

Orchid Island Capital, Inc.  
Form 10-Q  
July 27, 2018

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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

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35236  
Orchid Island Capital, Inc.  
(Exact name of registrant as specified in its charter)

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

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

(772) 231-1400  
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

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

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

Number of shares outstanding at July 27, 2018: 52,034,596

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ORCHID ISLAND CAPITAL, INC.

TABLE OF CONTENTS

|   | Page |
|---|------|
| <b>PART I. FINANCIAL INFORMATION</b>  |      |
| ITEM 1. Condensed Financial Statements  | 1    |
| Condensed Consolidated Balance Sheets (unaudited)   | 1    |
| Condensed Consolidated Statements of Operations (unaudited)                                   | 2    |
| Condensed Consolidated Statement of Stockholders' Equity (unaudited)                          | 3    |
| Condensed Consolidated Statements of Cash Flows (unaudited)                                   | 4    |
| Notes to Condensed Consolidated Financial Statements  | 5    |
| ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 24   |
| ITEM 3. Quantitative and Qualitative Disclosures about Market Risk                            | 45   |
| ITEM 4. Controls and Procedures   | 48   |
| <b>PART II. OTHER INFORMATION</b>   |      |
| ITEM 1. Legal Proceedings   | 49   |
| ITEM 1A. Risk Factors   | 49   |
| ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds                           | 49   |
| ITEM 3. Defaults upon Senior Securities   | 49   |
| ITEM 4. Mine Safety Disclosures   | 49   |
| ITEM 5. Other Information   | 49   |
| ITEM 6. Exhibits  | 50   |
| SIGNATURES  | 51   |



## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED FINANCIAL STATEMENTS

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

|   | (Unaudited)      |                      |
|---|------------------|----------------------|
|   | June 30,<br>2018 | December<br>31, 2017 |
| <b>ASSETS:</b>                            |                  |                      |
| Mortgage-backed securities, at fair value |                  |                      |
| Pledged to counterparties                 | \$ 3,644,163     | \$ 3,712,561         |
| Unpledged                                 | 45,433           | 32,250               |
| Total mortgage-backed securities          | 3,689,596        | 3,744,811            |
| Cash and cash equivalents                 | 137,947          | 214,363              |
| Restricted cash                           | 31,065           | 32,349               |
| Accrued interest receivable               | 14,771           | 14,444               |
| Derivative assets, at fair value          | 34,207           | 17,160               |
| Other assets                              | 445              | 216                  |
| Total Assets                              | \$ 3,908,031     | \$ 4,023,343         |

## LIABILITIES AND STOCKHOLDERS' EQUITY

|                                       |              |              |
|---------------------------------------|--------------|--------------|
| <b>LIABILITIES:</b>                   |              |              |
| Repurchase agreements                 | \$ 3,449,854 | \$ 3,533,786 |
| Dividends payable                     | 4,683        | 7,429        |
| Derivative liabilities, at fair value | 2,240        | 2,038        |
| Accrued interest payable              | 7,221        | 6,516        |
| Due to affiliates                     | 656          | 797          |
| Other liabilities                     | 34,178       | 10,566       |
| Total Liabilities                     | 3,498,832    | 3,561,132    |

## COMMITMENTS AND CONTINGENCIES

## STOCKHOLDERS' EQUITY:

|  |              |              |
|--|--------------|--------------|
| Preferred stock, \$0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding as of June 30, 2018 and December 31, 2017   | -            | -            |
| Common Stock, \$0.01 par value; 500,000,000 shares authorized, 52,034,596 shares issued and outstanding as of June 30, 2018 and 53,061,904 shares issued and outstanding as of December 31, 2017 | 520          | 531          |
| Additional paid-in capital   | 423,709      | 461,680      |
| Accumulated (deficit) retained earnings  | (15,030 )    | -            |
| Total Stockholders' Equity   | 409,199      | 462,211      |
| Total Liabilities and Stockholders' Equity   | \$ 3,908,031 | \$ 4,023,343 |
| See Notes to Consolidated Financial Statements   |              |              |



ORCHID ISLAND CAPITAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

For the Six and Three Months Ended June 30, 2018 and 2017

(\$ in thousands, except per share data)

|   | Six Months Ended June 30, |            | Three Months Ended June 30, |            |
|---|---------------------------|------------|-----------------------------|------------|
|   | 2018                      | 2017       | 2018                        | 2017       |
| Interest income                                       | \$78,526                  | \$66,890   | \$38,590                    | \$34,579   |
| Interest expense                                      | (31,728 )                 | (15,478 )  | (16,579 )                   | (8,763 )   |
| Net interest income                                   | 46,798                    | 51,412     | 22,011                      | 25,816     |
| Realized (losses) gains on mortgage-backed securities | (20,513 )                 | 2,585      | (12,175 )                   | 3,935      |
| Unrealized losses on mortgage-backed securities       | (92,129 )                 | (32,048 )  | (20,418 )                   | (17,090 )  |
| Gains (losses) on derivative instruments              | 56,853                    | (23,861 )  | 14,859                      | (19,442 )  |
| Net portfolio (loss) income                           | (8,991 )                  | (1,912 )   | 4,277                       | (6,781 )   |
| Expenses:   |                           |            |                             |            |
| Management fees                                       | 3,318                     | 2,702      | 1,606                       | 1,400      |
| Allocated overhead                                    | 742                       | 756        | 361                         | 388        |
| Accrued incentive compensation                        | 12                        | 230        | 1                           | 218        |
| Directors' fees and liability insurance               | 500                       | 508        | 248                         | 232        |
| Audit, legal and other professional fees              | 463                       | 389        | 167                         | 219        |
| Direct REIT operating expenses                        | 810                       | 496        | 407                         | 265        |
| Other administrative                                  | 194                       | 200        | 141                         | 140        |
| Total expenses  | 6,039                     | 5,281      | 2,931                       | 2,862      |
| Net (loss) income                                     | \$(15,030 )               | \$(7,193 ) | \$1,346                     | \$(9,643 ) |
| Basic and diluted net (loss) income per share         | \$(0.29 )                 | \$(0.21 )  | \$0.03                      | \$(0.26 )  |
| Weighted Average Shares Outstanding                   | 52,794,513                | 35,117,364 | 52,587,472                  | 37,211,362 |
| Dividends declared per common share                   | \$0.58                    | \$0.84     | \$0.27                      | \$0.42     |
| See Notes to Consolidated Financial Statements        |                           |            |                             |            |

ORCHID ISLAND CAPITAL, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

For the Six Months Ended June 30, 2018

(\$ in thousands, except per share data)

|   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Deficit) | Total      |
|---|-----------------|----------------------------------|-----------------------------------|------------|
| Balances, January 1, 2018   | \$ 531          | \$ 461,680                       | \$-                               | \$ 462,211 |
| Net loss  | -               | -                                | (15,030)                          | (15,030)   |
| Cash dividends declared, \$0.58 per share                             | -               | (30,624 )                        | -                                 | (30,624 )  |
| Issuance of common stock pursuant to stock based<br>compensation plan | -               | 219                              | -                                 | 219        |
| Amortization of stock based compensation                              | -               | 104                              | -                                 | 104        |
| Shares repurchased and retired  | (11 )           | (7,670 )                         | -                                 | (7,681 )   |
| Balances, June 30, 2018   | \$ 520          | \$ 423,709                       | \$(15,030)                        | \$ 409,199 |

See Notes to Consolidated Financial Statements



ORCHID ISLAND CAPITAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)  
 For the Six Months Ended June 30, 2018 and 2017  
 (\$ in thousands)

|   | 2018              | 2017              |
|---|-------------------|-------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                    |                   |                   |
| Net loss  | \$(15,030)        | ) \$(7,193 )      |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                   |                   |
| Stock based compensation  | 323               | 359               |
| Realized and unrealized losses on mortgage-backed securities                    | 112,642           | 29,463            |
| Realized and unrealized gains on interest rate swaptions                        | (4,434 )          | -                 |
| Realized and unrealized (gains) losses on interest rate swaps                   | (12,805 )         | ) 3,689           |
| Realized (gains) losses on forward settling to-be-announced securities          | (9,971 )          | ) 2,384           |
| Changes in operating assets and liabilities:                                    |                   |                   |
| Accrued interest receivable   | (327 )            | ) (2,491 )        |
| Other assets  | (269 )            | ) (212 )          |
| Accrued interest payable  | 705               | 342               |
| Other liabilities   | 6,716             | (2,563 )          |
| Due (from) to affiliates  | (141 )            | ) 124             |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                | <b>77,409</b>     | <b>23,902</b>     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                    |                   |                   |
| From mortgage-backed securities investments:                                    |                   |                   |
| Purchases   | (1,995,208 )      | ) (3,692,066 )    |
| Sales   | 1,757,652         | 3,064,979         |
| Principal repayments  | 180,169           | 155,303           |
| Redemption of FHLB stock  | -                 | 3                 |
| Proceeds from (payments on) net settlement of to-be-announced securities        | 12,493            | (5,591 )          |
| Purchase of derivative financial instruments, net of margin cash received       | 14,768            | -                 |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                    | <b>(30,126 )</b>  | <b>(477,372 )</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                   |                   |
| Proceeds from repurchase agreements   | 26,040,287        | 25,243,560        |
| Principal payments on repurchase agreements                                     | (26,124,219)      | (24,758,809)      |
| Cash dividends  | (33,370 )         | ) (28,902 )       |
| Proceeds from issuance of common stock, net of issuance costs                   | -                 | 122,857           |
| Common stock repurchases  | (7,681 )          | -                 |
| <b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>                      | <b>(124,983 )</b> | <b>) 578,706</b>  |
| <b>NET (DECREASE) INCREASE IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH</b>    | <b>(77,700 )</b>  | <b>) 125,236</b>  |
| <b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, beginning of the period</b>      | <b>246,712</b>    | <b>94,425</b>     |
| <b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, end of the period</b>            | <b>\$ 169,012</b> | <b>\$ 219,661</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                        |                   |                   |
| Cash paid during the period for:  |                   |                   |
| Interest  | \$31,023          | \$ 15,136         |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:</b>                 |                   |                   |

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|  |     |           |
|--|-----|-----------|
| Securities acquired settled in later period    | \$- | \$273,689 |
| See Notes to Consolidated Financial Statements |     |           |

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4

ORCHID ISLAND CAPITAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

JUNE 30, 2018

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Description

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

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

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

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

On August 2, 2017, Orchid entered into another equity distribution agreement (the "August 2017 Equity Distribution Agreement") with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. Through June 30, 2018, the Company issued a total of 7,746,052 shares under the August 2017 Equity Distribution Agreement for aggregate gross proceeds of approximately \$76.0 million, and net proceeds of approximately \$74.7 million, net of commissions and fees.

## Basis of Presentation and Use of Estimates

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The consolidated financial statements include the accounts of our wholly-owned subsidiary, Orchid Island Casualty, LLC. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six and three month period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

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

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

## Statement of Comprehensive Income (Loss)

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

## Cash and Cash Equivalents and Restricted Cash

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

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

(in thousands)

|  | June 30,<br>2018 | December<br>31, 2017 |
|--|------------------|----------------------|
| Cash and cash equivalents                        | \$137,947        | \$214,363            |
| Restricted cash                                  | 31,065           | 32,349               |
| Total cash, cash equivalents and restricted cash | \$169,012        | \$246,712            |

The Company maintains cash balances at four banks and excess margin on account at derivative exchanges, and, at times, balances may exceed federally insured limits. The Company has not experienced any losses related to these balances. The Federal Deposit Insurance Corporation insures eligible accounts up to \$250,000 per depositor at each financial institution. At June 30, 2018, the Company's cash deposits exceeded federally insured limits by

approximately \$134.7 million. Restricted cash balances are uninsured, but are held in separate customer accounts that are segregated from the general funds of the counterparty. The Company limits uninsured balances to only large, well-known bank and derivative exchanges and believes that it is not exposed to any significant credit risk on cash and cash equivalents or restricted cash balances.

## Mortgage-Backed Securities

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

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

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

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

## Derivative Financial Instruments

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

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



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

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

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

#### Financial Instruments

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

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, receivable for securities sold, other assets, due to affiliates, repurchase agreements, payable for unsettled securities purchased, accrued interest payable and other liabilities generally approximates their carrying values as of June 30, 2018 and December 31, 2017 due to the short-term nature of these financial instruments.

#### Repurchase Agreements

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

#### Manager Compensation

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



## Earnings Per Share

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

## Income Taxes

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

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

## Recent Accounting Pronouncements

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

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

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

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



## NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's RMBS portfolio as of June 30, 2018 and December 31, 2017:

(in thousands)

|                                    | June 30,<br>2018 | December<br>31, 2017 |
|------------------------------------|------------------|----------------------|
| Pass-Through RMBS Certificates:    |                  |                      |
| Hybrid Adjustable-rate Mortgages   | \$24,684         | \$27,398             |
| Adjustable-rate Mortgages          | 1,718            | 1,754                |
| Fixed-rate Mortgages               | 2,978,653        | 3,594,533            |
| Fixed-rate CMOs                    | 542,656          | -                    |
| Total Pass-Through Certificates    | 3,547,711        | 3,623,685            |
| Structured RMBS Certificates:      |                  |                      |
| Interest-Only Securities           | 116,181          | 86,918               |
| Inverse Interest-Only Securities   | 25,704           | 34,208               |
| Total Structured RMBS Certificates | 141,885          | 121,126              |
| Total                              | \$3,689,596      | \$3,744,811          |

The following table summarizes the Company's RMBS portfolio as of June 30, 2018 and December 31, 2017, according to the contractual maturities of the securities in the portfolio. Actual maturities of RMBS investments are generally shorter than stated contractual maturities and are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal.

(in thousands)

|   | June 30,<br>2018 | December<br>31, 2017 |
|---|------------------|----------------------|
| Greater than one year and less than five years  | \$5              | \$29                 |
| Greater than five years and less than ten years | 3,600            | 3,281                |
| Greater than or equal to ten years              | 3,685,991        | 3,741,501            |
| Total   | \$3,689,596      | \$3,744,811          |

## NOTE 3. REPURCHASE AGREEMENTS AND OTHER BORROWINGS

The Company pledges certain of its RMBS as collateral under repurchase agreements with financial institutions. Interest rates are generally fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is generally paid at the termination of a borrowing. If the fair value of the pledged securities declines, lenders will typically require the Company to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of the pledged securities increases, lenders may release collateral back to the Company. As of June 30, 2018, the Company had met all margin call requirements.

As of June 30, 2018, the Company had outstanding repurchase obligations of approximately \$3,449.9 million with a net weighted average borrowing rate of 2.07%. These agreements were collateralized by RMBS with a fair value, including accrued interest and securities pledged related to securities sold but not yet settled, of approximately \$3,658.3 million, and cash pledged to the counterparties of approximately \$23.1 million. As of December 31, 2017, the Company had outstanding repurchase obligations of approximately \$3,533.8 million with a net weighted average borrowing rate of 1.54%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$3,726.5 million, and cash pledged to the counterparties of approximately \$25.3 million.



