
Other income (loss):				
(Loss) gain on investment securities	(31,882)	31,249	(52,553)	(21,103)
Servicing income	77,665	51,308	148,855	91,081
Gain (loss) on servicing asset	9,853	(46,630)	81,660	(61,195)
Gain (loss) on interest rate swap and swaption agreements	29,133	(76,710)	179,678	(66,783)
Gain (loss) on other derivative instruments	7,675	(19,540)	15,728	(47,404)
Other income	730	3,126	1,788	12,622
Total other income (loss)	93,174	(57,197)	375,156	(92,782)
Expenses:				
Management fees	11,453	9,847	23,161	19,655
Servicing expenses	11,539	11,296	26,093	16,594
Other operating expenses	15,515	17,471	30,007	31,235
Total expenses	38,507	38,614	79,261	67,484
Income from continuing operations before income taxes	133,439	3,220	472,032	37,234
(Benefit from) provision for income taxes	(6,051)	8,759	(2,267)	(15,758)
Net income (loss) from continuing operations	139,490	(5,539)	474,299	52,992
Income from discontinued operations, net of tax	—	14,197	—	27,651
Net income	139,490	8,658	474,299	80,643
Income from discontinued operations attributable to noncontrolling interest	—	40	—	40
Net income attributable to Two Harbors Investment Corp.	139,490	8,618	474,299	80,603
Dividends on preferred stock	13,747	4,285	27,494	4,285
Net income attributable to common stockholders	\$125,743	\$4,333	\$446,805	\$76,318

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited), continued

(in thousands, except share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic earnings per weighted average common share:				
Continuing operations	\$0.72	\$ (0.06)	\$2.55	\$ 0.28
Discontinued operations	—	0.08	—	0.16
Net income	\$0.72	\$ 0.02	\$2.55	\$ 0.44
Diluted earnings per weighted average common share:				
Continuing operations	\$0.68	\$ (0.06)	\$2.36	\$ 0.28
Discontinued operations	—	0.08	—	0.16
Net income	\$0.68	\$ 0.02	\$2.36	\$ 0.44
Dividends declared per common share	\$0.47	\$ 0.52	\$0.94	\$ 1.02
Weighted average number of shares of common stock:				
Basic	175,451,989	174,473,168	175,299,822	174,378,095
Diluted	193,212,877	174,473,168	193,016,793	174,378,095
Comprehensive income:				
Net income	\$ 139,490	\$ 8,658	\$ 474,299	\$ 80,643
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on available-for-sale securities	(34,887)	81,628	(379,664)	155,390
Other comprehensive (loss) income	(34,887)	81,628	(379,664)	155,390
Comprehensive income	104,603	90,286	94,635	236,033
Comprehensive income attributable to noncontrolling interest	—	42	—	42
Comprehensive income attributable to Two Harbors Investment Corp.	104,603	90,244	94,635	235,991
Dividends on preferred stock	13,747	4,285	27,494	4,285
Comprehensive income attributable to common stockholders	\$90,856	\$ 85,959	\$67,141	\$ 231,706

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (unaudited)
(in thousands, except share data)

	Series A Preferred Stock	Series B Preferred Stock	Series C Preferred Stock	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity	Non- controlling Interest
Balance, December 31, 2016	\$—	\$—	\$—	\$1,739	\$3,661,711	\$199,227	\$2,038,033	\$(2,499,599)	\$3,401,111	\$—
Net income	—	—	—	—	—	—	80,603	—	80,603	40
Other comprehensive income before reclassifications, net of tax expense of \$27,014	—	—	—	—	—	151,789	—	—	151,789	2
Amounts reclassified from accumulated other comprehensive income, net of tax benefit of \$2,722	—	—	—	—	—	3,595	—	—	3,595	—
Other comprehensive income, net of tax expense of \$24,292	—	—	—	—	—	155,384	—	—	155,384	2
Contribution of TH Commercial Holdings LLC to Granite Point	—	—	—	—	(13,777)	6	—	—	(13,771)	19
Issuance of preferred stock, net of offering costs	138,872	—	—	—	—	—	—	—	138,872	—
Issuance of common stock, net of offering costs	—	—	—	—	256	—	—	—	256	—
Preferred dividends declared	—	—	—	—	—	—	—	(4,285)	(4,285)	—

