

Orchid Island Capital, Inc.  
Form 10-Q  
October 28, 2014

---

---

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 September 30, 2014

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

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

Commission File Number: 001-35236

Orchid Island Capital, Inc.

(Exact name of registrant as specified in its charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)

27-3269228  
(I.R.S. Employer  
Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  
 Smaller Reporting Company

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

Number of shares outstanding at October 28, 2014: 13,076,981

---

ORCHID ISLAND CAPITAL, INC.

TABLE OF CONTENTS

	Page
<b>PART I. FINANCIAL INFORMATION</b>	
<b>ITEM 1. Financial Statements</b>	<b>1</b>
Balance Sheets as of September 30, 2014 (unaudited) and December 31, 2013	1
Statements of Operations (unaudited) for the nine and three months ended September 30, 2014 and 2013	2
Statement of Stockholders' Equity (unaudited) for the nine months ended September 30, 2014	3
Statements of Cash Flows (unaudited) for the nine months ended September 30, 2014 and 2013	4
<b>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</b>	<b>21</b>
<b>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</b>	<b>44</b>
<b>ITEM 4. Controls and Procedures</b>	<b>44</b>
<b>PART II. OTHER INFORMATION</b>	
<b>ITEM 1. Legal Proceedings</b>	<b>43</b>
<b>ITEM 1A. Risk Factors</b>	<b>45</b>
<b>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</b>	<b>45</b>
<b>ITEM 3. Defaults Upon Senior Securities</b>	<b>45</b>
<b>ITEM 4. Mine Safety Disclosures</b>	<b>45</b>
<b>ITEM 5. Other Information</b>	<b>45</b>
<b>ITEM 6. Exhibits</b>	<b>46</b>
<b>SIGNATURES</b>	<b>47</b>

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

ORCHID ISLAND CAPITAL, INC.  
BALANCE SHEETS

	(Unaudited) September 30, 2014	December 31, 2013
<b>ASSETS:</b>		
Mortgage-backed securities, at fair value		
Pledged to counterparties	\$ 1,073,815,699	\$ 335,774,980
Unpledged	101,716,731	15,447,532
Total mortgage-backed securities	1,175,532,430	351,222,512
Cash and cash equivalents	55,026,519	8,169,402
Restricted cash	7,781,000	2,445,625
Accrued interest receivable	5,655,306	1,559,437
Derivative assets, at fair value	3,906,100	-
Receivable for securities sold, pledged to counterparties	249,410,368	-
Other assets	3,344,623	179,071
Total Assets	\$ 1,500,656,346	\$ 363,576,047
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Repurchase agreements	\$ 1,255,977,886	\$ 318,557,054
Payable for unsettled securities purchased	66,812,482	-
Accrued interest payable	387,919	91,461
Due to affiliates	303,358	81,925
Other liabilities	4,388,200	80,260
Total Liabilities	1,327,869,845	318,810,700
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding as of September 30, 2014 and December 31, 2013	-	-
Common Stock, \$0.01 par value; 500,000,000 shares authorized, 13,024,449 shares issued and outstanding as of September 30, 2014 and 3,341,665 shares issued and outstanding as of December 31, 2013	130,244	33,417
Additional paid-in capital	167,585,817	46,115,961
Retained earnings (accumulated deficit)	5,070,440	(1,384,031 )
Total Stockholders' Equity	172,786,501	44,765,347
Total Liabilities and Stockholders' Equity	\$ 1,500,656,346	\$ 363,576,047