As of June 30, 2018 and 2017, the Company's repurchase agreements had remaining maturities as summarized below:

(\$ in thousands)

|   | OVERNIGHT2<br>(1 DAY OR<br>LESS) | BETWEEN<br>AND<br>30 DAYS | BETWEEN<br>31<br>AND<br>90 DAYS | GREATER<br>THAN<br>90 DAYS | TOTAL        |
|---|----------------------------------|---------------------------|---------------------------------|----------------------------|--------------|
| June 30, 2018   |                                  |                           |                                 |                            |              |
| Fair market value of securities pledged,<br>including |                                  |                           |                                 |                            |              |
| accrued interest receivable                           | \$ -                             | \$ 1,916,675              | \$ 1,741,654                    | \$ -                       | \$ 3,658,329 |
| Repurchase agreement liabilities associated<br>with   |                                  |                           |                                 |                            |              |
| these securities                                      | \$ -                             | \$ 1,794,668              | \$ 1,655,186                    | \$ -                       | \$ 3,449,854 |
| Net weighted average borrowing rate                   | -                                | 2.13                      | % 2.00                          | % -                        | 2.07         |
| December 31, 2017                                     |                                  |                           |                                 |                            |              |
| Fair market value of securities pledged,<br>including |                                  |                           |                                 |                            |              |
| accrued interest receivable                           | \$ -                             | \$ 1,983,958              | \$ 1,266,590                    | \$ 475,975                 | \$ 3,726,523 |
| Repurchase agreement liabilities associated<br>with   |                                  |                           |                                 |                            |              |
| these securities                                      | \$ -                             | \$ 1,871,833              | \$ 1,208,518                    | \$ 453,435                 | \$ 3,533,786 |
| Net weighted average borrowing rate                   | -                                | 1.53                      | % 1.53                          | % 1.57                     | % 1.54       |

If, during the term of a repurchase agreement, a lender files for bankruptcy, the Company might experience difficulty recovering its pledged assets, which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged to such lender, including the accrued interest receivable and cash posted by the Company as collateral. At June 30, 2018, the Company had an aggregate amount at risk (the difference between the amount loaned to the Company, including interest payable and securities posted by the counterparty (if any), and the fair value of securities and cash pledged (if any), including accrued interest on such securities) with all counterparties of approximately \$224.3 million. The Company did not have an amount at risk with any individual counterparty greater than 10% of the Company's equity at June 30, 2018 and December 31, 2017.

#### NOTE 4. DERIVATIVE FINANCIAL INSTRUMENTS

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

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



Derivative Assets (Liabilities), at Fair Value

The table below summarizes fair value information about our derivative assets and liabilities as of June 30, 2018 and December 31, 2017.

(in thousands)

| Derivative Instruments and Related Accounts            | Balance Sheet Location                | June 30, 2018 | December 31, 2017 |
|--|---------------------------------------|---------------|-------------------|
| <b>Assets</b>  |                                       |               |                   |
| Interest rate swaps                                    | Derivative assets, at fair value      | \$26,334      | \$ 13,745         |
| Payer swaptions  | Derivative assets, at fair value      | 7,233         | 3,405             |
| Receiver swaptions                                     | Derivative assets, at fair value      | 640           | -                 |
| TBA securities   | Derivative assets, at fair value      | -             | 10                |
| Total derivative assets, at fair value                 |                                       | \$34,207      | \$ 17,160         |
| <b>Liabilities</b>                                     |                                       |               |                   |
| Interest rate swaps                                    | Derivative liabilities, at fair value | \$-           | \$ 215            |
| TBA securities   | Derivative liabilities, at fair value | 2,240         | 1,823             |
| Total derivative liabilities, at fair value            |                                       | \$2,240       | \$ 2,038          |
| <b>Margin Balances Posted to (from) Counterparties</b> |                                       |               |                   |
| Futures contracts                                      | Restricted cash                       | \$5,922       | \$ 5,545          |
| TBA securities   | Restricted cash                       | 2,050         | 1,508             |
| TBA securities   | Other liabilities                     | -             | (59 )             |
| Interest rate swaption contracts                       | Other liabilities                     | (7,959 )      | (3,505 )          |
| Total margin balances on derivative contracts          |                                       | \$13          | \$ 3,489          |

Eurodollar and T-Note futures are cash settled futures contracts on an interest rate, with gains and losses credited or charged to the Company's cash accounts on a daily basis. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. The tables below present information related to the Company's Eurodollar and T-Note futures positions at June 30, 2018 and December 31, 2017.

(\$ in thousands)

| Expiration Year   | June 30, 2018                    |                             |                                 |                            |
|---|----------------------------------|-----------------------------|---------------------------------|----------------------------|
|   | Average Contract Notional Amount | Weighted Average Entry Rate | Weighted Average Effective Rate | Open Equity <sup>(1)</sup> |
| <b>Eurodollar Futures Contracts (Short Positions)</b>                   |                                  |                             |                                 |                            |
| 2018  | \$1,375,000                      | 1.97                        | % 2.56                          | % \$4,035                  |
| 2019  | 1,500,000                        | 2.16                        | % 2.88                          | % 10,779                   |
| 2020  | 1,500,000                        | 2.64                        | % 2.98                          | % 5,011                    |
| Total / Weighted Average  | \$1,475,000                      | 2.32                        | % 2.86                          | % \$19,825                 |
| <b>Treasury Note Futures Contracts (Short Position)<sup>(2)</sup></b>   |                                  |                             |                                 |                            |
| September 2018 5-year T-Note futures (Sep 2018 - Sep 2023 Hedge Period) | \$165,000                        | 2.90                        | % 3.04                          | % \$(7 )                   |

(\$ in thousands)

| Expiration Year   | December 31, 2017                |                             |                                 |                            |  |
|---|----------------------------------|-----------------------------|---------------------------------|----------------------------|--|
|   | Average Contract Notional Amount | Weighted Average Entry Rate | Weighted Average Effective Rate | Open Equity <sup>(1)</sup> |  |
| Eurodollar Futures Contracts (Short Positions)                  |                                  |                             |                                 |                            |  |
| 2018  | \$1,212,500                      | 1.86                        | % 1.98                          | % \$1,418                  |  |
| 2019  | 1,350,000                        | 2.11                        | % 2.27                          | % 2,152                    |  |
| 2020  | 987,500                          | 2.59                        | % 2.36                          | % (2,360 )                 |  |
| Total / Weighted Average  | \$1,183,333                      | 2.16                        | % 2.20                          | % \$1,210                  |  |
| Treasury Note Futures Contracts (Short Position) <sup>(2)</sup> |                                  |                             |                                 |                            |  |
| March 2018 10 year T-Note futures                               |                                  |                             |                                 |                            |  |
| (Mar 2018 - Mar 2028 Hedge Period)                              | \$140,000                        | 2.23                        | % 2.33                          | % \$755                    |  |

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

T-Note futures contracts were valued at a price of \$113.62 at June 30, 2018 and \$124.05 at December 31, 2017.

(2) The notional contract values of the short positions were \$187.5 million and \$173.7 million at June 30, 2018 and December 31, 2017, respectively.

Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on the London Interbank Offered Rate ("LIBOR") ("payer swaps"). The floating rate we receive under our swap agreements has the effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. We are typically required to post collateral on our interest rate swap agreements. The table below presents information related to the Company's interest rate swap positions at June 30, 2018 and December 31, 2017.

(\$ in thousands)

|                             | Notional Amount | Average Fixed Pay Rate | Average Receive Rate | Net Estimated Fair Value | Average Maturity (Years) |
|-----------------------------|-----------------|------------------------|----------------------|--------------------------|--------------------------|
| June 30, 2018               |                 |                        |                      |                          |                          |
| Expiration > 1 to ≤ 3 years | \$650,000       | 1.09                   | % 2.36               | % \$16,223               | 1.6                      |
| Expiration > 3 to ≤ 5 years | 360,000         | 2.05                   | % 2.33               | % 10,111                 | 3.8                      |
|                             | \$1,010,000     | 1.43                   | % 2.35               | % \$26,334               | 2.4                      |
| December 31, 2017           |                 |                        |                      |                          |                          |
| Expiration > 1 to ≤ 3 years | \$650,000       | 1.09                   | % 1.41               | % \$11,828               | 2.1                      |
| Expiration > 3 to ≤ 5 years | 360,000         | 2.05                   | % 1.53               | % 1,702                  | 4.3                      |
|                             | \$1,010,000     | 1.43                   | % 1.45               | % \$13,530               | 2.8                      |



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The table below presents information related to the Company's interest rate swaption positions at June 30, 2018 and December 31, 2017.

(\$ in thousands)

| Expiration         | Option  |            | Underlying Swap                       |                 |                    |                                 |                               |
|--------------------|---------|------------|---------------------------------------|-----------------|--------------------|---------------------------------|-------------------------------|
|                    | Cost    | Fair Value | Weighted Average Months to Expiration | Notional Amount | Average Fixed Rate | Average Adjustable Rate (LIBOR) | Weighted Average Term (Years) |
| June 30, 2018      |         |            |                                       |                 |                    |                                 |                               |
| ≤ 1 year           |         |            |                                       |                 |                    |                                 |                               |
| Payer Swaptions    | \$9,770 | \$7,232    | 6.4                                   | \$950,000       | 3.20               | %3 Month                        | 9.3                           |
| Receiver Swaptions | 760     | 640        | 7.4                                   | 100,000         | 2.80               | %3 Month                        | 5.0                           |
| December 31, 2017  |         |            |                                       |                 |                    |                                 |                               |
| ≤ 1 year           |         |            |                                       |                 |                    |                                 |                               |
| Payer Swaptions    | \$2,367 | \$3,405    | 8.0                                   | \$200,000       | 2.16               | %3 Month                        | 6.0                           |

The following table summarizes our contracts to purchase and sell TBA securities as of June 30, 2018 and December 31, 2017.

(\$ in thousands)

|                         | Notional Amount Long (Short) <sup>(1)</sup> | Cost Basis <sup>(2)</sup> | Market Value <sup>(3)</sup> | Net Carrying Value <sup>(4)</sup> |
|-------------------------|---|---------------------------|-----------------------------|-----------------------------------|
| June 30, 2018           |   |                           |                             |                                   |
| 30-Year TBA securities: |   |                           |                             |                                   |
| 3.0%                    | \$(200,000)                                 | \$(192,404)               | \$(193,624)                 | \$(1,220)                         |
| 3.5%                    | (200,000)                                   | (197,980)                 | (199,000)                   | (1,020)                           |
| Total                   | \$(400,000)                                 | \$(390,384)               | \$(392,624)                 | \$(2,240)                         |
| December 31, 2017       |   |                           |                             |                                   |
| 30-Year TBA securities: |   |                           |                             |                                   |
| 3.0%                    | \$(300,000)                                 | \$(299,371)               | \$(300,153)                 | \$(782)                           |
| 4.0%                    | (357,000)                                   | (373,403)                 | (373,477)                   | (74)                              |
| 4.5%                    | 356,556                                     | 380,371                   | 379,414                     | (957)                             |
| Total                   | \$(300,444)                                 | \$(292,403)               | \$(294,216)                 | \$(1,813)                         |

(1) Notional amount represents the par value (or principal balance) of the underlying Agency RMBS.

(2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.

(3) Market value represents the current market value of the TBA securities (or of the underlying Agency RMBS) as of period-end.

(4)

Net carrying value represents the difference between the market value and the cost basis of the TBA securities as of period-end and is reported in derivative assets (liabilities), at fair value in our consolidated balance sheets.

Gain (Loss) From Derivative Instruments, Net

The table below presents the effect of the Company's derivative financial instruments on the consolidated statements of operations for the six and three months ended June 30, 2018 and 2017.

(in thousands)

|  | Six Months Ended |            | Three Months |            |
|--|------------------|------------|--------------|------------|
|  | June 30,<br>2018 | 2017       | 2018         | 2017       |
| Eurodollar futures contracts (short positions) | \$20,661         | \$(7,562 ) | \$6,121      | \$(6,990 ) |
| T-Note futures contracts (short position)      | 7,750            | (9,740 )   | 928          | (5,890 )   |
| Interest rate swaps                            | 14,037           | (4,175 )   | 3,530        | (4,178 )   |
| Receiver swaptions                             | (779 )           | -          | (430 )       | -          |
| Payer swaptions                                | 5,213            | -          | 3,146        | -          |
| Net TBA securities                             | 9,971            | (2,384 )   | 1,564        | (2,384 )   |
| Total  | \$56,853         | \$(23,861) | \$14,859     | \$(19,442) |

Credit Risk-Related Contingent Features

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

NOTE 5. PLEDGED ASSETS

Assets Pledged to Counterparties

The table below summarizes our assets pledged as collateral under our repurchase agreements and derivative agreements by type, including securities pledged related to securities sold but not yet settled, as of June 30, 2018 and December 31, 2017.

(in thousands)

|  | June 30, 2018            |                          |             | December 31, 2017        |                          |             |
|--|--------------------------|--------------------------|-------------|--------------------------|--------------------------|-------------|
|  | Repurchase<br>Agreements | Derivative<br>Agreements | Total       | Repurchase<br>Agreements | Derivative<br>Agreements | Total       |
| Assets Pledged to Counterparties       |                          |                          |             |                          |                          |             |
| PT RMBS - fair value                   | \$3,522,217              | \$ 11,319                | \$3,533,536 | \$3,612,244              | \$ -                     | \$3,612,244 |
| Structured RMBS - fair value           | 110,627                  | -                        | 110,627     | 100,317                  | -                        | 100,317     |
| Accrued interest on pledged securities | 14,130                   | 36                       | 14,166      | 13,962                   | -                        | 13,962      |
| Restricted cash                        | 23,093                   | 7,972                    | 31,065      | 25,296                   | 7,053                    | 32,349      |
| Total                                  | \$3,670,067              | \$ 19,327                | \$3,689,394 | \$3,751,819              | \$ 7,053                 | \$3,758,872 |

Assets Pledged from Counterparties

The table below summarizes our assets pledged to us from counterparties under our repurchase agreements as of June 30, 2018 and December 31, 2017.

(in thousands)

| Assets Pledged to Orchid              | June 30, 2018         |                       |           | December 31, 2017     |                       |          |
|---------------------------------------|-----------------------|-----------------------|-----------|-----------------------|-----------------------|----------|
|                                       | Repurchase Agreements | Derivative Agreements | Total     | Repurchase Agreements | Derivative Agreements | Total    |
| Cash                                  | \$ 1,392              | \$ 7,959              | \$ 9,351  | \$ 67                 | \$ 3,564              | \$ 3,631 |
| PT RMBS - fair value                  | 9                     | -                     | 9         | -                     | -                     | -        |
| U.S. Treasury securities - fair value | 3,906                 | -                     | 3,906     | -                     | -                     | -        |
| Total                                 | \$ 5,307              | \$ 7,959              | \$ 13,266 | \$ 67                 | \$ 3,564              | \$ 3,631 |

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

NOTE 6. OFFSETTING ASSETS AND LIABILITIES

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

The following table presents information regarding those assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of June 30, 2018 and December 31, 2017.

