Invesco Mortgage Capital Inc.
Form 10-Q
August 07, 2018

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-34385

(Exact Name of Registrant as Specified in Its Charter)

Maryland	26-2749336
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1555 Peachtree Street, N.E., Suite 1800 Atlanta, Georgia	30309
(Address of Principal Executive Offices)	(Zip Code)

(404) 892-0896
(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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 ý No o

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	ý	Accelerated filer	o
Non-Accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o
		Emerging growth company	o

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. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No ý
As of August 3, 2018, there were 111,643,188 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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INVESCO MORTGAGE CAPITAL INC.
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PART I
ITEM 1. FINANCIAL STATEMENTS
INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

$ in thousands except share amounts	As of June 30, 2018	December 31, 2017
ASSETS		
Mortgage-backed and credit risk transfer securities, at fair value (including pledged securities of $17,047,937 and $17,560,811, respectively)	17,583,187	18,190,754
Commercial loans, held-for-investment	127,607	191,808
Cash and cash equivalents	70,254	88,381
Restricted cash	—	620
Due from counterparties	7,255	—
Investment related receivable	70,839	73,217
Derivative assets, at fair value	47,509	6,896
Other assets	108,124	105,580
Total assets	18,014,775	18,657,256
LIABILITIES AND EQUITY		
Liabilities:		
Repurchase agreements	13,702,321	14,080,801
Secured loans	1,650,000	1,650,000
Exchangeable senior notes, net	—	143,231
Derivative liabilities, at fair value	6,071	32,765
Dividends and distributions payable	50,201	50,193
Investment related payable	23,562	5,191
Accrued interest payable	18,886	17,845
Collateral held payable	39,748	7,327
Accounts payable and accrued expenses	1,705	2,200
Due to affiliate	10,558	10,825
Total liabilities	15,503,052	16,000,378
Commitments and contingencies (See Note 16):		
Equity:		
Preferred Stock, par value $0.01 per share; 50,000,000 shares authorized:		
7.75% Series A Cumulative Redeemable Preferred Stock: 5,600,000 shares issued and outstanding ($140,000 aggregate liquidation preference)	135,356	135,356
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock: 6,200,000 shares issued and outstanding ($155,000 aggregate liquidation preference)	149,860	149,860
7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock: 11,500,000 shares issued and outstanding ($287,500 aggregate liquidation preference)	278,108	278,108
Common Stock, par value $0.01 per share; 450,000,000 shares authorized; 111,643,188 and 111,624,159 shares issued and outstanding, respectively	1,116	1,116
Additional paid in capital	2,384,902	2,384,356
Accumulated other comprehensive income	89,461	261,029
Retained earnings (distributions in excess of earnings)	(551,632)	(579,334)
Total stockholders' equity	2,487,171	2,630,491
Non-controlling interest	24,552	26,387

Total equity	2,511,723	2,656,878
Total liabilities and equity	18,014,775	18,657,256

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
$ in thousands, except share amounts	2018	2017	2018	2017
Interest Income				
Mortgage-backed and credit risk transfer securities	147,548	121,027	296,551	239,900
Commercial loans	4,051	6,021	8,273	11,785
Total interest income	151,599	127,048	304,824	251,685
Interest Expense				
Repurchase agreements	69,389	36,072	128,974	66,019
Secured loans	8,471	4,535	15,398	7,948
Exchangeable senior notes	—	3,504	1,621	8,512
Total interest expense	77,860	44,111	145,993	82,479
Net interest income	73,739	82,937	158,831	169,206
Other Income (loss)				
Gain (loss) on investments, net	(36,377)	11,175	(196,747)	9,322
Equity in earnings (losses) of unconsolidated ventures	798	(154)	1,694	(1,688)
Gain (loss) on derivative instruments, net	67,169	(53,513)	200,536	(48,051)
Realized and unrealized credit derivative income (loss), net	735	21,403	3,900	41,358
Net loss on extinguishment of debt	—	(526)	(26)	(5,237)
Other investment income (loss), net	(2,160)	2,533	942	3,862
Total other income (loss)	30,165	(19,082)	10,299	(434)
Expenses				
Management fee – related party	10,102	9,027	20,323	17,828
General and administrative	1,525	1,608	3,281	3,692
Total expenses	11,627	10,635	23,604	21,520
Net income	92,277	53,220	145,526	147,252
Net income attributable to non-controlling interest	1,163	670	1,834	1,856
Net income attributable to Invesco Mortgage Capital Inc.	91,114	52,550	143,692	145,396
Dividends to preferred stockholders	11,106	5,716	22,213	11,432
Net income attributable to common stockholders	80,008	46,834	121,479	133,964
Earnings per share:				
Net income attributable to common stockholders				
Basic	0.72	0.42	1.09	1.20
Diluted	0.72	0.41	1.08	1.15
Dividends declared per common share	0.42	0.40	0.84	0.80

