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Two Harbors Investment Corp.
Form 10-Q
August 03, 2012

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, 2012

Commission File Number 001-34506

TWO HARBORS INVESTMENT CORP.
(Exact Name of Registrant as Specified in Its Charter)

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

601 Carlson Parkway, Suite 150 55305
Minnetonka, Minnesota (Zip Code)
(Address of Principal Executive Offices)
(612) 629-2500
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of August 3, 2012 there were 279,354,704 shares of outstanding common stock, par value \$.01 per share, issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Available-for-sale securities, at fair value	\$10,724,149	\$6,249,252
Trading securities, at fair value	999,375	1,003,301
Mortgage loans held-for-sale, at fair value	11,378	5,782
Investment in real estate, net	71,726	—
Cash and cash equivalents	496,674	360,016
Restricted cash	138,336	166,587
Accrued interest receivable	35,954	23,437
Due from counterparties	81,039	32,587
Derivative assets, at fair value	361,073	251,856
Other assets	60,998	7,566
Total Assets	\$12,980,702	\$8,100,384
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	\$10,438,441	\$6,660,148
Derivative liabilities, at fair value	82,619	49,080
Accrued interest payable	11,545	6,456
Due to counterparties	166,949	45,565
Accrued expenses	11,164	8,912
Dividends payable	87,061	56,239
Income taxes payable	266	3,898
Total liabilities	10,798,045	6,830,298
Stockholders' Equity		
Preferred stock, par value \$0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value \$0.01 per share; 450,000,000 shares authorized and 219,655,462 and 140,596,708 shares issued and outstanding, respectively	2,196	1,406
Additional paid-in capital	2,142,554	1,373,099
Receivable from issuance of common stock	(22,248) —
Accumulated other comprehensive income (loss)	202,798	(58,716)
Cumulative earnings	233,256	157,452
Cumulative distributions to stockholders	(375,899	) (203,155)
Total stockholders' equity	2,182,657	1,270,086
Total Liabilities and Stockholders' Equity	\$12,980,702	\$8,100,384

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

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	(unaudited)		(unaudited)	
Interest income:				
Available-for-sale securities	\$ 104,319	\$ 39,959	\$ 188,533	\$ 59,494
Trading securities	1,250	805	2,300	1,077
Mortgage loans held-for-sale	126	—	195	—
Cash and cash equivalents	209	64	377	127
Total interest income	105,904	40,828	191,405	60,698
Interest expense	15,527	3,863	26,994	6,362
Net interest income	90,377	36,965	164,411	54,336
Other-than-temporary impairments:				
Total other-than temporary impairment losses	(4,476	) (294	) (8,751	) (294
Non-credit portion of loss recognized in other comprehensive income	—	—	—	—
Net other-than-temporary credit impairment losses	(4,476	) (294	) (8,751	) (294
Other income:				
Gain on investment securities, net	1,789	3,189	11,720	4,728
Loss on interest rate swap and swaption agreements	(61,014	) (50,808	) (77,207	) (48,869
(Loss) gain on other derivative instruments	(7,617	) 9,766	(16,507	) 15,113
Other income	131	—	91	—
Total other loss	(66,711	) (37,853	) (81,903	) (29,028
Expenses:				
Management fees	7,610	2,728	14,353	4,278
Other operating expenses	4,181	2,155	7,782	3,667
Total expenses	11,791	4,883	22,135	7,945
Income (loss) before income taxes	7,399	(6,065	) 51,622	17,069
Benefit from income taxes	(16,605	) (5,081	) (24,182	) (4,324
Net income (loss) attributable to common stockholders	\$24,004	\$(984	) \$75,804	\$21,393
Basic and diluted earnings (loss) per weighted average common share	\$0.11	\$(0.01	) \$0.38	\$0.35
Dividends declared per common share	\$0.40	\$0.40	\$0.80	\$0.80
Basic and diluted weighted average number of shares of common stock	214,810,579	77,101,606	200,833,084	61,443,978
Comprehensive income:				
Net income (loss)	\$24,004	\$(984	) \$75,804	\$21,393
Other comprehensive income:				
Unrealized gain on available-for-sale securities, net	117,604	14,514	261,514	23,629
Other comprehensive income	117,604	14,514	261,514	23,629
Comprehensive income	\$ 141,608	\$ 13,530	\$ 337,318	\$ 45,022

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

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

	Common Stock			Receivable from Issuance of Common Stock	Accumulated Other Comprehensive Income (Loss) (unaudited)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity
	Shares	Amount	Additional Paid-in Capital					
Balance, January 1, 2011	40,501,212	\$405	\$366,974	\$—	\$ 22,619	\$ 30,020	\$(37,570)	\$ 382,448
Net income	—	—	—	—	—	21,393	—	21,393
Other comprehensive income	—	—	—	—	23,629	—	—	23,629
Net proceeds from issuance of common stock, net of offering costs	51,769,180	518	522,558	—	—	—	—	523,076
Common dividends declared	—	—	—	—	—	—	\$(53,112)	\$(53,112)
Non-cash equity award compensation	7,599	—	147	—	—	—	—	147
Balance, June 30, 2011	92,277,991	\$923	\$889,679	\$—	\$ 46,248	\$ 51,413	\$(90,682)	\$ 897,581
Balance, January 1, 2012	140,596,708	\$1,406	\$1,373,099	\$—	\$(58,716)	\$ 157,452	\$(203,155)	\$ 1,270,086
Net income	—	—	—	—	—	75,804	—	75,804
Other comprehensive income	—	—	—	—	261,514	—	—	261,514
Net proceeds from issuance of common stock, net of offering costs	79,058,754	790	769,022	—	—	—	—	769,812
Increase in receivable from issuance of	—	—	—	(22,248)	—	—	—	(22,248)