(in thousands)

Offsetting of Assets

|                         | Gross Amount of Recognized Assets | Offset in the Consolidated Balance Sheet | Net Amount Presented in the Consolidated Balance Sheet | Gross Amount Not Offset in the Consolidated Balance Sheet |               |            |
|-------------------------|-----------------------------------|--|--|---|---------------|------------|
|                         |                                   |  |  | Financial Instruments Received                            | Cash Received | Net Amount |
| June 30, 2018           |                                   |  |  |   |               |            |
| Interest rate swaps     | \$ 26,334                         | \$ -                                     | \$ 26,334  | \$-   | \$-           | \$ 26,334  |
| Interest rate swaptions | 7,873                             | -  | 7,873  | -   | (7,873 )      | -          |
|                         | \$ 34,207                         | \$ -                                     | \$ 34,207  | \$-   | \$(7,873 )    | \$ 26,334  |
| December 31, 2017       |                                   |  |  |   |               |            |
| Interest rate swaps     | \$ 13,745                         | \$ -                                     | \$ 13,745  | \$-   | \$-           | \$ 13,745  |

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

16

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(in thousands)

Offsetting of Liabilities

|                       | Gross Amount of Recognized Liabilities | Gross Amount Offset in the Consolidated Balance Sheet | Net Amount Presented in the Consolidated Balance Sheet | Gross Amount Not Offset in the Consolidated Balance Sheet | Cash Posted Collateral | Net Amount |
|-----------------------|--|---|--|---|------------------------|------------|
| June 30, 2018         |  |   |  |   |                        |            |
| Repurchase Agreements | \$3,449,854                            | \$ -  | \$3,449,854  | \$(3,426,761)   | \$(23,093)             | \$ -       |
| TBA securities        | 2,240                                  | -   | 2,240  | -   | (2,050)                | 190        |
|                       | \$3,452,094                            | \$ -  | \$3,452,094  | \$(3,426,761)   | \$(25,143)             | \$ 190     |
| December 31, 2017     |  |   |  |   |                        |            |
| Repurchase Agreements | \$3,533,786                            | \$ -  | \$3,533,786  | \$(3,508,490)   | \$(25,296)             | \$ -       |
| Interest rate swaps   | 215                                    | -   | 215  | -   | -                      | 215        |
| TBA securities        | 1,823                                  | -   | 1,823  | -   | (1,508)                | 315        |
|                       | \$3,535,824                            | \$ -  | \$3,535,824  | \$(3,508,490)   | \$(26,804)             | \$ 530     |

The amounts disclosed for collateral received by or posted to the same counterparty up to and not exceeding the net amount of the asset or liability presented in the consolidated balance sheets. The fair value of the actual collateral received by or posted to the same counterparty typically exceeds the amounts presented. See Note 5 for a discussion of collateral posted or received against or for repurchase obligations and derivative instruments.

NOTE 7. CAPITAL STOCK

Common Stock Issuances

During 2017, the Company completed the following public offerings of shares of its common stock. There were no common stock issuances through public offerings during the three months ended June 30, 2018, March 31, 2018 and September 30, 2017.

(\$ in thousands, except per share amounts)

| Type of Offering                              | Period         | Book Value Per Share Beginning | Book Value Per Share Ending | Weighted Average Price Received Per Share <sup>(1)</sup> | Shares     | Net Proceeds <sup>(2)</sup> |
|---|----------------|--------------------------------|-----------------------------|--|------------|-----------------------------|
| 2017  |                |                                |                             |  |            |                             |
| At the Market Offering Program <sup>(3)</sup> | First Quarter  | \$ 10.10                       | \$ 9.75                     | \$ 10.13   | 1,286,196  | \$ 12,792                   |
| At the Market Offering Program <sup>(3)</sup> | Second Quarter | 9.75                           | 9.23                        | 10.17  | 11,012,836 | 110,065                     |
| At the Market Offering Program <sup>(3)</sup> | Fourth Quarter | 9.15                           | 8.71                        | 9.81   | 7,746,052  | 74,750                      |
|   |                |                                |                             |  | 20,045,084 | \$ 197,607                  |

- (1) Weighted average price received per share is before deducting the underwriters' discount, if applicable, and other offering costs.
- (2) Net proceeds are net of the underwriters' discount, if applicable, and other offering costs.
- (3) The Company has entered into six equity distribution agreements, five of which have either been terminated because all shares were sold or were replaced with a subsequent agreement.

## Stock Repurchase Program

On July 29, 2015, the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of the Company's common stock. On February 8, 2018, the Board of Directors approved an increase in the stock repurchase program for up to an additional 4,522,822 shares of the Company's common stock. As part of the stock repurchase program, shares may be purchased in open market transactions, including through block purchases, through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Open market repurchases will be made in accordance with Exchange Act Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of open market stock repurchases. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice.

From the inception of the stock repurchase program through June 30, 2018, the Company repurchased a total of 2,285,084 shares at an aggregate cost of approximately \$18.5 million, including commissions and fees, for a weighted average price of \$8.11 per share. During the three months ended June 30, 2018, the Company repurchased a total of 1,068,841 shares at an aggregate cost of approximately \$7.7 million, including commissions and fees, for a weighted average price of \$7.19 per share. No shares were repurchased during the year ended December 31, 2017. As of June 30, 2018, the remaining authorization under the repurchase program is for up to 4,237,738 shares of the Company's common stock.

## Cash Dividends

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

(in thousands, except per share amounts)

| Year                      | Per Share Amount | Total     |
|---------------------------|------------------|-----------|
| 2013                      | \$ 1.395         | \$4,662   |
| 2014                      | 2.160            | 22,643    |
| 2015                      | 1.920            | 38,748    |
| 2016                      | 1.680            | 41,388    |
| 2017                      | 1.680            | 70,717    |
| 2018 - YTD <sup>(1)</sup> | 0.670            | 35,313    |
| Totals                    | \$ 9.505         | \$213,471 |

On July 18, 2018, the Company declared a dividend of \$0.09 per share to be paid on August 10, 2018. The effect (1) of this dividend is included in the table above, but is not reflected in the Company's financial statements as of June 30, 2018.

## NOTE 8. STOCK INCENTIVE PLAN

In October 2012, the Company's 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.

Restricted Stock Awards

The table below presents information related to the Company's restricted common stock at June 30, 2018 and 2017.

(\$ in thousands, except per share data)

|                                    | Six Months Ended June 30,                             |   |
|------------------------------------|---|---|
|                                    | 2018  | 2017  |
|                                    | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|                                    | Shares  | Shares  |
| Unvested, beginning of period      | - \$ -  | 8,000 \$ 12.23  |
| Granted                            | -   | -   |
| Vested and issued                  | -   | (8,000) 12.23   |
| Unvested, end of period            | - \$ -  | - \$ -  |
| Compensation expense during period | \$ -  | \$ 33   |

Stock Awards

The Company issues immediately vested common stock under the Incentive Plan to certain executive officers, employees and directors. The following table presents information related to fully vested common stock issued during the six months ended June 30, 2018 and 2017.

(\$ in thousands, except per share data)

|   | Six Months Ended<br>June 30, |        |
|---|------------------------------|--------|
|   | 2018                         | 2017   |
| Fully vested shares granted <sup>(1)</sup>  | 37,920                       | 21,839 |
| Weighted average grant date price per share   | \$7.62                       | \$9.74 |
| Compensation expense related to fully vested shares of common stock awards <sup>(2)</sup> | \$289                        | \$213  |

The table above includes 31,816 fully vested shares of common stock which were granted in January and April (1)2018 with respect to service performed during 2017 and 17,335 fully vested shares common stock which were granted in January and March 2017 with respect to service performed during 2016.

Approximately \$244,000 of compensation expense related to the 2018 share awards was accrued and recognized in (2)2017. Approximately \$168,000 of compensation expense related to the 2017 share awards was accrued and recognized in 2016.

Performance Units

The Company may issue performance units under the Incentive Plan to certain executive officers and employees. "Performance Units" vest after the end of a defined performance period, based on satisfaction of the performance conditions set forth in the performance unit agreement. When earned, each Performance Unit will be settled by the issuance of one share of the Company's common stock, at which time the Performance Unit will be cancelled. The Performance Units contain dividend equivalent rights which entitle the Participants to receive distributions declared by the Company on common stock, but do not include the right to vote the shares. Performance Units are subject to forfeiture should the participant no longer serve as an executive officer or employee for the Company. Compensation expense for the Performance Units are recognized over the remaining vesting period once it becomes probable that the

performance conditions will be achieved.

19

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The following table presents information related to Performance Units outstanding during the six months ended June 30, 2018 and 2017.

(\$ in thousands, except per share data)

|  | Six Months Ended June 30, |  |         |  |
|--|---------------------------|--|---------|--|
|  | 2018                      |  | 2017    |  |
|  | Shares                    | Weighted Average Grant Date Fair Value | Shares  | Weighted Average Grant Date Fair Value |
| Unvested, beginning of period                      | 41,693                    | \$ 9.95                                | 45,305  | \$ 10.33                               |
| Granted  | 27,935                    | 7.45                                   | 15,707  | 9.55                                   |
| Vested and issued                                  | (12,806)                  | 10.28                                  | (9,660) | 10.52                                  |
| Unvested, end of period                            | 56,822                    | \$ 8.65                                | 51,352  | \$ 10.06                               |
| Compensation expense during period                 |                           | \$ 104                                 |         | \$ 130                                 |
| Unrecognized compensation expense, end of period   |                           | \$ 270                                 |         | \$ 276                                 |
| Intrinsic value, end of period                     |                           | \$ 427                                 |         | \$ 506                                 |
| Weighted-average remaining vesting term (in years) |                           | 1.4                                    |         | 1.3                                    |

#### NOTE 9. 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 June 30, 2018.

#### NOTE 10. 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 11. EARNINGS PER SHARE (EPS)

The Company had dividend eligible shares of restricted common stock and Performance Units that were outstanding during the six and three months ended June 30, 2018 and 2017. The basic and diluted per share computations include these unvested shares of restricted common stock and performance units if there is income available to common stock, as they have dividend participation rights. The shares of restricted common stock and Performance Units have no contractual obligation to share in losses. Because there is no such obligation, the shares of restricted common stock and Performance Units are not included in the basic and diluted EPS computations when no income is available to common stock even though they are considered participating securities.

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The table below reconciles the numerator and denominator of EPS for the six and three months ended June 30, 2018 and 2017.

(in thousands, except per-share information)

|  | Six Months Ended<br>June 30, |            | Three Months<br>Ended June 30, |            |
|--|------------------------------|------------|--------------------------------|------------|
|  | 2018                         | 2017       | 2018                           | 2017       |
| Basic and diluted EPS per common share:  |                              |            |                                |            |
| Numerator for basic and diluted EPS per share of common stock:                               |                              |            |                                |            |
| Net (loss) income - Basic and diluted  | \$(15,030)                   | \$(7,193 ) | \$1,346                        | \$(9,643 ) |
| Weighted average shares of common stock:   |                              |            |                                |            |
| Shares of common stock outstanding at the balance sheet date                                 | 52,035                       | 45,300     | 52,035                         | 45,300     |
| Unvested dividend eligible share based compensation<br>outstanding at the balance sheet date | -                            | -          | 57                             | -          |
| Effect of weighting  | 760                          | (10,183)   | 495                            | (8,089 )   |
| Weighted average shares-basic and diluted  | 52,795                       | 35,117     | 52,587                         | 37,211     |
| Net (loss) income per common share:  |                              |            |                                |            |
| Basic and diluted  | \$(0.29 )                    | \$(0.21 )  | \$0.03                         | \$(0.26 )  |
| Anti-dilutive incentive shares not included in calculation.                                  | 51                           | 61         | -                              | 54         |

NOTE 12. 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.

The Company's RMBS, interest rate swaps, interest rate swaptions and TBA securities are valued using Level 2 valuations, and such valuations currently are determined by the Company based on independent pricing sources and/or third party broker quotes, 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 its positions in RMBS, interest rate swaps, interest rate swaptions and TBA securities determined by either an independent third-party or could do so internally.



RMBS (based on the fair value option), interest rate swaps, interest rate swaptions, TBA securities and futures contracts were recorded at fair value on a recurring basis during the six and three months ended June 30, 2018 and 2017. 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 (liabilities) measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017:

(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) |
|----------------------------|-------------------------|--|--------------|------|---|--|---|
|                            |                         |  |              |      |   |  |   |
| June 30, 2018              |                         |  |              |      |   |  |   |
| Mortgage-backed securities | \$ 3,689,596            | \$ -   | \$ 3,689,596 | \$ - |   |  |   |
| Interest rate swaps        | 26,334                  | -  | 26,334       | -    |   |  |   |
| Interest rate swaptions    | 7,873                   | -  | 7,873        | -    |   |  |   |
| TBA securities             | (2,240 )                | -  | (2,240 )     | -    |   |  |   |
| December 31, 2017          |                         |  |              |      |   |  |   |
| Mortgage-backed securities | \$ 3,744,811            | \$ -   | \$ 3,744,811 | \$ - |   |  |   |
| Interest rate swaps        | 13,530                  | -  | 13,530       | -    |   |  |   |
| Interest rate swaptions    | 3,405                   | -  | 3,405        | -    |   |  |   |
| TBA securities             | (1,813 )                | -  | (1,813 )     | -    |   |  |   |

During the six and three months ended June 30, 2018 and 2017, there were no transfers of financial assets or liabilities between levels 1, 2 or 3.

#### NOTE 13. RELATED PARTY TRANSACTIONS

##### Management Agreement

The Company is externally managed and advised by Bimini Advisors, LLC (the "Manager") pursuant to the terms of a management agreement. The management agreement has been renewed through February 20, 2019 and provides for automatic one-year extension options thereafter and is subject to certain termination rights. Under the terms of the management agreement, the Manager is responsible for administering the business activities and day-to-day operations of the Company. The Manager receives 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 the Manager for any direct expenses incurred on its behalf and to pay the Manager the Company's pro rata portion of certain overhead costs set forth in the management agreement. Should the Company terminate the management agreement without cause, it will pay to the Manager 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 term of the agreement.



Total expenses recorded for the management fee and costs incurred were approximately \$4.1 million and \$2.0 million for the six and three months ended June 30, 2018, respectively, and approximately \$3.5 million and \$1.8 for the six and three months ended June 30, 2017, respectively. At June 30, 2018 and December 31, 2017, the net amount due to affiliates was approximately \$0.7 million and \$0.8 million, respectively.