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
$ in thousands	2018	2017	2018	2017
Net income	92,277	53,220	145,526	147,252
Other comprehensive income (loss):				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	(47,929)	39,633	(180,246)	55,922
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	9,889	651	19,126	1,501
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	(6,898)	(6,369)	(13,437)	(12,667)
Currency translation adjustments on investment in unconsolidated venture	486	139	798	(476)
Total other comprehensive income (loss)	(44,452)	34,054	(173,759)	44,280
Comprehensive income (loss)	47,825	87,274	(28,233)	191,532
Less: Comprehensive (income) loss attributable to non-controlling interest	(602)	(1,099)	357	(2,414)
Less: Dividends to preferred stockholders	(11,106)	(5,716)	(22,213)	(11,432)
Comprehensive income (loss) attributable to common stockholders	36,117	80,459	(50,089)	177,686

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

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF EQUITY
For the six months ended June 30, 2018
(Unaudited)

							Attributable to Common Stockholders				
$ in thousands except share amounts	Series A Preferred Stock		Series B Preferred Stock		Series C Preferred Stock		Common Stock		Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retain Earnin (Distri in exc of earnin
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance at December 31, 2017	5,600,000	135,356	6,200,000	149,860	11,500,000	278,108	111,624,159	1,116	2,384,356	261,029	(579,3
Net income	—	—	—	—	—	—	—	—	—	—	143,69
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	—	(171,568)	—
Stock awards	—	—	—	—	—	—	19,029	—	—	—	—
Common stock dividends	—	—	—	—	—	—	—	—	—	—	(93,77
Common unit dividends	—	—	—	—	—	—	—	—	—	—	—
Preferred stock dividends	—	—	—	—	—	—	—	—	—	—	(22,21
Amortization of equity-based compensation	—	—	—	—	—	—	—	—	262	—	—
Rebalancing of ownership percentage of non-controlling interest	—	—	—	—	—	—	—	—	284	—	—
Balance at June 30, 2018	5,600,000	135,356	6,200,000	149,860	11,500,000	278,108	111,643,188	1,116	2,384,902	89,461	(551,6

The accompanying notes are an integral part of this condensed consolidated financial statement.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

$ in thousands	Six Months Ended June 30, 2018	2017
Cash Flows from Operating Activities		
Net income	145,526	147,252
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of mortgage-backed and credit risk transfer securities premiums and (discounts), net	25,657	37,534
Realized and unrealized (gain) loss on derivative instruments, net	(217,159)	5,191
Realized and unrealized (gain) loss on credit derivatives, net	7,371	(29,707)
(Gain) loss on investments, net	196,747	(9,322)
(Income) loss from investments in unconsolidated ventures in excess of distributions received	(1,150)	2,106
Other amortization	(13,052)	(11,656)
Net loss on extinguishment of debt	26	5,237
(Gain) loss on foreign currency transactions, net	1,099	(2,229)
Changes in operating assets and liabilities:		
(Increase) decrease in operating assets	2,267	(2,497)
Increase (decrease) in operating liabilities	435	(3,016)
Net cash provided by operating activities	147,767	138,893
Cash Flows from Investing Activities		
Purchase of mortgage-backed and credit risk transfer securities	(1,213,558)	(2,533,663)
(Contributions to) distributions from investments in unconsolidated ventures, net	(1,077)	7,408
Change in other assets	—	(3,457)
Principal payments from mortgage-backed and credit risk transfer securities	1,061,392	1,081,479
Proceeds from sale of mortgage-backed and credit risk transfer securities	387,726	572,616
Proceeds from/ (payments for) settlement or termination of forwards, swaps and futures, net	149,852	(25,311)
Net change in due from counterparties and collateral held payable	25,165	1,771
Principal payments from commercial loans held-for-investment	64,814	—
Origination and advances of commercial loans, net of origination fees	(1,677)	(3,170)
Net cash provided by (used in) investing activities	472,637	(902,327)
Cash Flows from Financing Activities		
Due from counterparties - secured loans	—	(1,246)
Proceeds from repurchase agreements	72,281,324	63,154,822
Principal repayments of repurchase agreements	(72,659,696)	(62,200,623)
Extinguishment of exchangeable senior notes	(143,433)	(185,386)
Payments of deferred costs	(167)	—
Payments of dividends and distributions	(117,179)	(101,852)
Net cash (used in) provided by financing activities	(639,151)	665,715
Net change in cash, cash equivalents and restricted cash	(18,747)	(97,719)
Cash, cash equivalents and restricted cash, beginning of period	89,001	161,788
Cash, cash equivalents and restricted cash, end of period	70,254	64,069
Supplement Disclosure of Cash Flow Information		
Interest paid	158,027	97,003
Non-cash Investing and Financing Activities Information		