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common stock								
Common								
dividends	—	—	—	—	—	—	(172,744)	(172,744)
declared								
Non-cash equity								
award	—	—	433	—	—	—	—	433
compensation								
Balance, June 30,	219,655,462	\$2,196	\$2,142,554	\$(22,248)	\$202,798	\$233,256	\$(375,899)	\$2,182,657
2012								

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

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

	Six Months Ended	
	June 30,	2011
	2012	(unaudited)
Cash Flows From Operating Activities:		
Net income	\$75,804	\$21,393
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of premiums and discounts on RMBS, net	(9,058)	) 4,693
Other-than-temporary impairment losses	8,751	294
Gain on investment securities, net	(11,720)	) (4,728)
Loss on termination and option expiration of interest rate swaps and swaptions	18,540	227
Unrealized loss on interest rate swaps and swaptions	46,296	38,351
Unrealized gain on other derivative instruments	(4,773)	) (5,893)
Unrealized gain on mortgage loans	(4)) —
Equity based compensation expense	433	147
Depreciation of real estate	32	—
Purchases of mortgage loans held-for-sale	(6,618)) —
Proceeds from repayment of mortgage loans held-for-sale	1,026	—
Net change in assets and liabilities:		
Increase in accrued interest receivable	(12,517)	) (12,334)
Increase in deferred income taxes, net	(19,720)	) (4,330)
Increase in current income tax receivable	(4,465)) —
(Increase)/decrease in prepaid and fixed assets	(554)	) 157
Increase in accrued interest payable, net	5,089	2,085
(Decrease)/increase in income taxes payable	(3,632)	) 5
Increase in accrued expenses	2,252	2,858
Net cash provided by operating activities	85,162	42,925
Cash Flows From Investing Activities:		
Purchases of available-for-sale securities	(4,696,861)	) (3,338,528)
Proceeds from sales of available-for-sale securities	197,714	95,782
Principal payments on available-for-sale securities	295,829	116,651
Purchases of other derivative instruments	(205,440)	) (165,831)
Proceeds from sales of other derivative instruments	69,699	19,572
Purchases of trading securities	(996,016)	) (1,319,959)
Proceeds from sales of trading securities	1,001,904	500,133
Purchases of investments in real estate	(71,758)) —
Increase in escrow deposits	(28,693)) —
Increase (decrease) in due to counterparties, net	72,932	(19,866)
Decrease (increase) in restricted cash	28,251	(66,695)
Net cash used in investing activities	(4,332,439)	) (4,178,741)

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

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

	Six Months Ended	
	June 30,	
	2012	2011
	(unaudited)	
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	\$23,100,723	\$8,283,571
Principal payments on repurchase agreements	(19,322,430)	(4,626,172)
Proceeds from issuance of common stock, net of offering costs	769,812	523,076
Increase in receivable from issuance of common stock	(22,248)	—
Dividends paid on common stock	(141,922)	(26,650)
Net cash provided by financing activities	4,383,935	4,153,825
Net increase in cash and cash equivalents	136,658	18,009
Cash and cash equivalents at beginning of period	360,016	163,900
Cash and cash equivalents at end of period	\$496,674	\$181,909
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$10,438	\$4,277
Cash paid for taxes	\$3,635	\$1
Non-Cash Financing Activity:		
Dividends declared but not paid at end of period	\$87,061	\$36,911
Reconciliation of mortgage loans held-for-sale:		
Mortgage loans held-for-sale at beginning of period	\$5,782	\$—
Purchases of mortgage loans held-for-sale	6,618	—
Proceeds from repayment of mortgage loans held-for-sale	(1,026)	—
Unrealized gain on mortgage loans	4	—
Loans held-for-sale at end of period	\$11,378	\$—

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

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TWO HARBORS INVESTMENT CORP.

Notes to the Condensed Consolidated Financial Statements (unaudited)

Note 1. Organization and Operations

Two Harbors Investment Corp., or the Company, is a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, residential real properties, and other financial assets. The Company is externally managed and advised by PRCM Advisers LLC, a subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm. The Company's common stock is listed on the NYSE and its warrants are listed on the NYSE MKT under the symbols "TWO" and "TWO.WS," respectively.

The Company has elected to be treated as a real estate investment trust, or REIT, for U.S. federal income tax purposes commencing with its initial taxable period ended December 31, 2009. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income which will not be qualifying income for REIT purposes. The Company has designated certain of its subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and the Company may in the future form additional TRSs.

Note 2. Basis of Presentation and Significant Accounting Policies

Consolidation and Basis of Presentation

The interim unaudited condensed co