#### Other Relationships with Bimini

Robert Cauley, our Chief Executive Officer and Chairman of our 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. George H. Haas, our Chief Financial Officer, Chief Investment Officer, Secretary and a member of our 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. In addition, as of June 30, 2018, Bimini owned 1,520,036 shares, or 2.9%, of the Company's common stock.

23

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## 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 consolidated 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, our actual results may differ materially from those anticipated in such forward-looking statements.

### Overview

We are a specialty finance company that invests in residential mortgage-backed securities ("RMBS") which are issued and guaranteed by a federally chartered corporation or agency ("Agency RMBS"). Our investment strategy focuses on, and our portfolio consists of, two categories of Agency RMBS: (i) traditional pass-through Agency RMBS ("PT RMBS") and (ii) structured Agency RMBS, such as collateralized mortgage obligations ("CMOs"), interest-only securities ("IOs"), inverse interest-only securities ("IIOs") and principal only securities ("POs"), among other types of structured Agency RMBS. We were formed by Bimini in August 2010, commenced operations on November 24, 2010 and completed our initial public offering ("IPO") on February 20, 2013. We are externally managed by Bimini Advisors, a registered investment adviser with the Securities and Exchange Commission (the "SEC").

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 PT 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 PT RMBS and certain of our structured Agency RMBS through short-term borrowings structured as repurchase agreements. PT 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 operate so as to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). We generally will not be subject to U.S. federal income tax to the extent that we currently distribute all of our REIT taxable income (as defined in the Code) to our stockholders and maintain our REIT qualification.

The Company's common stock trades on the New York Stock Exchange ("NYSE") under the symbol "ORC".

### Capital Raising Activities

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



On February 23, 2017, we entered into another equity distribution agreement, as amended and restated on May 10, 2017, (the "May 2017 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The May 2017 Equity Distribution Agreement replaced the July 2016 Equity Distribution Agreement. We issued a total of 12,299,032 shares under the May 2017 Equity Distribution Agreement for aggregate gross proceeds of \$125.0 million, and net proceeds of approximately \$122.9 million, net of commissions and fees, prior to its termination.

On August 2, 2017, we entered into another equity distribution agreement (the "August 2017 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The August 2017 Equity Distribution Agreement replaced the May 2017 Equity Distribution Agreement. Through June 30, 2018, we issued a total of 7,746,052 shares under the August 2017 Equity Distribution Agreement for aggregate gross proceeds of \$76.0 million, and net proceeds of approximately \$74.7 million, net of commissions and fees.

#### Stock Repurchase Agreement

On July 29, 2015, the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of our common stock. The timing, manner, price and amount of any repurchases is determined by the Company in its discretion and is subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice. On February 8, 2018, the Board of Directors approved an increase in the stock repurchase program for up to an additional 4,522,822 shares of the Company's common stock. This stock repurchase program has no termination date.

From the inception of the stock repurchase program through June 30, 2018, we have repurchased a total of 2,285,084 shares at an aggregate cost of approximately \$18.5 million, including commissions and fees, for a weighted average price of \$8.11 per share. During the three months ended June 30, 2018, we repurchased a total of 1,068,841 shares at an aggregate cost of approximately \$7.7 million, including commissions and fees, for a weighted average price of \$7.19 per share. As of June 30, 2018, the remaining authorization under the repurchase program is for up to 4,237,738 shares of the Company's common stock.

#### 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;
- the difference between Agency RMBS yields and our funding and hedging costs;
- competition for, and supply of, investments in Agency RMBS;
- actions taken by the U.S. government, including the presidential administration, the Federal Reserve (the "Fed"), the Federal Open Market Committee (the "FOMC") and the U.S. Treasury;
- prepayment rates on mortgages underlying our Agency RMBS, and credit trends insofar as they affect prepayment rates; 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.

## Results of Operations

Described below are the Company's results of operations for the six and three months ended June 30, 2018, as compared to the Company's results of operations for the six and three months ended June 30, 2017.

## Net (Loss) Income Summary

Net loss for the six months ended June 30, 2018 was \$15.0 million, or \$0.29 per share. Net loss for the six months ended June 30, 2017 was \$7.2 million, or \$0.21 per share. Net income for the three months ended June 30, 2018 was \$1.3 million, or \$0.03 per share. Net loss for the three months ended June 30, 2017 was \$9.6 million, or \$0.26 per share. The components of net (loss) income for the six and three months ended June 30, 2018 and 2017, along with the changes in those components are presented in the table below:

(in thousands)

|   | Six Months Ended June 30, |           |           | Three Months Ended, June 30, |           |          |
|---|---------------------------|-----------|-----------|------------------------------|-----------|----------|
|   | 2018                      | 2017      | Change    | 2018                         | 2017      | Change   |
| Interest income                         | \$78,526                  | \$66,890  | \$11,636  | \$38,590                     | \$34,579  | \$4,011  |
| Interest expense                        | (31,728)                  | (15,478)  | (16,250)  | (16,579)                     | (8,763)   | (7,816)  |
| Net interest income                     | 46,798                    | 51,412    | (4,614)   | 22,011                       | 25,816    | (3,805)  |
| Losses on RMBS and derivative contracts | (55,789)                  | (53,324)  | (2,465)   | (17,734)                     | (32,597)  | 14,863   |
| Net portfolio (deficiency) income       | (8,991)                   | (1,912)   | (7,079)   | 4,277                        | (6,781)   | 11,058   |
| Expenses                                | (6,039)                   | (5,281)   | (758)     | (2,931)                      | (2,862)   | (69)     |
| Net (loss) income                       | \$(15,030)                | \$(7,193) | \$(7,837) | \$1,346                      | \$(9,643) | \$10,989 |

## GAAP and Non-GAAP Reconciliations

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including "Net Earnings Excluding Realized and Unrealized Gains and Losses", "Economic Interest Expense" and "Economic Net Interest Income."

## Net Earnings Excluding Realized and Unrealized Gains and Losses

We have elected to account for our Agency RMBS under the fair value option. Securities held under the fair value option are recorded at estimated fair value, with changes in the fair value recorded as unrealized gains or losses through the consolidated statements of operations.

In addition, 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 the Company's consolidated statements of operations and not included in interest expense. As such, for financial reporting purposes, interest expense and cost of funds are not impacted by the fluctuation in value of the derivative instruments.

Presenting net earnings excluding realized and unrealized gains allows management to: (i) isolate the net interest income and other expenses of the Company over time, free of all mark-to-market adjustments and (ii) assess the effectiveness of our funding and hedging strategies on our capital allocation decisions and our asset allocation performance. Our funding and hedging strategies, capital allocation and asset selection are integral to our risk management strategy, and therefore critical to the management of our portfolio. We believe that the presentation of our net earnings excluding realized and unrealized gains is useful to investors because it provides a means of comparing our results of operations to those of our peers who have not elected the same accounting treatment. Our presentation of net earnings excluding realized and unrealized gains and losses may not be comparable to similarly-titled measures of other companies, who may use different calculations. As a result, net earnings excluding realized and unrealized gains and losses should not be considered as a substitute for our GAAP net income (loss) as a measure of our financial performance or any measure of our liquidity under GAAP. The table below presents a reconciliation of our net income (loss) determined in accordance with GAAP and net earnings excluding realized and unrealized gains.

Net Earnings Excluding Realized and Unrealized Gains and Losses  
(in thousands, except per share data)

|                           | Per Share               |   |  |                         |  |  |
|---------------------------|-------------------------|---|--|-------------------------|--|--|
|                           | Net<br>Income<br>(GAAP) | Realized<br>and<br>Unrealized<br>Gains and<br>Losses <sup>(1)</sup> | Net<br>Earnings<br>Excluding<br>Realized<br>and<br>Unrealized<br>Gains and<br>Losses | Net<br>Income<br>(GAAP) | Realized<br>and<br>Unrealized<br>Gains and<br>Losses | Net<br>Earnings<br>Excluding<br>Realized<br>and<br>Unrealized<br>Gains and<br>Losses |
| <b>Three Months Ended</b> |                         |   |  |                         |  |  |
| June 30, 2018             | \$ 1,346                | \$ (17,734 )  | \$ 19,080  | \$0.03                  | \$ (0.34 )   | \$ 0.37  |
| March 31, 2018            | (16,377)                | (38,055 )   | 21,678   | (0.31)                  | (0.72 )  | 0.41   |
| December 31, 2017         | (5,982 )                | (29,540 )   | 23,558   | (0.12)                  | (0.61 )  | 0.49   |
| September 30, 2017        | 15,183                  | (8,254 )  | 23,437   | 0.33                    | (0.18 )  | 0.52   |
| June 30, 2017             | (9,643 )                | (32,597 )   | 22,954   | (0.26)                  | (0.88 )  | 0.62   |
| March 31, 2017            | 2,449                   | (20,727 )   | 23,176   | 0.07                    | (0.63 )  | 0.70   |
| <b>Six Months Ended</b>   |                         |   |  |                         |  |  |
| June 30, 2018             | \$(15,030)              | \$(55,789 )   | \$ 40,759  | \$(0.29)                | \$( 1.06 )   | \$ 0.77  |
| June 30, 2017             | (7,193 )                | (53,324 )   | 46,131   | (0.21)                  | (1.51 )  | 1.31   |

(1) Includes realized and unrealized gains (losses) on RMBS and derivative financial instruments, including net interest expense on interest rate swaps.

Economic Interest Expense and Economic Net Interest Income

We use derivative instruments, specifically Eurodollar and Treasury Note ("T-Note") futures contracts, interest rate swaps and swaptions, to hedge a portion of 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 consolidated statements of operations and not included in interest expense. As such, for financial reporting purposes, interest expense and cost of funds are not impacted by the fluctuation in value of the derivative instruments.





For the purpose of computing economic net interest income and ratios relating to cost of funds measures, GAAP interest expense has been adjusted to reflect the realized gains or losses on specific derivative instruments that pertain to each period presented. We believe that adjusting our interest expense for the periods presented by the gains or losses on all derivative instruments would not accurately reflect our economic interest expense for these periods. For each period presented, we have combined the effects of the derivative financial instruments in place for the respective period with the actual interest expense incurred on borrowings to reflect total economic interest expense for the applicable period. Interest expense, including the effect of derivative instruments for the period, is referred to as economic interest expense. Net interest income, when calculated to include the effect of derivative instruments for the period, is referred to as economic net interest income. This presentation includes gains or losses on all contracts in effect during the reporting period, covering the current period as well as periods in the future.

We believe that economic interest expense and economic net interest income provide meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The non-GAAP measures help management to evaluate its 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. The unrealized gains or losses on derivative instruments presented in our consolidated statements of operations are not necessarily representative of the total interest rate expense that we will ultimately realize. This is because as interest rates move up or down in the future, the gains or losses we ultimately realize, and which will affect our total interest rate expense in future periods, may differ from the unrealized gains or losses recognized as of the reporting date.

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 the way 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 tables below present a reconciliation of the adjustments to interest expense shown for each period relative to our derivative instruments, and the income statement line item, gains (losses) on derivative instruments, calculated in accordance with GAAP for each quarter during 2018 and 2017.

Gains (Losses) on Derivative Instruments  
(in thousands)

|                    | Recognized in Income Statement (GAAP) |          | Funding Hedges Attributed to Current Period (Non-GAAP) |  | Attributed to Future Periods (Non-GAAP) |  |
|--------------------|---------------------------------------|----------|--|--|---|--|
|                    | TBA Securities Income                 |          | Current Period (Non-GAAP)                              |  | Future Periods (Non-GAAP)               |  |
| Three Months Ended |                                       |          |  |  |   |  |
| June 30, 2018      | \$ 14,859                             | \$ 1,564 | \$(852 )   |  | \$ 14,147                               |  |
| March 31, 2018     | 41,994                                | 8,407    | (3,011)  |  | 36,598                                  |  |
| December 31, 2017  | 13,982                                | (2,094 ) | (3,763)  |  | 19,839                                  |  |
| September 30, 2017 | (5,470 )                              | (1,459 ) | (3,761)  |  | (250 )                                  |  |
| June 30, 2017      | (19,442 )                             | (2,384 ) | (3,654)  |  | (13,404 )                               |  |
| March 31, 2017     | (4,419 )                              | -        | (3,193)  |  | (1,226 )                                |  |
| Six Months Ended   |                                       |          |  |  |   |  |
| June 30, 2018      | \$ 56,853                             | \$ 9,971 | \$(3,863)  |  | \$ 50,745                               |  |
| June 30, 2017      | (23,861 )                             | (2,384 ) | (6,847)  |  | (14,630 )                               |  |



Economic Interest Expense and Economic Net Interest Income  
(in thousands)

|                           | Interest Expense on Borrowings |                     |   |                                    | Net Interest Income |                                   |
|---------------------------|--------------------------------|---------------------|---|------------------------------------|---------------------|-----------------------------------|
|                           | GAAP                           | GAAP                | Gains<br>(Losses) on<br>Derivative<br>Instruments | Economic                           | GAAP                | Economic                          |
|                           | Interest<br>Income             | Interest<br>Expense | to Current<br>Period <sup>(1)</sup>               | Interest<br>Expense <sup>(2)</sup> | Interest<br>Income  | Interest<br>Income <sup>(3)</sup> |
| <b>Three Months Ended</b> |                                |                     |   |                                    |                     |                                   |
| June 30, 2018             | \$38,590                       | \$16,579            | \$ (852 )   | \$ 17,431                          | \$22,011            | \$ 21,159                         |
| March 31, 2018            | 39,935                         | 15,149              | (3,011 )  | 18,160                             | 24,786              | 21,775                            |
| December 31, 2017         | 40,098                         | 13,554              | (3,763 )  | 17,317                             | 26,544              | 22,781                            |
| September 30, 2017        | 38,974                         | 12,638              | (3,761 )  | 16,399                             | 26,336              | 22,575                            |
| June 30, 2017             | 34,579                         | 8,763               | (3,654 )  | 12,417                             | 25,816              | 22,162                            |
| March 31, 2017            | 32,311                         | 6,715               | (3,193 )  | 9,908                              | 25,596              | 22,403                            |
| <b>Six Months Ended</b>   |                                |                     |   |                                    |                     |                                   |
| June 30, 2018             | \$78,526                       | \$31,728            | \$ (3,863 )                                       | \$ 35,591                          | \$46,798            | \$ 42,935                         |
| June 30, 2017             | 66,890                         | 15,478              | (6,847 )  | 22,325                             | 51,412              | 44,565                            |

(1) Reflects the effect of derivative instrument hedges for only the period presented.

(2) Calculated by adding the effect of derivative instrument hedges attributed to the period presented to GAAP interest expense.

(3) Calculated by adding the effect of derivative instrument hedges attributed to the period presented to GAAP net interest income.