Net change in unrealized gain (loss) on mortgage-backed and credit risk transfer securities	(161,120)	57,423
Dividends and distributions declared not paid	50,201	50,930
Net change in investment related payable (receivable)	(18,871)	(163,489)
Net change in repurchase agreements, not settled	(108)	4,081
Change in due from counterparties and collateral held payable	—	86,450

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Organization and Business Operations

Invesco Mortgage Capital Inc. (the "Company", "we") is a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. ("Invesco"), a leading independent global investment management firm. We conduct our business through IAS Operating Partnership LP (the "Operating Partnership"), as its sole general partner. As of June 30, 2018, we owned 98.7% of the Operating Partnership, and a wholly-owned subsidiary of Invesco owned the remaining 1.3%. We have one operating segment.

We primarily invest in:

- Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association, or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively "Agency RMBS");
- Commercial mortgage-backed securities (“CMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively "Agency CMBS");
- RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");
- CMBS that are not guaranteed by a U.S. government agency (“non-Agency CMBS”);
- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");
- Residential and commercial mortgage loans; and
- Other real estate-related financing agreements.

We elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986 commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits exclusion from the "Investment Company" definition under the Investment Company Act of 1940.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

Certain disclosures included in our Annual Report on Form 10-K are not required to be included on an interim basis in our quarterly reports on Form 10-Q. We have condensed or omitted these disclosures. Therefore, this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017.

The condensed consolidated financial statements have been prepared in accordance with U.S. GAAP and consolidate the financial statements of the Company and our controlled subsidiaries. All significant intercompany transactions, balances, revenues and expenses are eliminated upon consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for a fair statement of our financial condition and results of operations for the periods presented.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed and credit risk transfer securities, allowance for loan losses and other-than-temporary impairment charges. Actual results may differ from those estimates.

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Significant Accounting Policies

There have been no changes to our accounting policies included in Note 2 to the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017, other than the significant accounting policy disclosed below.

Restricted Cash

Restricted cash represents cash posted with the Federal Home Loan Bank of Indianapolis ("FHLBI") as collateral for secured loans and cash posted with counterparties as collateral for various derivative instruments. Cash held by counterparties as collateral is legally restricted and is not available for general corporate purposes.

Accounting Pronouncements Recently Adopted

Effective January 1, 2018, we adopted the accounting guidance that amends certain aspects of recognition, measurement, presentation, and disclosure of financial assets and liabilities. The standard requires that all equity investments, other than those accounted for as equity method investments, be measured at fair value with changes recognized in income. As of January 1, 2018, we had three types of equity investments: investments in unconsolidated ventures, an investment in an exchange traded fund, and an investment in FHLBI stock. Our investments in unconsolidated ventures are accounted for as equity method investments, and our investment in an exchange-traded fund is measured at fair value with changes recognized in income. While the standard eliminates the cost method for equity investments without readily determinable fair values, it does allow an election to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus adjustments for observable price changes. We have elected to record our investment in FHLBI stock at cost, less impairment. As such, the adoption of this accounting guidance did not impact our financial condition or results of operations. The standard also amends certain disclosure requirements for financial instruments. Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" for a tabular summary of the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type.

Effective January 1, 2018, we adopted the accounting guidance intended to reduce diversity in how restricted cash and certain transactions are classified in the statement of cash flows. The new guidance requires that the statement of cash flows explains the difference during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. We adopted the accounting standard on a retrospective basis, which required us to restate our statement of cash flows for the six months ended June 30, 2017. The adoption resulted in a $15.5 million decrease in net cash provided by operating activities, $17.3 million decrease in net cash used in investing activities and $1.8 million decrease in net cash provided by financing activities. We included restricted cash of $620,000 as of December 31, 2017 in our reconciliation of cash, cash equivalents and restricted cash on the condensed consolidated statements of cash flows. We did not have any restricted cash as of June 30, 2018.