See Notes to Financial Statements



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

For the Nine and Three Months Ended September 30, 2014 and 2013

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	2013	2014	2013
Interest income	\$19,657,656	\$6,393,156	\$9,285,729	\$2,551,199
Interest expense	(1,904,894 )	(817,219 )	(818,383 )	(293,913 )
Net interest income	17,752,762	5,575,937	8,467,346	2,257,286
Realized gains (losses) on mortgage-backed securities	1,931,617	(1,490,712)	(1,959,822 )	(667,182 )
Unrealized gains (losses) on mortgage-backed securities	8,719,844	(9,072,712)	(1,404,122 )	86,070
(Losses) gains on derivative instruments	(4,363,837 )	4,095,788	3,057,651	(2,271,875)
Net portfolio income (loss)	24,040,386	(891,699 )	8,161,053	(595,701 )
<b>Expenses:</b>				
Management fees	1,275,500	489,700	543,000	179,500
Accrued incentive compensation	450,000	-	225,000	-
Directors' fees and liability insurance	404,927	207,309	164,641	82,924
Audit, legal and other professional fees	405,697	321,436	160,260	70,949
Direct REIT operating expenses	124,358	133,399	35,973	36,550
Other administrative	381,213	99,358	263,693	31,483
Total expenses	3,041,695	1,251,202	1,392,567	401,406
Net income (loss)	\$20,998,691	\$(2,142,901)	\$6,768,486	\$(997,107 )
Basic and diluted net income (loss) per share	\$2.53	\$(0.74 )	\$0.63	\$(0.30 )
Weighted Average Shares Outstanding	8,314,512	2,900,786	10,710,153	3,341,665
Dividends declared per common share	\$1.620	\$0.945	\$0.540	\$0.405
See Notes to Financial Statements				

ORCHID ISLAND CAPITAL, INC.  
STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
For the Nine Months Ended September 30, 2014

	Common Stock	Additional Paid-in Capital	(Accumulated Deficit) / Retained Earnings	Total
Balances, January 1, 2014	\$33,417	\$46,115,961	\$ (1,384,031 )	\$44,765,347
Net income	-	-	20,998,691	20,998,691
Cash dividends declared, \$1.62 per share	-	-	(14,544,220 )	(14,544,220 )
Issuance of common stock pursuant to public offerings	96,769	121,352,215	-	121,448,984
Issuance of common stock pursuant to equity compensation plan	58	76,874	-	76,932
Amortization of equity plan compensation	-	40,767	-	40,767
Balances, September 30, 2014	\$ 130,244	\$ 167,585,817	\$ 5,070,440	\$ 172,786,501
See Notes to Financial Statements				

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

For the Nine Months Ended September 30, 2014 and 2013

	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$20,998,691	\$(2,142,901 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock based compensation	117,699	-
Realized and unrealized (gains) losses on mortgage-backed securities	(10,651,461 )	10,563,424
Realized and unrealized losses on interest rate swaptions	1,119,525	-
Changes in operating assets and liabilities:		
Accrued interest receivable	(4,005,742 )	(907,884 )
Other assets	(253,038 )	(118,425 )
Accrued interest payable	296,458	23,613
Other liabilities	531,940	(19,540 )
Due to affiliates	221,433	125,004
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>8,375,505</b>	<b>7,523,291</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
From mortgage-backed securities investments:		
Purchases	(1,521,605,989)	(489,923,917 )
Sales	470,012,125	237,375,025
Principal repayments	52,334,880	22,563,699
Increase in restricted cash	(5,335,375 )	(2,131,875 )
Purchase of interest rate swaptions, net of margin cash received	(1,249,625 )	-
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(1,005,843,984)</b>	<b>(232,117,068 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from repurchase agreements	5,306,415,537	2,423,975,175
Principal payments on repurchase agreements	(4,368,994,705)	(2,226,259,826)
Cash dividends	(14,544,220 )	(3,157,873 )
Proceeds from issuance of common stock, net of issuance costs	121,448,984	35,400,000
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>1,044,325,596</b>	<b>229,957,476</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>46,857,117</b>	<b>5,363,699</b>
<b>CASH AND CASH EQUIVALENTS, beginning of the period</b>	<b>8,169,402</b>	<b>2,537,257</b>
<b>CASH AND CASH EQUIVALENTS, end of the period</b>	<b>\$55,026,519</b>	<b>\$7,900,956</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$1,608,436	\$793,606
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING ACTIVITIES:</b>		
Securities acquired settled in later period	\$66,812,482	\$38,720,351
Securities sold settled in later period	249,410,368	40,955,374

**SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITY:**

Issuance of common shares to Bimini Capital Management, Inc. pursuant to stock dividend	\$-	\$8,276
See Notes to Financial Statements		

ORCHID ISLAND CAPITAL, INC.  
NOTES TO FINANCIAL STATEMENTS  
(Unaudited)  
SEPTEMBER 30, 2014

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. Orchid is an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”).

Orchid completed a secondary offering of 1,800,000 common shares on January 23, 2014. The underwriters exercised their overallotment option in full for an additional 270,000 shares on January 29, 2014. The aggregate net proceeds to Orchid were approximately \$24.2 million which were invested in Agency RMBS securities on a leveraged basis.

Orchid completed a secondary offering of 3,200,000 common shares on March 24, 2014. The underwriters exercised their overallotment option in full for an additional 480,000 shares on April 11, 2014. The aggregate net proceeds to Orchid were approximately \$44.0 million which were invested in Agency RMBS securities on a leveraged basis.

On June 17, 2014, Orchid entered into an equity distribution agreement (the “June 2014 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 \$35,000,000 of shares of the Company’s common stock in transactions that are deemed to be “at-the-market” offerings and privately negotiated transactions. Through September 2, 2014, with final settlement on September 5, 2014, the Company issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees.

On September 3, 2014, Orchid entered into a second equity distribution agreement (the “September 2014 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 \$75,000,000 of shares of the Company’s common stock in transactions that are deemed to be “at-the-market” offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. Through September 30, 2014, the Company issued a total of 1,398,524 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$19.1 million, net of commissions and fees. After September 30, 2014, the Company issued an additional 52,532 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$0.7 million, net of commissions and fees.

#### Basis of Presentation and Use of Estimates

The accompanying unaudited 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. 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 nine and three month periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The balance sheet at December 31, 2013 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, 2013.

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, Eurodollar futures contracts and the interest rate swaptions.

#### Statement of Comprehensive Income (Loss)

In accordance with the Financial Accounting Standards Board’s Accounting Standards Codification (“FASB ASC”) Topic 220, Comprehensive Income, a statement of comprehensive income has not been included as the Company has no items of other comprehensive income. Comprehensive income is the same as net income 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 September 30, 2014 restricted cash consisted of \$3,000,000 of cash held by a broker as margin on Eurodollar futures contracts and \$4,781,000 of cash held on deposit as collateral with repurchase agreement counterparties. At December 31, 2013 restricted cash consisted of approximately \$2,446,000 of cash held by a broker as margin on Eurodollar futures contracts.

The Company maintains cash balances at four banks, 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 September 30, 2014, the Company’s cash deposits exceeded federally insured limits by approximately \$54.1 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 uses only large, well-known bank and derivative counterparties 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, and interest only (“IO”) securities and inverse interest only (“IIO”) securities representing interest in or obligations backed by pools of mortgage-backed loans (collectively, “RMBS”). These investments meet the requirements to be classified as available for sale under ASC 320-10-25, Debt and Equity Securities (which requires the securities to be carried at fair value on the balance sheet with changes in fair value charged to other comprehensive income, a component of stockholders’ equity). However, the Company has elected to account for its investment in RMBS under the fair value option. Electing the fair value option requires the Company to record changes in fair value in the statement of operations, which, in management’s view, more appropriately reflects the results of our operations for a particular reporting period and is consistent with the underlying economics and how the portfolio is managed.