#### Net Interest Income

During the six months ended June 30, 2018, we generated \$46.8 million of net interest income, consisting of \$78.5 million of interest income from RMBS assets offset by \$31.7 million of interest expense on borrowings. For the comparable period ended June 30, 2017, we generated \$51.4 million of net interest income, consisting of \$66.9 million of interest income from RMBS assets offset by \$15.5 million of interest expense on borrowings. The \$11.6 million increase in interest income and \$16.2 million increase in interest expense for the six months ended June 30, 2018 primarily reflects the growth of our portfolio fueled by our net capital raising activities, combined with increased yields earned on our portfolio and increased costs and amounts of our borrowings.

On an economic basis, our interest expense on borrowings for the six months ended June 30, 2018 and 2017 was \$35.6 million and \$22.3 million, respectively, resulting in \$42.9 million and \$44.6 million of economic net interest income, respectively.

During the three months ended June 30, 2018, we generated \$22.0 million of net interest income, consisting of \$38.6 million of interest income from RMBS assets offset by \$16.6 million of interest expense on borrowings. For the three months ended June 30, 2017, we generated \$25.8 million of net interest income, consisting of \$34.6 million of interest income from RMBS assets offset by \$8.8 million of interest expense on borrowings. As in the six months ended June 30, 2018, the increased interest income and interest expense for the three months ended June 30, 2018, as compared to the same period in 2017, reflects a combination of the growth of our portfolio and increased yields on the portfolio and costs of borrowings.

On an economic basis, our interest expense on repurchase liabilities for the three months ended June 30, 2018 and 2017 was \$17.4 million and \$12.4 million, respectively, resulting in \$21.2 million and \$22.2 million of economic net interest income, respectively.

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The tables below provide information on our portfolio average balances, interest income, yield on assets, average borrowings, interest expense, cost of funds, net interest income and net interest spread for the six months ended June 30, 2018 and 2017 and each quarter during 2018 and 2017 on both a GAAP and economic basis.

(\$ in thousands)

|                    | Average<br>RMBS<br>Held <sup>(1)</sup> | Interest<br>Income | Yield on        |   | Average<br>Borrowings <sup>(1)</sup> | Interest Expense |                                  | Average Cost of<br>Funds |                                  |   |
|--------------------|--|--------------------|-----------------|---|--------------------------------------|------------------|----------------------------------|--------------------------|----------------------------------|---|
|                    |  |                    | Average<br>RMBS | % |                                      | GAAP<br>Basis    | Economic<br>Basis <sup>(2)</sup> | GAAP<br>Basis            | Economic<br>Basis <sup>(3)</sup> |   |
| Three Months Ended |  |                    |                 |   |                                      |                  |                                  |                          |                                  |   |
| June 30, 2018      | \$3,717,690                            | \$38,590           | 4.15            | % | \$ 3,534,567                         | \$16,579         | \$ 17,431                        | 1.88%                    | 1.97                             | % |
| March 31, 2018     | 3,745,298                              | 39,935             | 4.27            | % | 3,576,533                            | 15,149           | 18,160                           | 1.69%                    | 2.03                             | % |
| December 31, 2017  | 3,837,575                              | 40,098             | 4.18            | % | 3,621,931                            | 13,554           | 17,317                           | 1.50%                    | 1.91                             | % |
| September 30, 2017 | 3,834,083                              | 38,974             | 4.07            | % | 3,494,266                            | 12,638           | 16,399                           | 1.45%                    | 1.88                             | % |
| June 30, 2017      | 3,499,922                              | 34,579             | 3.95            | % | 3,164,532                            | 8,763            | 12,417                           | 1.11%                    | 1.57                             | % |
| March 31, 2017     | 3,142,095                              | 32,311             | 4.11            | % | 2,922,157                            | 6,715            | 9,908                            | 0.92%                    | 1.36                             | % |
| Six Months Ended   |  |                    |                 |   |                                      |                  |                                  |                          |                                  |   |
| June 30, 2018      | \$3,731,494                            | \$78,526           | 4.21            | % | \$ 3,555,550                         | \$31,728         | \$ 35,591                        | 1.78%                    | 2.00                             | % |
| June 30, 2017      | 3,321,009                              | 66,890             | 4.03            | % | 3,043,344                            | 15,478           | 22,325                           | 1.02%                    | 1.47                             | % |

(\$ in thousands)

|                    | Net Interest<br>Income |                                  | Net Interest<br>Spread |                                  |   |
|--------------------|------------------------|----------------------------------|------------------------|----------------------------------|---|
|                    | GAAP<br>Basis          | Economic<br>Basis <sup>(2)</sup> | GAAP<br>Basis          | Economic<br>Basis <sup>(4)</sup> |   |
| Three Months Ended |                        |                                  |                        |                                  |   |
| June 30, 2018      | \$22,011               | \$ 21,159                        | 2.27%                  | 2.18                             | % |
| March 31, 2018     | 24,786                 | 21,775                           | 2.58%                  | 2.24                             | % |
| December 31, 2017  | 26,544                 | 22,781                           | 2.68%                  | 2.27                             | % |
| September 30, 2017 | 26,336                 | 22,575                           | 2.62%                  | 2.19                             | % |
| June 30, 2017      | 25,816                 | 22,162                           | 2.84%                  | 2.38                             | % |
| March 31, 2017     | 25,596                 | 22,403                           | 3.19%                  | 2.75                             | % |
| Six Months Ended   |                        |                                  |                        |                                  |   |
| June 30, 2018      | \$46,798               | \$ 42,934                        | 2.43%                  | 2.21                             | % |
| June 30, 2017      | 51,412                 | 44,565                           | 3.01%                  | 2.56                             | % |

Portfolio yields and costs of borrowings presented in the tables above and the tables on pages 31 and 32 are calculated based on the average balances of the underlying investment portfolio/borrowings balances and are annualized for the periods presented. Average balances for quarterly periods are calculated using two data points, the beginning and ending balances.

(2) Economic interest expense and economic net interest income presented in the table above and the tables on page 32 includes the effect of our derivative instrument hedges for only the periods presented.

(3) Represents interest cost of our borrowings and the effect of derivative instrument hedges attributed to the period divided by average RMBS.

(4) Economic net interest spread is calculated by subtracting average economic cost of funds from realized yield on average RMBS.

Interest Income and Average Asset Yield

Our interest income for the six months ended June 30, 2018 and 2017 was \$78.5 million and \$66.9 million, respectively. We had average RMBS holdings of \$3,731.5 million and \$3,321.0 million for the six months ended June 30, 2018 and 2017, respectively. The yield on our portfolio was 4.21% and 4.03% for the six months ended June 30, 2018 and 2017, respectively. For the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, there was a \$11.6 million increase in interest income due to a \$410.5 million increase in average RMBS, combined with a 18 basis point ("bps") increase in the yield on average RMBS. The increase in average RMBS during the six months ended June 30, 2018 reflects the deployment of the proceeds of our net capital raising activities, on a leveraged basis.

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Our interest income for the three months ended June 30, 2018 and 2017 was \$38.6 million and \$34.6 million, respectively. We had average RMBS holdings of \$3,717.7 million and \$3,499.9 million for the three months ended June 30, 2018 and 2017, respectively. The yield on our portfolio was 4.15% and 3.95% for the three months ended June 30, 2018 and 2017, respectively. For the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, there was a \$4.0 million increase in interest income due to a \$217.8 million increase in average RMBS, combined with a 20 bps increase in the yield on average RMBS. The increase in average RMBS during the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, reflects the deployment of the proceeds of our net capital raising activities.

The table below presents the average portfolio size, income and yields of our respective sub-portfolios, consisting of structured RMBS and PT RMBS, for the six months ended June 30, 2018 and 2017, and for each quarter during 2018 and 2017.

(\$ in thousands)

|                    | Average RMBS Held |                 |             | Interest Income |                 |          | Realized Yield on Average RMBS |                 |       |
|--------------------|-------------------|-----------------|-------------|-----------------|-----------------|----------|--------------------------------|-----------------|-------|
|                    | PT RMBS           | Structured RMBS | Total       | PT RMBS         | Structured RMBS | Total    | PT RMBS                        | Structured RMBS | Total |
| Three Months Ended |                   |                 |             |                 |                 |          |                                |                 |       |
| June 30, 2018      | \$3,572,540       | \$145,150       | \$3,717,690 | \$36,273        | \$2,317         | \$38,590 | 4.06%                          | 6.38%           | 4.15% |
| March 31, 2018     | 3,610,527         | 134,771         | 3,745,298   | 38,725          | 1,210           | 39,935   | 4.29%                          | 3.59%           | 4.27% |
| December 31, 2017  | 3,704,163         | 133,412         | 3,837,575   | 38,927          | 1,171           | 40,098   | 4.20%                          | 3.51%           | 4.18% |
| September 30, 2017 | 3,687,533         | 146,550         | 3,834,083   | 38,476          | 498             | 38,974   | 4.17%                          | 1.36%           | 4.07% |
| June 30, 2017      | 3,349,042         | 150,880         | 3,499,922   | 32,479          | 2,100           | 34,579   | 3.88%                          | 5.57%           | 3.95% |
| March 31, 2017     | 2,990,937         | 151,158         | 3,142,095   | 29,772          | 2,539           | 32,311   | 3.98%                          | 6.72%           | 4.11% |
| Six Months Ended   |                   |                 |             |                 |                 |          |                                |                 |       |
| June 30, 2018      | \$3,591,534       | \$139,960       | \$3,731,494 | \$74,998        | \$3,527         | \$78,526 | 4.18%                          | 5.04%           | 4.21% |
| June 30, 2017      | 3,169,990         | 151,019         | 3,321,009   | 62,251          | 4,639           | 66,890   | 3.93%                          | 6.14%           | 4.03% |

#### Interest Expense and the Cost of Funds

We had average outstanding borrowings of \$3,555.6 million and \$3,043.3 million and total interest expense of \$31.7 million and \$15.5 million for the six months ended June 30, 2018 and 2017, respectively. Our average cost of funds was 1.78% for the six months ended June 30, 2018, compared to 1.02% for the comparable period in 2017. Contributing to the increase in interest expense was a 76 bps increase in the average cost of funds and a \$512.2 million increase in average outstanding borrowings during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. The higher cost of funds for the six months ended June 30, 2018, compared to the same period in 2017, reflects the higher short-term rates as presented in the table below. The increase in average outstanding borrowings reflects the investment, on a leveraged basis, of the proceeds of our net capital raising activities.

Our economic interest expense was \$35.6 million and \$22.3 million for the six months ended June 30, 2018 and 2017, respectively. There was a 53 bps increase in the average economic cost of funds to 2.00% for the six months ended June 30, 2018 from 1.47% for the six months ended June 30, 2017. The reason for the increase in economic cost of funds is primarily due to the increases in our average outstanding borrowings and the cost of our borrowings noted above, combined with the negative performance of our derivative financial instruments during the period.

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We had average outstanding borrowings of \$3,534.6 million and \$3,164.5 million and total interest expense of \$16.6 million and \$8.8 million for the three months ended June 30, 2018 and 2017, respectively. Our average cost of funds was 1.88% and 1.11% for three months ended June 30, 2018 and 2017, respectively. There was a 77 bps increase in the average cost of funds and a \$370.0 million increase in average outstanding borrowings during the three months ended June 30, 2018, compared to the three months ended June 30, 2017. As in the six months ended June 30, 2018, the higher cost of funds for the three months ended June 30, 2018, compared to the same period in 2017, reflects higher short-term rates, and the increase in average outstanding borrowings reflects the investment, on a leveraged basis, of the proceeds of our net capital raising activities.

Our economic interest expense was \$17.4 million and \$12.4 million for the three months ended June 30, 2018 and 2017, respectively. There was a 40 bps increase in the average economic cost of funds to 1.97% for the three months ended June 30, 2018 from 1.57% for the three months ended June 30, 2017. The increase in economic interest expense during the three months ended June 30, 2018 was due to a combination of the increase in average outstanding borrowings, higher average interest rates charged for those borrowings, and the negative performance of our derivative financial instruments during the period.

Since all of our repurchase agreements are short-term, changes in market rates directly affect our interest expense. Our average cost of funds calculated on a GAAP basis was 11 bps below the average one-month LIBOR and 60 bps below the average six-month LIBOR for the quarter ended June 30, 2018. Our average economic cost of funds was 2 bps below the average one-month LIBOR and 51 bps below the average six-month LIBOR for the quarter ended June 30, 2018. The average term to maturity of the outstanding repurchase agreements decreased to 37 days at June 30, 2018 from 52 days at December 31, 2017.

The tables below present the average balance of borrowings outstanding, interest expense and average cost of funds, and average one-month and six-month LIBOR rates for the six months ended June 30, 2018 and 2017, and for each quarter in 2018 and 2017 on both a GAAP and economic basis.

(\$ in thousands)

|                           | Average Balance of Borrowings |                            | Interest Expense |                                | Average Cost of Funds |                |
|---------------------------|-------------------------------|----------------------------|------------------|--------------------------------|-----------------------|----------------|
|                           | GAAP Basis                    | Economic Basis             | GAAP Basis       | Economic Basis                 | GAAP Basis            | Economic Basis |
| <b>Three Months Ended</b> |                               |                            |                  |                                |                       |                |
| June 30, 2018             | \$3,534,567                   | \$16,579                   | \$17,431         | 1.88%                          | 1.97%                 | %              |
| March 31, 2018            | 3,576,533                     | 15,149                     | 18,160           | 1.69%                          | 2.03%                 | %              |
| December 31, 2017         | 3,621,931                     | 13,554                     | 17,317           | 1.50%                          | 1.91%                 | %              |
| September 30, 2017        | 3,494,266                     | 12,638                     | 16,399           | 1.45%                          | 1.88%                 | %              |
| June 30, 2017             | 3,164,532                     | 8,763                      | 12,417           | 1.11%                          | 1.57%                 | %              |
| March 31, 2017            | 2,922,157                     | 6,715                      | 9,908            | 0.92%                          | 1.36%                 | %              |
| <b>Six Months Ended</b>   |                               |                            |                  |                                |                       |                |
| June 30, 2018             | \$3,555,550                   | \$31,728                   | \$35,591         | 1.78%                          | 2.00%                 | %              |
| June 30, 2017             | 3,043,344                     | 15,478                     | 22,325           | 1.02%                          | 1.47%                 | %              |
| <br>                      |                               |                            |                  |                                |                       |                |
|                           |                               | Average GAAP Cost of Funds |                  | Average Economic Cost of Funds |                       |                |
|                           |                               | Relative to Average        |                  | Relative to Average            |                       |                |
| Average LIBOR             |                               | One-Month                  | Six-Month        | One-Month                      | Six-Month             |                |
| One-Month                 |                               | LIBOR                      | LIBOR            | LIBOR                          | LIBOR                 |                |
| <b>Three Months Ended</b> |                               |                            |                  |                                |                       |                |
| June 30, 2018             | 1.99%                         | 2.48%                      | (0.11)%          | (0.60)%                        | (0.02)%               | (0.51)%        |
| March 31, 2018            | 1.69%                         | 2.11%                      | 0.00%            | (0.42)%                        | 0.34%                 | (0.08)%        |



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|                    |       |      |   |        |   |       |    |      |   |       |    |
|--------------------|-------|------|---|--------|---|-------|----|------|---|-------|----|
| December 31, 2017  | 1.36% | 1.62 | % | 0.14   | % | (0.12 | )% | 0.55 | % | 0.29  | %  |
| September 30, 2017 | 1.20% | 1.45 | % | 0.25   | % | (0.00 | )% | 0.68 | % | 0.43  | %  |
| June 30, 2017      | 1.05% | 1.43 | % | 0.06   | % | (0.32 | )% | 0.52 | % | 0.14  | %  |
| March 31, 2017     | 0.82% | 1.37 | % | 0.10   | % | (0.45 | )% | 0.54 | % | (0.01 | )% |
| Six Months Ended   |       |      |   |        |   |       |    |      |   |       |    |
| June 30, 2018      | 1.84% | 2.30 | % | (0.06) | % | (0.52 | )% | 0.16 | % | (0.30 | )% |
| June 30, 2017      | 0.94% | 1.40 | % | 0.08   | % | (0.38 | )% | 0.53 | % | 0.07  | %  |

32

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Gains or Losses

The table below presents our gains or losses for the six and three months ended June 30, 2018 and 2017.