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Common dividends declared	—	—	—	—	—	—	—	(177,963)	(177,963)	—
Non-cash equity award compensation	—	—	—	7	8,207	—	—	—	8,214	—
Balance, June 30, 2017	\$ 138,872	\$—	\$—	\$ 1,745	\$ 3,656,398	\$ 354,617	\$ 2,118,636	\$ (2,681,847)	\$ 3,588,421	\$ 1,906,574
Balance, December 31, 2017	\$ 138,872	\$ 278,094	\$ 285,571	\$ 1,745	\$ 3,672,003	\$ 334,813	\$ 2,386,604	\$ (3,526,278)	\$ 3,571,424	\$—
Cumulative effect of adoption of new accounting principle	—	—	—	—	—	9,918	(9,918)	—	—	—
Adjusted balance, January 1, 2018	138,872	278,094	285,571	1,745	3,672,003	344,731	2,376,686	(3,526,278)	3,571,424	—
Net income	—	—	—	—	—	—	474,299	—	474,299	—
Other comprehensive loss before reclassifications, net of tax benefit of \$658	—	—	—	—	—	(402,218)	—	—	(402,218)	—
Amounts reclassified from accumulated other comprehensive income, net of tax benefit of \$0	—	—	—	—	—	22,554	—	—	22,554	—
Other comprehensive loss, net of tax benefit of \$658	—	—	—	—	—	(379,664)	—	—	(379,664)	—
Issuance of preferred stock, net of offering costs	—	—	13	—	—	—	—	—	13	—
Issuance of common stock, net of offering costs	—	—	—	—	195	—	—	—	195	—
Preferred dividends declared	—	—	—	—	—	—	—	(27,494)	(27,494)	—
Common dividends	—	—	—	—	—	—	—	(164,926)	(164,926)	—

declared										
Non-cash equity										
award	—	—	—	10	6,388	—	—	—	6,398	—
compensation										
Balance,										
June 30, 2018	\$ 138,872	\$ 278,094	\$ 285,584	\$ 1,755	\$ 3,678,586	\$ (34,933)	\$ 2,850,985	\$ (3,718,698)	\$ 3,480,245	\$-

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
 (in thousands)

	Six Months Ended June 30,	
	2018	2017
Cash Flows From Operating Activities:		
Net income from continuing operations	\$474,299	\$52,992
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Amortization of premiums and discounts on investment securities, net	44,891	23,293
Amortization of deferred debt issuance costs on convertible senior notes	441	176
Other-than-temporary impairment losses	268	429
Realized and unrealized losses on investment securities	53,846	21,103
(Gain) loss on servicing asset	(81,660)	61,195
Gain on residential mortgage loans held-for-sale	(556)	(1,794)
Gain on residential mortgage loans held-for-investment and collateralized borrowings in securitization trusts	—	(8,077)
Realized and unrealized (gain) loss on interest rate swaps and swaptions	(162,029)	56,305
Unrealized loss on other derivative instruments	22,040	35,111
Equity based compensation	6,398	8,214
Depreciation of fixed assets	348	550
Purchases of residential mortgage loans held-for-sale	—	(567)
Proceeds from sales of residential mortgage loans held-for-sale	—	3,708
Proceeds from repayment of residential mortgage loans held-for-sale	1,754	4,532
Net change in assets and liabilities:		
Decrease (increase) in accrued interest receivable	7,201	(10,217)
Increase in deferred income taxes, net	(1,954)	(16,078)
(Increase) decrease in income taxes receivable	(316)	80
Increase in prepaid and fixed assets	(143)	(253)
(Increase) decrease in other receivables	(2,267)	4,637
Decrease in servicing advances	2,332	5,031
(Decrease) increase in accrued interest payable	(3,402)	25,797
Increase in income taxes payable	—	51
Decrease in accrued expenses and other liabilities	(2,053)	(6,695)
Net cash provided by operating activities of discontinued operations	—	16,838
Net cash provided by operating activities	\$359,438	\$276,361
The accompanying notes are an integral part of these condensed consolidated financial statements.		

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited), continued
(in thousands)
Six
Months
Ended