The Company records 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. For IO securities, the income is accrued based on the carrying value and the effective yield. The difference between income accrued and the interest received on the security is characterized as a return of investment and serves to reduce the asset’s carrying value. At each reporting date, the effective yield is adjusted prospectively from the reporting period based on the new estimate of prepayments and the contractual terms of the security. For IIO securities, effective yield and income recognition calculations also take into account the index value applicable to the security. Changes in fair value of RMBS during each reporting period are recorded in earnings and reported as unrealized gains or losses on mortgage-backed securities in the accompanying statements of operations.

## Derivative Financial Instruments

The Company 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 T-Note and Eurodollar futures contracts and options to enter in interest rate swaps (“interest rate swaptions”), but may enter into other transactions in the future. The Company has elected to not treat any of its derivative financial instruments as hedges. FASB ASC Topic 815, Derivatives and Hedging, requires that all derivative instruments be carried at fair value. Changes in fair value are recorded in earnings for each period.

Holding derivatives creates exposure to credit risk related to the potential for failure on the part of counterparties 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 as counterparties.

7

---

## 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 and interest rate swaptions are accounted for at fair value in the balance sheet. The methods and assumptions used to estimate fair value for these instruments are presented in Note 11 of the financial statements.

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, 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 September 30, 2014 and December 31, 2013 due to the short-term nature of these financial instruments.

## Repurchase Agreements

The Company finances the acquisition of the majority of its PT 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 the payment to the Manager of a management fee and reimbursement of certain operating expenses, which are accrued and expensed during the period for which they are earned or incurred. Refer to Note 12 for the terms of the management agreement.

## Earnings Per Share

The Company follows the provisions of FASB ASC 260, Earnings Per Share. Basic earnings per share (“EPS”) is calculated as net income 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 “if converted” method for common stock equivalents, if any. However, the common stock equivalents are not included in computing diluted EPS if the result is anti-dilutive.

## Income Taxes

Bimini has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”). Until the closing of its IPO on February 20, 2013, Orchid was a “qualified REIT subsidiary” of Bimini under the Code. Beginning with its short tax period commencing on February 20, 2013 and ended December 31, 2013, Orchid has qualified and elected to be taxed as a REIT, and filed a REIT tax return separate from Bimini. 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 June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-12, Compensation-Stock Compensation: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that performance targets that affect vesting and that could be achieved after the requisite service period be treated as performance conditions. The effective date of ASU 2014-12 is for interim and annual reporting periods beginning after December 15, 2015. The ASU is not expected to materially impact the Company's financial statements.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. ASU 2014-11 amends the accounting guidance for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings, and requires additional disclosure about certain transactions by the transferor. ASU 2014-11 is effective for certain transactions that qualify for sales treatment for the first interim or annual period beginning after December 15, 2014. The new disclosure requirements for repurchase agreements, securities lending transactions and repurchase-to-maturity transactions that qualify for secured borrowing treatment is effective for annual periods beginning after December 15, 2014 and for interim periods beginning after March 15, 2015. We currently record our repurchase arrangements as secured borrowings and do not anticipate that ASU 2014-11 will have a material impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the unrecognized tax benefits. The ASU became effective beginning January 1, 2014 on either a prospective or retrospective basis. The guidance represents a change in financial statement presentation only and the adoption of this ASU did not have a material impact on the Company's financial results.

In June 2013, the FASB issued ASU 2013-08, Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements. The amendments in this update modify the guidance for determining whether an entity is an investment company, update the measurement requirements for noncontrolling interests in other investment companies and require additional disclosures for investment companies under US GAAP. The amendments in the update develop a two-tiered approach for the assessment of whether an entity is an investment company which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. The amendments in this update also revise the measurement guidance in Topic 946 such that investment companies must measure noncontrolling ownership interests in other investment companies at fair value, rather than applying the equity method of accounting to such interests. The new guidance became effective beginning January 1, 2014. The adoption of this ASU did not have a material impact on the Company's financial statements.