(in thousands)

|  | Six Months Ended June 30, |          |            | Three Months Ended June 30, |          |            |
|--|---------------------------|----------|------------|-----------------------------|----------|------------|
|  | 2018                      | 2017     | Change     | 2018                        | 2017     | Change     |
| Realized (losses) gains on sales of RMBS | \$(20,513 )               | \$2,585  | \$(23,098) | \$(12,175)                  | \$3,935  | \$(16,110) |
| Unrealized losses on RMBS                | (92,129 )                 | (32,048) | (60,081)   | (20,418)                    | (17,090) | (3,328 )   |
| Total losses on RMBS                     | (112,642)                 | (29,463) | (83,179)   | (32,593)                    | (13,155) | (19,438)   |
| Gains (losses) on interest rate futures  | 28,411                    | (17,302) | 45,713     | 7,049                       | (12,880) | 19,929     |
| Gains (losses) on interest rate swaps    | 14,037                    | (4,175 ) | 18,212     | 3,530                       | (4,178 ) | 7,708      |
| (Losses) gains on receiver swaptions     | (779 )                    | -        | (779 )     | (430 )                      | -        | (430 )     |
| Gains on payer swaptions                 | 5,213                     | -        | 5,213      | 3,146                       | -        | 3,146      |
| Gains (losses) on TBA securities         | 9,971                     | (2,384 ) | 12,355     | 1,564                       | (2,384 ) | 3,948      |

We invest in RMBS with the intent to earn net income from the realized yield on those assets over their related funding and hedging costs, and not for the purpose of making short term gains from sales. However, we have sold, and may continue to sell, existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns in light of current or anticipated interest rates, federal government programs or general economic conditions or to manage our balance sheet as part of our asset/liability management strategy. During the six months ended June 30, 2018 and 2017, we received proceeds of \$1,757.7 million and \$3,065.0 million, respectively, from the sales of RMBS. During the three months ended June 30, 2018 and 2017, we received proceeds of \$1,529.0 million and \$1,657.3 million, respectively, from the sales of RMBS.

Realized and unrealized gains and losses on RMBS are driven in part by changes in yields and interest rates, which affect the pricing of the securities in our portfolio. Gains and losses on interest rate futures contracts are affected by changes in implied forward rates during the reporting period. The table below presents historical interest rate data for each quarter end during 2018 and 2017.

|                    | 5 Year<br>U.S.<br>Treasury<br>Rate <sup>(1)</sup> | 10 Year<br>U.S.<br>Treasury<br>Rate <sup>(1)</sup> | 15 Year<br>Fixed-Rate<br>Mortgage<br>Rate <sup>(2)</sup> | 30 Year<br>Fixed-Rate<br>Mortgage<br>Rate <sup>(2)</sup> | Three<br>Month<br>LIBOR <sup>(3)</sup> |
|--------------------|---|--|--|--|--|
| June 30, 2018      | 2.73 %  | 2.85 %   | 4.04 %   | 4.57 %   | 2.34 %                                 |
| March 31, 2018     | 2.56 %  | 2.74 %   | 3.91 %   | 4.44 %   | 2.31 %                                 |
| December 31, 2017  | 2.21 %  | 2.40 %   | 3.39 %   | 3.95 %   | 1.61 %                                 |
| September 30, 2017 | 1.93 %  | 2.33 %   | 3.11 %   | 3.81 %   | 1.32 %                                 |
| June 30, 2017      | 1.88 %  | 2.30 %   | 3.17 %   | 3.90 %   | 1.26 %                                 |
| March 31, 2017     | 1.93 %  | 2.40 %   | 3.41 %   | 4.20 %   | 1.13 %                                 |

(1) Historical 5 and 10 Year U.S. Treasury Rates are obtained from quoted end of day prices on the Chicago Board Options Exchange.

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

(3) Historical LIBOR is obtained from the Intercontinental Exchange Benchmark Administration Ltd.

## Expenses

For the six and three months ended June 30, 2018, the Company's total operating expenses were approximately \$6.0 million and \$2.9 million, respectively, compared to approximately \$5.3 million and \$2.9 million, respectively, for the six and three months ended June 30, 2017. The table below presents a breakdown of operating expenses for the six and three months ended June 30, 2018 and 2017.

(in thousands)

|  | Six Months Ended June 30, |         |        | Three Months Ended June 30, |         |        |
|--|---------------------------|---------|--------|-----------------------------|---------|--------|
|  | 2018                      | 2017    | Change | 2018                        | 2017    | Change |
| Management fees                          | \$3,318                   | \$2,702 | \$ 616 | \$1,606                     | \$1,400 | \$ 206 |
| Overhead allocation                      | 742                       | 756     | (14 )  | 361                         | 388     | (27 )  |
| Accrued incentive compensation           | 12                        | 230     | (218 ) | 1                           | 218     | (217 ) |
| Directors fees and liability insurance   | 500                       | 508     | (8 )   | 248                         | 232     | 16     |
| Audit, legal and other professional fees | 463                       | 389     | 74     | 167                         | 219     | (52 )  |
| Direct REIT operating expenses           | 810                       | 496     | 314    | 407                         | 265     | 142    |
| Other administrative                     | 194                       | 200     | (6 )   | 141                         | 140     | 1      |
| Total expenses                           | \$6,039                   | \$5,281 | \$ 758 | \$2,931                     | \$2,862 | \$ 69  |

We are externally managed and advised by Bimini Advisors, LLC (the "Manager") pursuant to the terms of a management agreement. The management agreement has been renewed through February 20, 2019 and provides for automatic one-year extension options thereafter and is subject to certain termination rights. Under the terms of the management agreement, the Manager is responsible for administering the business activities and day-to-day operations of the Company. The Manager receives 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.

We are obligated to reimburse Bimini Advisors for any direct expenses incurred on its behalf. In addition, beginning July 1, 2014, Bimini Advisors began allocating to us its pro rata portion of certain overhead costs in accordance with the management agreement. Should we terminate the management agreement without cause, we will pay to the Manager 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 term of the agreement.

## Financial Condition:

## Mortgage-Backed Securities

As of June 30, 2018, our RMBS portfolio consisted of \$3,689.6 million of Agency RMBS at fair value and had a weighted average coupon on assets of 4.28%. During the six months ended June 30, 2018, we received principal repayments of \$180.2 million compared to \$155.3 million for the six months ended June 30, 2017. The average prepayment speeds for the quarters ended June 30, 2018 and 2017 were 9.8% and 9.5%, respectively.

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The following table presents the 3-month constant prepayment rate ("CPR") experienced on our structured and PT RMBS sub-portfolios, on an annualized basis, for the quarterly periods presented. CPR is a method of expressing the prepayment rate for a mortgage pool that assumes that a constant fraction of the remaining principal is prepaid each month or year. Specifically, the CPR in the chart below represents the three month prepayment rate of the securities in the respective asset category. 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                 | Structured         |                     |
|--------------------|--------------------|--------------------|---------------------|
|                    | RMBS Portfolio (%) | RMBS Portfolio (%) | Total Portfolio (%) |
| June 30, 2018      | 8.7                | 11.8               | 9.8                 |
| March 31, 2018     | 6.5                | 11.6               | 7.7                 |
| December 31, 2017  | 7.0                | 13.6               | 9.1                 |
| September 30, 2017 | 8.3                | 14.9               | 10.3                |
| June 30, 2017      | 7.0                | 12.7               | 9.5                 |
| March 31, 2017     | 7.5                | 14.3               | 9.9                 |

The following tables summarize certain characteristics of the Company's PT RMBS and structured RMBS as of June 30, 2018 and December 31, 2017:

(\$ 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 |
|------------------------------------|-------------|--------------------------------|-------------------------|-------------------------------------|------------------|---|-------------------------------|-------------------------------|
|                                    |             |                                |                         |                                     |                  |   |                               |                               |
| June 30, 2018                      |             |                                |                         |                                     |                  |   |                               |                               |
| Adjustable Rate RMBS               | \$1,718     | 0.0%                           | 3.95%                   | 200                                 | 1-Sep-35         | 0.81                                    | 10.05%                        | 2.00%                         |
| Fixed Rate RMBS                    | 2,978,653   | 80.7%                          | 4.30%                   | 298                                 | 1-May-48         | NA                                      | NA                            | NA                            |
| Fixed Rate CMOs                    | 542,656     | 14.7%                          | 4.39%                   | 310                                 | 15-Jul-47        | NA                                      | NA                            | NA                            |
| Hybrid Adjustable Rate RMBS        | 24,684      | 0.7%                           | 2.57%                   | 295                                 | 1-Aug-43         | 53.98                                   | 7.57%                         | 2.00%                         |
| Total Mortgage-backed Pass-through | 3,547,711   | 96.1%                          | 4.30%                   | 300                                 | 1-May-48         | NA                                      | NA                            | NA                            |
| Interest-Only Securities           | 116,181     | 3.1%                           | 3.83%                   | 279                                 | 25-Feb-48        | NA                                      | NA                            | NA                            |
| Inverse Interest-Only Securities   | 25,704      | 0.8%                           | 3.57%                   | 309                                 | 15-Jul-47        | NA                                      | 5.30%                         | NA                            |
| Total Structured RMBS              | 141,885     | 3.9%                           | 3.79%                   | 285                                 | 25-Feb-48        | NA                                      | NA                            | NA                            |
| Total Mortgage Assets              | \$3,689,596 | 100.0%                         | 4.28%                   | 299                                 | 1-May-48         | NA                                      | NA                            | NA                            |
| December 31, 2017                  |             |                                |                         |                                     |                  |   |                               |                               |
| Adjustable Rate RMBS               | \$1,754     | 0.0%                           | 3.95%                   | 206                                 | 1-Sep-35         | 5.50                                    | 10.05%                        | 2.00%                         |
| Fixed Rate RMBS                    | 3,594,533   | 96.0%                          | 4.25%                   | 338                                 | 1-Dec-47         | NA                                      | NA                            | NA                            |
| Hybrid Adjustable Rate RMBS        | 27,398      | 0.7%                           | 2.59%                   | 301                                 | 1-Aug-43         | 59.77                                   | 7.59%                         | 2.00%                         |
| Total Mortgage-backed Pass-through | 3,623,685   | 96.7%                          | 4.24%                   | 338                                 | 1-Dec-47         | NA                                      | NA                            | NA                            |
| Interest-Only Securities           | 86,918      | 2.3%                           | 3.75%                   | 262                                 | 15-Apr-47        | NA                                      | NA                            | NA                            |
| Inverse Interest-Only Securities   | 34,208      | 1.0%                           | 4.02%                   | 318                                 | 15-Jul-47        | NA                                      | 5.11%                         | NA                            |
| Total Structured RMBS              | 121,126     | 3.3%                           | 3.82%                   | 278                                 | 15-Jul-47        | NA                                      | NA                            | NA                            |
| Total Mortgage Assets              | \$3,744,811 | 100.0%                         | 4.23%                   | 336                                 | 1-Dec-47         | NA                                      | NA                            | NA                            |



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(\$ in thousands)

| Agency          | June 30, 2018 |                                |   | December 31, 2017 |                                |   |
|-----------------|---------------|--------------------------------|---|-------------------|--------------------------------|---|
|                 | Fair Value    | Percentage of Entire Portfolio |   | Fair Value        | Percentage of Entire Portfolio |   |
| Fannie Mae      | \$2,164,713   | 58.7                           | % | \$2,242,213       | 59.9                           | % |
| Freddie Mac     | 1,519,420     | 41.2                           | % | 1,496,615         | 40.0                           | % |
| Ginnie Mae      | 5,463         | 0.1                            | % | 5,983             | 0.1                            | % |
| Total Portfolio | \$3,689,596   | 100.0                          | % | \$3,744,811       | 100.0                          | % |

|  | June 30, 2018 | December 31, 2017 |
|--|---------------|-------------------|
| Weighted Average Pass-through Purchase Price | \$106.25      | \$107.52          |
| Weighted Average Structured Purchase Price   | \$14.37       | \$13.82           |
| Weighted Average Pass-through Current Price  | \$104.08      | \$106.79          |
| Weighted Average Structured Current Price    | \$14.18       | \$12.50           |
| Effective Duration <sup>(1)</sup>            | 3.421         | 2.989             |

Effective duration is the approximate percentage change in price for a 100 bps change in rates. An effective duration of 3.421 indicates that an interest rate increase of 1.0% would be expected to cause a 3.421% decrease in the value of the RMBS in the Company's investment portfolio at June 30, 2018. An effective duration of 2.989 (1) indicates that an interest rate increase of 1.0% would be expected to cause a 2.989% decrease in the value of the RMBS in the Company's investment portfolio at December 31, 2017. These figures include the structured securities in the portfolio, but do not include the effect of the Company's funding cost hedges. Effective duration quotes for individual investments are obtained from The Yield Book, Inc.

The following table presents a summary of portfolio assets acquired during the six months ended June 30, 2018 and 2017, including securities purchased during the period that settled after the end of the period, if any.

(\$ in thousands)

|                   | 2018        |               |                        | 2017        |               |                        |
|-------------------|-------------|---------------|------------------------|-------------|---------------|------------------------|
|                   | Total Cost  | Average Price | Weighted Average Yield | Total Cost  | Average Price | Weighted Average Yield |
| Pass-through RMBS | \$1,966,300 | \$104.60      | 3.39 %                 | \$3,906,120 | \$108.29      | 2.74 %                 |
| Structured RMBS   | 28,908      | 21.56         | 5.39 %                 | 59,272      | 16.34         | 5.03 %                 |

### Borrowings

As of June 30, 2018, we had established borrowing facilities in the repurchase agreement market with a number of commercial banks and other financial institutions and had borrowings in place with 24 of these counterparties. None of these lenders are affiliated with the Company. These borrowings are secured by the Company's RMBS and cash, and bear interest at prevailing market rates. We believe our established repurchase agreement borrowing facilities provide borrowing capacity in excess of our needs.