Pending Accounting Pronouncements

In June 2016, new accounting guidance was issued for reporting credit losses for assets measured at amortized cost and available-for-sale securities. The new guidance significantly changes how entities will measure credit losses for most financial assets, including loans, that are not measured at fair value through net income. The guidance replaces the existing “incurred loss” model with an “expected loss” model for instruments measured at amortized cost, and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. The new guidance also simplifies the accounting model for purchased credit-impaired debt securities and loans. We are required to adopt the new guidance in the first quarter of 2020 by recording a cumulative effect adjustment to retained earnings as of January 1, 2020. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements.

In June 2018, new accounting guidance was issued that aligns the measurement and classification for stock-based payments to non-employees with the guidance for stock-based payments to employees. Under the new guidance, the measurement of equity-classified non-employee awards will be fixed at the grant date. We are required to adopt the new guidance in the first quarter of 2019 by recording a cumulative effect adjustment to retained earnings as of January 1, 2019. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements.

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Note 3 - Variable Interest Entities ("VIEs")
Our maximum risk of loss in VIEs in which we are not the primary beneficiary at June 30, 2018 is presented in the table below.

$ in thousands	Carrying Amount	Company's Maximum Risk of Loss
Non-Agency CMBS	3,151,237	3,151,237
Non-Agency RMBS	1,220,076	1,220,076
Investments in unconsolidated ventures	28,997	28,997
Total	4,400,310	4,400,310

Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" and Note 6 - "Other Assets" for additional details regarding these investments.

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Note 4 – Mortgage-Backed and Credit Risk Transfer Securities

The following tables summarize our mortgage-backed securities ("MBS") and GSE CRT portfolio by asset type as of June 30, 2018 and December 31, 2017.

June 30, 2018

$ in thousands	Principal/ Notional Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Period-end Weighted Average Yield (1)	Quarterly Weighted Average Yield (2)
Agency RMBS:							
15 year fixed-rate	2,532,605	85,680	2,618,285	(95,101)	2,523,184	2.32 %	1.99 %
30 year fixed-rate	7,602,464	284,277	7,886,741	(221,602)	7,665,139	3.14 %	2.95 %
ARM*	215,178	1,300	216,478	(1,677)	214,801	2.58 %	2.43 %
Hybrid ARM	1,566,739	23,143	1,589,882	(22,831)	1,567,051	2.56 %	2.28 %
Total Agency RMBS pass-through	11,916,986	394,400	12,311,386	(341,211)	11,970,175	2.88 %	2.65 %
Agency-CMO (3)	995,408	(745,565)	249,843	(11,027)	238,816	3.26 %	3.04 %
Agency CMBS	150,268	1,940	152,208	19	152,227	3.46 %	3.63 %
Non-Agency CMBS (4)	3,871,603	(700,887)	3,170,716	(19,479)	3,151,237	5.02 %	4.95 %
Non-Agency RMBS (5)(6)(7)	2,945,105	(1,851,911)	1,093,194	126,882	1,220,076	7.09 %	7.12 %
GSE CRT (8)	744,545	22,913	767,458	83,198	850,656	2.81 %	3.37 %
Total	20,623,915	(2,879,110)	17,744,805	(161,618)	17,583,187	3.53 %	3.36 %

* Adjustable-rate mortgage ("ARM")

(1) Period-end weighted average yield is based on amortized cost as of June 30, 2018 and incorporates future prepayment and loss assumptions.

(2) Quarterly weighted average yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by the average balance of the amortized cost of the investments. All yields are annualized.

(3) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 79.3% of principal/notional balance, 17.0% of amortized cost and 16.1% of fair value.

(4) Non-Agency CMBS includes interest-only securities which represent 15.7% of principal/notional balance, 0.5% of amortized cost and 0.6% of fair value.

(5) Non-Agency RMBS held by us is 47.6% variable rate, 46.0% fixed rate and 6.4% floating rate based on fair value.

(6) Of the total discount in non-Agency RMBS, $190.7 million is non-accretable calculated using the principal/notional balance and based on estimated future cash flows of the securities.

(7) Non-Agency RMBS includes interest-only securities ("Non-Agency IO") which represent 55.7% of principal/notional balance, 2.4% of amortized cost and 2.3% of fair value.

(8) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

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December
31,
2017