In February 2013, the FASB issued ASU 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date ("ASU 2013-04"). The objective of the amendments in this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing GAAP. The amendments in ASU 2013-04 became effective for fiscal years, and interim periods within those

years, beginning after December 15, 2013, and should be retrospectively applied to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU's scope that exist at the beginning of an entity's fiscal year of adoption. The adoption of this ASU did not have a material impact on the Company's financial statements.

## NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's RMBS portfolio as of September 30, 2014 and December 31, 2013:

(in thousands)

	September 30, 2014	December 31, 2013
Pass-Through RMBS Certificates:		
Hybrid Adjustable-rate Mortgages	\$71,442	\$76,118
Adjustable-rate Mortgages	3,847	5,334
Fixed-rate Mortgages	1,035,857	245,523
Total Pass-Through Certificates	1,111,146	326,975
Structured RMBS Certificates:		
Interest-Only Securities	45,947	19,206
Inverse Interest-Only Securities	18,439	5,042
Total Structured RMBS Certificates	64,386	24,248
Total	\$1,175,532	\$351,223

The following table summarizes the Company's RMBS portfolio as of September 30, 2014 and December 31, 2013, 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)

	September 30, 2014	December 31, 2013
Greater than five years and less than ten years	\$1,047	\$1,521
Greater than or equal to ten years	1,174,485	349,702
Total	\$1,175,532	\$351,223

The Company generally pledges its RMBS assets as collateral under repurchase agreements. At September 30, 2014 and December 31, 2013, the Company had unpledged securities totaling \$101.7 million and \$15.4 million, respectively. The unpledged balance at September 30, 2014 includes unsettled security purchases with a fair value of approximately \$67.1 million that will be pledged as collateral under repurchase agreements on their settlement dates in October 2014.

## NOTE 3. REPURCHASE AGREEMENTS

As of September 30, 2014, the Company had outstanding repurchase obligations of approximately \$1,256.0 million with a net weighted average borrowing rate of 0.34%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$1,325.7 million, (including unsettled securities sold with a fair value of approximately \$246.9 million), and cash pledged to counterparties of approximately \$4.8 million. As of December 31, 2013, the Company had outstanding repurchase obligations of approximately \$318.6 million with a net weighted average borrowing rate of 0.39%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$337.0 million.



As of September 30, 2014 and December 31, 2013, the Company's repurchase agreements had remaining maturities as summarized below:

(\$ in thousands)

	OVERNIGHT (1 DAY OR LESS)	BETWEEN 2 AND 30 DAYS	BETWEEN 31 AND 90 DAYS	GREATER THAN 90 DAYS	TOTAL
<b>September 30, 2014</b>					
Fair market value of securities pledged, including					
accrued interest receivable	\$ 48,439	\$ 695,152	\$ 462,617	\$ 119,449	\$ 1,325,657
Repurchase agreement liabilities associated with these securities	\$ 47,080	\$ 660,293	\$ 436,110	\$ 112,495	\$ 1,255,978
Net weighted average borrowing rate	0.32	% 0.34	% 0.34	% 0.38	% 0.34
<b>December 31, 2013</b>					
Fair market value of securities pledged, including					
accrued interest receivable	\$ -	\$ 326,348	\$ 10,650	\$ -	\$ 336,998
Repurchase agreement liabilities associated with these securities	\$ -	\$ 308,402	\$ 10,155	\$ -	\$ 318,557
Net weighted average borrowing rate	-	0.39	% 0.37	% -	0.39

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 September 30, 2014, the Company had a maximum amount at risk (the difference between the amount loaned to the Company, including interest payable, and the fair value of securities and cash pledged (if any), including accrued interest on such securities) of approximately \$74.1 million. Summary information regarding the Company's amounts at risk with individual counterparties greater than 10% of the Company's equity at September 30, 2014 and December 31, 2013 is as follows:

(\$ in thousands)

Repurchase Agreement Counterparties	Amount at Risk	% of Stockholders' Equity at Risk	Weighted Average Maturity (in Days)
<b>September 30, 2014</b>			
Citigroup Global Markets, Inc.	\$ 19,074	11.0	% 20
<b>December 31, 2013</b>			
Citigroup Global Markets, Inc.	\$ 5,487	12.3	% 11

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, such as Eurodollar and T-Note futures contracts and interest rate swaptions. 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.