As of June 30, 2018, we had obligations outstanding under the repurchase agreements of approximately \$3,449.9 million with a net weighted average borrowing cost of 2.07%. The remaining maturity of our outstanding repurchase agreement obligations ranged from 2 to 90 days, with a weighted average remaining maturity of 37 days. Securing the repurchase agreement obligations as of June 30, 2018 are RMBS with an estimated fair value, including accrued

interest, of approximately \$3,658.3 million and a weighted average maturity of 298 months, and cash pledged to counterparties of approximately \$23.1 million. Through July 27, 2018, we have been able to maintain our repurchase facilities with comparable terms to those that existed at June 30, 2018 with maturities through October 23, 2018.

The table below presents information about our period end and average repurchase agreement obligations for each quarter in 2018 and 2017.

(\$ in thousands)

| Three Months Ended | Ending                   | Average                  | Difference<br>Between Ending<br>Borrowings and<br>Average<br>Borrowings |          |
|--------------------|--------------------------|--------------------------|---|----------|
|                    | Balance of<br>Borrowings | Balance of<br>Borrowings | Amount  | Percent  |
| June 30, 2018      | \$3,449,854              | \$3,534,567              | \$(84,713 )   | (2.40 )% |
| March 31, 2018     | 3,619,280                | 3,576,533                | 42,747  | 1.20 %   |
| December 31, 2017  | 3,533,786                | 3,621,931                | (88,145 )   | (2.43 )% |
| September 30, 2017 | 3,710,077                | 3,494,266                | 215,811   | 6.18 %   |
| June 30, 2017      | 3,278,456                | 3,164,532                | 113,924   | 3.60 %   |
| March 31, 2017     | 3,050,608                | 2,922,157                | 128,451   | 4.40 %   |

### 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 RMBS 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 RMBS portfolio, (b) the repayments on borrowings and (c) the payment of dividends to the extent required for our continued qualification as a REIT. We may also generate liquidity from time to time by selling our equity or debt securities in public offerings or private placements.

Because our PT RMBS 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 RMBS portfolio also consists entirely of governmental agency securities, although they typically do not trade with comparable bid / ask spreads as PT RMBS. However, we anticipate that we would be able to liquidate such securities readily, even in distressed markets, although we would likely do so at prices below where such securities could be sold in a more stable market. To enhance our liquidity even further, we may pledge a portion of our structured RMBS 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.

Our strategy for hedging our funding costs typically involves taking short positions in interest rate futures, treasury futures, interest rate swaps, interest rate swaptions or other instruments. When the market causes these short positions to decline in value we are required to meet margin calls with cash. This can reduce our liquidity position to the extent other securities in our portfolio move in price in such a way that we do not receive enough cash via margin calls to offset the derivative related margin calls. If this were to occur in sufficient magnitude, the loss of liquidity might force us to reduce the size of the levered portfolio, pledge additional structured securities to raise funds or risk operating the portfolio with less liquidity.

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.

37

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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 would be entitled to have excess margin returned to us by the counterparty. 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. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the six months ended June 30, 2018, haircuts on our pledged collateral remained stable and as of June 30, 2018, our weighted average haircut was approximately 5.1% of the value of our collateral.

As discussed earlier, we invest a portion of our capital in structured Agency RMBS. We do not apply leverage to this portion of our portfolio. The leverage inherent in structured securities replaces the leverage obtained by acquiring PT securities and funding them in the repurchase market. This structured RMBS 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 RMBS in order to raise our cash levels, but generally will not pledge these securities in order to acquire additional assets.

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<br>One Year   | One<br>to<br>Three<br>Years | Three<br>to<br>Five<br>Years | More<br>than<br>Five<br>Years |             |
| Repurchase agreements                                    | \$3,449,854          | \$ -                        | \$ -                         | \$ -                          | \$3,449,854 |
| Interest expense on repurchase agreements <sup>(1)</sup> | 14,289               | -                           | -                            | -                             | 14,289      |
| Totals   | \$3,464,143          | \$ -                        | \$ -                         | \$ -                          | \$3,464,143 |

(1) Interest expense on repurchase agreements is based on current interest rates as of June 30, 2018 and the remaining term of the liabilities existing at that date.

In future periods, we expect to continue to finance our activities in a manner that is consistent with our current operations through repurchase agreements. As of June 30, 2018, we had cash and cash equivalents of \$137.9 million. We generated cash flows of \$257.3 million from principal and interest payments on our RMBS and had average repurchase agreements outstanding of \$3,555.6 million during the six months ended June 30, 2018.

#### Stockholders' Equity

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

On February 23, 2017, we entered into another equity distribution agreement, as amended and restated on May 10, 2017, (the "May 2017 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The May 2017 Equity Distribution Agreement replaced the July 2016 Equity Distribution Agreement. We issued a total of 12,299,032 shares under the May 2017 Equity Distribution Agreement for aggregate gross proceeds of \$125.0 million, and net proceeds of approximately \$122.9 million, net of commissions and fees, prior to its termination.

On August 2, 2017, we entered into another equity distribution agreement (the "August 2017 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The August 2017 Equity Distribution Agreement replaced the May 2017 Equity Distribution Agreement. Through June 30, 2018, we issued a total of 7,746,052 shares under the August 2017 Equity Distribution Agreement for aggregate gross proceeds of \$76.0 million, and net proceeds of approximately \$74.7 million, net of commissions and fees.

## Outlook

The domestic economy of the United States during the second quarter of 2018, and the first half of 2018 generally, has been quite strong. The economy had clear momentum in late 2017 before the Tax Cuts and Jobs Act of 2017 was passed in December, and the Bipartisan Budget Act of 2018 was signed into law on February 9, 2018. The latter is projected to increase deficit spending by approximately \$300 billion over the next two years. This is in addition to the Tax Cuts and Jobs Act that is projected to add \$1.5 trillion to the deficit over the next ten years – or approximately \$150 billion per year on average. Combined, these two acts represent a significant source of fiscal stimulus for the economy. Economic data released year to date points to broad based strength as various measures of employment, business fixed investment, consumer spending and business activity are at very high levels. Continued strong growth will likely keep the Federal Reserve (the "Fed") on track to continue to remove monetary stimulus from the economy in an effort to engineer a soft landing. Per the Fed's own forecasts, as evidenced by their "dot plot" released after the June 2018 FOMC meeting, the Fed expects to raise rates twice more in 2018 and three times in 2019. On July 17, 2018, the Fed Chairman spoke to the Senate financial services committee in what used to be referred to as the semi-annual Humphrey-Hawkins testimony. The Chairman reiterated the Fed's view that gradual rate hikes appeared to be the appropriate path of monetary policy for now. If the markets were affected by the current strength of the economy alone, movements in interest rates and risk markets would be easy to predict. However, that is not the case. The first half of 2018, and the second quarter specifically, have been impacted by a host of factors that have outweighed the economy in their ability to drive the markets.

One of the factors countering the positive developments in the economy has been the specter of a global trade war. This first emerged in the first quarter but intensified during the second. President Trump, having fulfilled a significant campaign promise when the Tax Cuts and Job Act was passed, has shifted the administration's focus to trade. The President has long held that the United States has been taken advantage of by our various trading partners, whether it be Mexico or Canada in the case of NAFTA, or China and the European Union. The administration initiated its effort to meaningfully change the trading relationships the U.S. has with its major trading partners during the first quarter. As these efforts did not seem to bring about sufficient progress, the administration has increased its efforts, not just the rhetoric, but also the size of tariffs that will be imposed. Like the initial tariffs announced – which were quite small and mostly symbolic – the latest announcements have been met with counter threats and/or additional tariffs. It is clear the administration is eager to make progress on trade and reconfigure the trade landscape, eliminating practices that it sees as disadvantaging the U.S. The markets initially appeared to see through the threats as negotiating ploys and doubted they would ever come to fruition, or if they did, not be permanent. The market appears to be wavering on this view. The rates and risk assets markets have reacted to these developments negatively and interest rates retreated after moving above three percent in mid-May. Developments on the trade front often come via Twitter messages from President Trump, and occur without warning and at almost any time of day or the week. The markets appear to react in a "risk off" fashion when the events occur, as interest rates decrease as risk assets are sold and safe-haven assets are acquired.

Another development to impact the markets is a byproduct of the strong U.S. economy. As the Fed raises rates and frequent public pronouncements by Fed officials indicate rate hikes will continue, the dollar has strengthened. This has caused the currencies of many emerging economies to weaken versus the dollar. This impacts the economies of these countries in multiple ways. To the extent they have issued debt denominated in dollars, the cost to repay this debt, in local currency terms, has increased. Also, to the extent these nations export domestically produced goods to

the U.S., these goods now bring back fewer dollars to their respective local economies. In either case, the securities markets in these nations have been negatively impacted.

In late May 2018 elections in Italy brought a Populists government to power, and the markets feared the new government would fulfill their campaign promises to either leave the EU or deviate from Italy's previously professed commitment to fiscal austerity and discipline. The rates market reacted substantially to these developments as the 10-year U.S. treasury yield decreased from over 3.112% on May 17, 2018 to below 2.80% on May 29, 2018.

As we entered the third quarter the sum of the developments discussed above appear to be outweighing the consistently strong economic data and has kept interest rates rangebound with a flattening bias. The 10-year U.S. treasury has traded between 2.80% and 2.95% since initially breaking below 2.80% in late May. The spread between the 2-year U.S. treasury and 10-year U.S. treasury has continued to compress as the Fed is perceived to be intent on continuing to raise short-term rates while a potential trade war or other developments in Europe or emerging economies could slow growth and act to contain inflation – thus preventing longer-term rates from moving higher. This is the case with the spread between the 5-year and the 30-year treasury. In the case of the latter, the spread has narrowed to approximately 20 bps and the spread between the 2 and 10-year U.S. treasury has broken below 25 bps. Typically when these spreads are this narrow they are signs the market see a recession on the horizon. This question has been widely discussed by market participants and the Fed with no clear consensus answer apparent.

Volatility in the market has subsided as the rates market has become range bound and risk markets continue to trade within year-to-date ranges as well. Another positive development for levered investors has been a reversal in the pressures seen in the short-term funding markets earlier in the year. Both LIBOR and repurchase agreement funding rates have stabilized, albeit at higher levels as the Fed has increased the target range for the Federal Funds rate twice so far this year.

The Agency RMBS market had a small positive return for the second quarter while the spread between the current coupon, thirty-year fixed rate mortgage and a comparable duration U.S. treasury widened slightly from approximately 72 bps to approximately 74 bps. The Bloomberg Agency MBS index had a total return of approximately (1.0%) for the first six months of 2018 and 0.24% for the second quarter. The Fed continues to taper their reinvestment of pay-downs from its RMBS portfolio, but this reduced supply has been mostly offset by reduced supply of new mortgages owing to higher rates and strong home price appreciation, muting demand somewhat as affordability becomes a problem for many borrowers. The price appreciation is driven to some extent by insufficient supply of both new and existing homes. Refinancing activity has dropped to multi-year lows and does not appear to respond to the modest decreases in market rates seen during the second quarter.

#### Recent Regulatory Developments

On January 12, 2016, the FHFA issued RIN 2590-AA39, Members of Federal Home Loan Banks (the "Final Rule"). The Final Rule, among other things, expressly excludes captive insurance companies, such as our wholly-owned captive insurance subsidiary, Orchid Island Casualty, LLC ("Orchid Island Casualty"), from being eligible for membership in the Federal Home Loan Bank ("FHLB") system. Under the Final Rule, there was a one-year transition period from the effective date of February 19, 2016 within which the FHLBs were required to wind down their relationships with any captive insurance companies that had been admitted to membership on or after September 12, 2014, including Orchid Island Casualty ("Post-NPR Captives"). The Final Rule also precludes the FHLBs from making any new advances or extending existing advances to Post-NPR Captives. In addition, upon the termination of membership, the FHLBs were required to liquidate all outstanding advances to Post-NPR Captives, settle all other business transactions, and repurchase or redeem all FHLB stock held by the terminated Post-NPR Captive in accordance with the Final Rule. Therefore, Orchid Island Casualty, along with all other Post-NPR Captives, was required to completely wind down all business relationships with the FHLB, including the repayment of all outstanding advances, prior to or simultaneously with the termination of Orchid Island Casualty's membership with the FHLB.

The adopting release for the Final Rule expressly invited Congress to address the treatment of Post-NPR Captives with respect to membership in the FHLB. In October 2015, Reps. Blaine Luetkemeyer (R-Mo.), Denny Heck (D-Wash.), Patrick McHenry (R-N.C.) and John Carney (D-Del.) introduced H.R. 3808, a bill that would have preemptively prevented the FHFA from adopting the Final Rule in such a way that would foreclose membership in the FHLB to captive insurance companies. There can be no way of predicting if any subsequent legislation addressing the status of Post-NPR Captives with respect to the FHLB will be proposed in either house of Congress, the likelihood of passage of any such legislation, and the ultimate effects, if any, on the availability of short-term, low-cost funding provided by the FHLBs to Post-NPR Captives subsequent to the enactment of any such legislation.

The scope and nature of the actions the U.S. government or the Fed will ultimately undertake are unknown and will continue to evolve. Although the Trump administration has made statements of its intentions to reform housing finance and tax policy, many of these potential policy changes will require congressional action. In addition, the Fed has made statements regarding additional increases to the Federal Funds Rate in 2018 and beyond.

In September 2017, the FOMC announced that it would implement a balance sheet normalization policy by gradually decreasing the Fed's reinvestment of U.S. Treasuries and Agency RMBS. More specifically, principal payments received by the Fed will be reinvested only to the extent they exceed gradually rising caps until the FOMC determines that the Fed is holding no more securities than necessary to implement monetary policy efficiently and effectively. In October 2017, the FOMC commenced this balance sheet normalization program. During the January 2018 meeting, the FOMC reaffirmed this plan.

On January 30, 2018, legislation was introduced in the United States Senate that would permit captive insurance companies that were FHLB members prior to January 19, 2016 to restore or continue their membership in the FHLB. In June 2017, legislation was introduced in the United States House of Representatives that would permit a captive insurance company that was admitted to the FHLB prior to September 12, 2014 to continue its membership in the FHLB. The Company joined the FHLBC after September 12, 2014, so the House version of the legislation would not permit the Company to rejoin the FHLBC. It is still uncertain whether legislation on FHLB membership will be adopted, and if so, whether it would permit us to rejoin the FHLB.

#### Effect on Us

Regulatory developments, movements in interest rates and prepayment rates 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.

Higher long-term rates can also affect the value of our Agency RMBS. As long-term rates rise, rates available to borrowers also rise. This tends to cause prepayment activity to slow and extend the expected average life of mortgage cash flows. As the expected average life of the mortgage cash flows increases, coupled with higher discount rates, the value of Agency RMBS declines. Some of the instruments the Company uses to hedge our Agency RMBS assets, such as Euro Dollar futures, swaps, interest rate futures and swaptions, are stable average life instruments. This means that to the extent we use such instruments to hedge our Agency RMBS assets, our hedges may not adequately protect us from price declines, and therefore may negatively impact our book value. It is for this reason we use interest only securities in our portfolio. As interest rates rise, the expected average life of these securities increases, causing generally positive price movements as the number and size of the cash flows increase the longer the underlying mortgages remain outstanding. This makes interest only securities desirable hedge instruments for pass-through Agency RMBS.

As the economy has rebounded from the financial crisis, the Fed has taken steps to remove the considerable accommodation that was employed to combat the crisis. At the conclusion of its meeting in September 2017, the Fed announced it would implement caps on the amount of Agency RMBS assets it would allow to run off, or not be re-invested, starting in October 2017. Previously the Fed would re-invest all of the principal repayments it received each month on the Agency RMBS assets it had acquired during its quantitative easing programs. By capping the amount they would allow to run off each month, the Fed was effectively limiting the amount it would re-invest. Per the Fed's September 2017 announcement, the cap would eventually reach \$20 billion per month by the end of 2018. At the time of the Fed's announcement in September 2017, its monthly re-investments were approximately \$20 billion per month as well, so this implied the Fed would stop, or nearly stop, re-investing its monthly pay-downs by the end of 2018. The purchases each month by the Fed have been a significant source of demand in the Agency RMBS market and as it is reduced slowly over the course of 2018 and essentially eliminated beyond 2018, the removal of this source of demand could negatively impact Agency RMBS prices. The extent this negatively impacts the Agency RMBS market will be a function of the level of supply each month – as the supply/demand balance affects the price of any asset – and whether or not another source of demand emerges to replace the Fed.

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 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 PT RMBS, particularly PT RMBS backed by fixed-rate mortgages.

If Fannie Mae and Freddie Mac were to modify or end their repurchase programs, our investment portfolio could be negatively impacted.





### Effects on our borrowing costs

We leverage our PT 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 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, or utilize other hedging instruments such as Eurodollar and T-Note futures contracts or interest rate swaptions.

### Summary

The U.S. economy appears to be very strong. Growth in the second quarter of 2018 is expected to be 4% or higher on an annualized basis and, given the extent of fiscal stimulus introduced by the Tax Cuts and Jobs Act of 2017 and the Bipartisan Budget Act of 2018, is likely to remain strong for the foreseeable future. The Fed expects to continue to remove accommodation by raising the target range for the Federal Funds rate two more times in 2018 and three more times in 2019. By any measure, economic activity is robust and the employment market in particular appears to be overheating. Importantly, while inflation has returned to, or near, the Fed target level of 2%, it does not appear to be at risk of meaningfully exceeding this level in the near term. This should keep the Fed from raising rates beyond their current gradual pace.

One threat to the economy the market fears is a meaningful trade war. The Trump administration appears determined to reverse what the President sees as years of unfair trade that has weakened the United States. The administration has aggressively introduced tariffs in an apparent attempt to force our various trading counter-parties to agree to more even trade terms. To date, this strategy does not appear to be working, and the market fears a protracted trade war could develop. This threat seems to be trumping the effect of the economy on both the rates markets and risky asset markets. The perception that the strength of the economy will keep the Fed from raising short-term rates and the lack of inflation, coupled with the possible detrimental effects of a trade war slowing growth in the future, has kept long-term rates contained. The combination has caused the spread between short and long term rates to compress. This appears likely to continue.

The Agency RMBS market has generated a modest positive return of 0.24% for the second quarter and (1.0%) for 2018 to date. The reduction in asset purchases by the Fed has been offset by reduced supply of Agency RMBS, negating the negative effect of the former on the performance of the asset class. A continued slowing of prepayment behavior has benefited higher coupon mortgages as well, further negating the effect of reduced purchases by the Fed. Going forward, the continued compression of the yield curve should put downward pressure on both returns for Agency RMBS as well as demand for the asset class.

### Critical Accounting Policies

Our condensed consolidated 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. There have been no changes to our critical accounting policies as discussed in our annual report on Form 10-K for the year ended December 31, 2017.

### Capital Expenditures

At June 30, 2018, we had no material commitments for capital expenditures.

43

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## Off-Balance Sheet Arrangements

At June 30, 2018, we did not have any off-balance sheet arrangements.

## Dividends

In addition to other requirements that must be satisfied 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. REIT taxable income (loss) is computed in accordance with the Code, and can be greater than or less than our financial statement net income (loss) computed in accordance with GAAP. These book to tax differences primarily relate to the recognition of interest income on RMBS, unrealized gains and losses on RMBS, and the amortization of losses on derivative instruments that are treated as funding hedges for tax purposes.

We intend to pay regular monthly dividends to our stockholders and have declared the following dividends since the completion of our IPO.

(in thousands, except per share amounts)

| Year                      | Per Share Amount | Total     |
|---------------------------|------------------|-----------|
| 2013                      | \$ 1.395         | \$4,662   |
| 2014                      | 2.160            | 22,643    |
| 2015                      | 1.920            | 38,748    |
| 2016                      | 1.680            | 41,388    |
| 2017                      | 1.680            | 70,717    |
| 2018 - YTD <sup>(1)</sup> | 0.670            | 35,313    |
| Totals                    | \$ 9.505         | \$213,471 |

On July 18, 2018, the Company declared a dividend of \$0.09 per share to be paid on August 10, 2018. The effect (1) of this dividend is included in the table above but is not reflected in the Company's financial statements as of June 30, 2018.

## 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 consolidated 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

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk, prepayment risk, spread risk, liquidity risk, extension risk and counterparty credit risk.

#### Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the RMBS that constitute our investment portfolio, which affects our net income, ability to realize gains from the sale of these assets and ability to borrow, and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations. The principal instruments that we use are futures contracts and options to enter into interest rate swaps. These instruments are intended to serve as a hedge against future interest rate increases on our repurchase agreement borrowings. Hedging techniques are partly based on assumed levels of prepayments of our Agency RMBS. If prepayments are slower or faster than assumed, the life of the Agency RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns. Hedging techniques are also limited by the rules relating to REIT qualification. In order to preserve our REIT status, we may be forced to terminate a hedging transaction at a time when the transaction is most needed.

Our profitability and the value of our investment portfolio (including derivatives used for hedging purposes) may be adversely affected during any period as a result of changing interest rates, including changes in the forward yield curve.

Our portfolio of PT RMBS is typically comprised of adjustable-rate RMBS ("ARMs"), fixed-rate RMBS and hybrid adjustable-rate RMBS. We generally seek to acquire low duration assets that offer high levels of protection from mortgage prepayments provided they are 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 RMBS portfolio with an effective duration of less than 2.0. The stated contractual final maturity of the mortgage loans underlying our portfolio of PT RMBS 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 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 IOs may cause their durations to become extremely negative when prepayments are high, and less negative when prepayments are low. Prepayments affect the durations of IIOs similarly, but the floating rate nature of the coupon of IIOs (which is inversely related to the level of one month LIBOR) causes 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 RMBS can alter the timing of the cash flows from the underlying loans to us. As a result, we gauge the interest rate sensitivity of our 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 RMBS assets will increase or decrease at different rates than that of our structured RMBS 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 June 30, 2018 and December 31, 2017, assuming rates instantaneously fall 200 bps, fall 100 bps, fall 50 bps, rise 50 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' effective duration to movements in interest rates.

All changes in value in the table below are measured as percentage changes from the investment portfolio value and net asset value at the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of June 30, 2018 and December 31, 2017. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and hedge positions, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections and could be larger or smaller than the estimates in the table below. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate increases and decreases on a static portfolio, we may from time to time sell any of our agency securities as a part of our overall management of our investment portfolio.

Interest Rate Sensitivity<sup>(1)</sup>

| Change in Interest Rate | Portfolio                      |    | Book                    |    |
|-------------------------|--------------------------------|----|-------------------------|----|
|                         | Market Value <sup>(2)(3)</sup> |    | Value <sup>(2)(4)</sup> |    |
| As of June 30, 2018     |                                |    |                         |    |
| -200 Basis Points       | (1.37                          | )% | (12.31                  | )% |
| -100 Basis Points       | (0.20                          | )% | (1.80                   | )% |
| -50 Basis Points        | 0.07                           | %  | 0.64                    | %  |
| +50 Basis Points        | (0.23                          | )% | (2.08                   | )% |
| +100 Basis Points       | (0.50                          | )% | (4.52                   | )% |
| +200 Basis Points       | (1.64                          | )% | (14.80                  | )% |
| As of December 31, 2017 |                                |    |                         |    |
| -200 Basis Points       | (0.94                          | )% | (7.62                   | )% |
| -100 Basis Points       | (0.32                          | )% | (2.63                   | )% |
| -50 Basis Points        | (0.21                          | )% | (1.73                   | )% |
| +50 Basis Points        | (0.59                          | )% | (4.82                   | )% |



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|                   |          |           |
|-------------------|----------|-----------|
| +100 Basis Points | (1.61 )% | (13.05 )% |
| +200 Basis Points | (4.67 )% | (37.84 )% |

Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties as well as by our Manager, and assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.

(2) Includes the effect of derivatives and other securities used for hedging purposes.

(3) Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.

(4) Estimated dollar change in portfolio value expressed as a percent of stockholders' equity as of such date.

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.

#### Prepayment Risk

Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Various factors affect the rate at which mortgage prepayments occur, including changes in the level of and directional trends in housing prices, interest rates, general economic conditions, loan age and size, loan-to-value ratio, the location of the property and social and demographic conditions. Additionally, changes to GSE underwriting practices or other governmental programs could also significantly impact prepayment rates or expectations. Generally, prepayments on Agency RMBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case. We may reinvest principal repayments at a yield that is lower or higher than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets.

#### Spread Risk

When the market spread widens between the yield on our Agency RMBS and benchmark interest rates, our net book value could decline if the value of our Agency RMBS falls by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk." The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Fed, market liquidity, or changes in required rates of return on different assets. Consequently, while we use futures contracts and interest rate swaps and swaptions to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

#### Liquidity Risk

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements. Our assets that are pledged to secure repurchase agreements are Agency RMBS and cash. As of June 30, 2018, we had unrestricted cash and cash equivalents of \$137.9 million and unpledged securities of approximately \$45.4 million (not including securities pledged to us) available to meet margin calls on our repurchase agreements and derivative contracts, and for other corporate purposes. However, should the value of our Agency RMBS pledged as collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our repurchase and derivative agreements could increase, causing an adverse change in our liquidity position. Further, there is no assurance that we will always be able to renew (or roll) our repurchase agreements. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge against repurchase agreements, thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll the repurchase agreement. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

## Extension Risk

The projected weighted average life and the duration (or interest rate sensitivity) of our investments is based on our Manager's assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use futures contracts and interest rate swaps and swaptions to help manage our funding cost on our investments in the event that interest rates rise. These hedging instruments allow us to reduce our funding exposure on the notional amount of the instrument for a specified period of time.

However, if prepayment rates decrease in a rising interest rate environment, the average life or duration of our fixed-rate assets or the fixed-rate portion of the ARMs or other assets generally extends. This could have a negative impact on our results from operations, as our hedging instrument expirations are fixed and will, therefore, cover a smaller percentage of our funding exposure on our mortgage assets to the extent that their average lives increase due to slower prepayments. This situation may also cause the market value of our agency securities collateralized by fixed rate mortgages or hybrid ARMs to decline by more than otherwise would be the case, while most of our hedging instruments would not receive any incremental offsetting gains. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses.

## Counterparty Credit Risk

We are exposed to counterparty credit risk relating to potential losses that could be recognized in the event that the counterparties to our repurchase agreements and derivative contracts fail to perform their obligations under such agreements. The amount of assets we pledge as collateral in accordance with our agreements varies over time based on the market value and notional amount of such assets as well as the value of our derivative contracts. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our agreements and may have difficulty obtaining our assets pledged as collateral under such agreements. Our credit risk related to certain derivative transactions is largely mitigated through daily adjustments to collateral pledged based on changes in market value, and we limit our counterparties to major financial institutions with acceptable credit ratings. However, there is no guarantee our efforts to manage counterparty credit risk will be successful and we could suffer significant losses if unsuccessful.

## 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 subsidiary 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 our 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 as described in Item 103 of Regulation S-K.

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 with the SEC on February 15, 2018.

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

The table below presents share repurchase activity for the three months ended June 30, 2018.

|                           | Total Number<br>of Shares<br>Repurchased <sup>(1)</sup> | Weighted-Average<br>Price Paid<br>Per Share | Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Programs <sup>(2)</sup> | Maximum<br>Number<br>of Shares That<br>May Yet<br>Be Repurchased<br>Under<br>the<br>Authorization <sup>(2)</sup> |
|---------------------------|---|---|---|--|
| April                     | 8,088   | \$ 7.45                                     | -   | 5,306,579  |
| May                       | 1,068,841   | 7.19  | 1,068,841   | 4,237,738  |
| June                      | 1,077   | 7.50  | -   | 4,237,738  |
| Totals / Weighted Average | 1,078,006   | \$ 7.19                                     | 1,068,841   | 4,237,738  |

(1) Includes shares of the Company's common stock acquired by the Company in connection with the satisfaction of tax withholding obligations on vested employment-related awards under equity incentive plans.

On July 29, 2015, the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of the Company's common stock. On February 8, 2018, the Board of Directors approved an increase in the stock repurchase program for up to an additional 4,522,822 shares of the Company's common stock. Unless modified or revoked by the Board, the authorization does not expire.

The Company did not have any unregistered sales of its equity securities during the three months ended June 30, 2018.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.

- Articles of Amendment and Restatement of Orchid Island Capital, Inc. (filed as Exhibit 3.1 to the Company's  
3.1 Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012  
and incorporated herein by reference).  
Amended and Restated Bylaws of Orchid Island Capital, Inc. (filed as Exhibit 3.2 to the Company's Registration  
3.2 Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012 and  
incorporated herein by reference).  
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 George H. 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.  
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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.

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.

Orchid Island Capital, Inc.  
Registrant

Date: July 27, 2018 By: /s/ Robert E. Cauley  
Robert E. Cauley  
Chief Executive Officer,  
President and Chairman of  
the Board

Date: July 27, 2018 By: /s/ George H. Haas, IV  
George H. Haas, IV  
Secretary, Chief Financial  
Officer, Chief Investment  
Officer and Director  
(Principal Financial and  
Accounting Officer)

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