As of December 31, 2013, such instruments were comprised entirely of Eurodollar futures contracts. During the nine months ended September 30, 2014, the Company entered into, and settled before the end of the quarter, a T-Note futures contract. Eurodollar and T-Note futures are cash settled futures contracts on an interest rate, with gains or losses credited or charged to the Company's account on a daily basis and reflected in earnings as they occur. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. This margin represents the collateral the Company has posted for its open positions and is recorded on the balance sheet as part of restricted cash. The Company is exposed to the changes in value of the futures by the amount of margin held by the broker.

During the nine months ended September 30, 2014, the Company was a party to interest rate swaption agreements. At September 30, 2014, the Company had outstanding swaption agreements which grant the Company the right but not the obligation to enter into underlying pay fixed interest rate swap (“payer swaption”). The Company may also enter into swaption agreements that provide the Company the option to enter into receive fixed interest rate swap (“receiver swaption”).

Derivative Assets (Liability), at Fair Value

The table below summarizes fair value information about our derivative assets and liability as of September 30, 2014 and December 31, 2013.

(in thousands)

Derivative Instruments and Related Accounts	Balance Sheet Location	September 30, 2014	December 31, 2013
<b>Assets</b>			
Eurodollar futures - Margin posted to counterparty	Restricted cash	\$3,000	\$2,446
Payer swaptions	Derivative assets, at fair value	3,906	-
		\$6,906	\$2,446
<b>Liability</b>			
Payer swaptions - Margin posted by counterparty	Other liabilities	\$(3,776)	\$-

The tables below present information related to the Company’s Eurodollar futures positions at September 30, 2014 and December 31, 2013.

(\$ in thousands)

Expiration Year	September 30, 2014			December 31, 2013		
	Weighted Average LIBOR Rate	Average Contract Notional Amount	Open Equity(1)	Weighted Average LIBOR Rate	Average Contract Notional Amount	Open Equity(1)
2014	-	\$-	\$-	0.40	% \$262,500	\$(189)
2015	0.74	% 550,000	(329)	0.80	% 275,000	(146)
2016	1.76	% 550,000	1,379	1.90	% 250,000	1,367
2017	2.68	% 400,000	1,067	3.03	% 250,000	2,291
2018	3.07	% 400,000	(177)	3.77	% 250,000	1,575
Total / Weighted Average	1.87	% \$480,000	\$1,940	2.02	% \$257,353	\$4,898

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

The table below presents information related to the Company’s interest rate swaption positions at September 30, 2014.

(\$ in thousands)

Expiration	Option Cost	Fair Value	Option Weighted Average Months to Expiration	Notional Amount	Underlying Swap		Weighted Average Term (Years)
					Fixed Pay Rate	Receive Rate (LIBOR)	
≤ 1 year	\$4,720	\$3,906	10	\$275,000	2.96%	3 Month	8.2



## Gain (Loss) From Derivative Instruments, Net

The table below presents the effect of the Company's derivative financial instruments on the statements of operations for the nine and three months ended September 30, 2014 and 2013.

(in thousands)

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Eurodollar futures contracts (short positions)	\$(3,316 )	\$4,096	\$2,820	\$(2,272 )
T-Note futures contract (short position)	72	-	72	-
Payer swaptions	(1,120 )	-	166	-
	\$(4,364 )	\$4,096	\$3,058	\$(2,272 )

## 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 balance sheets.

## NOTE 5. 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 September 30, 2014 and December 31, 2013.

(in thousands)

Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Offsetting of Assets		Gross Amount Not Offset in the Balance Sheet			
		Net Amount of Assets Presented in the Balance Sheet	Financial Instruments	Cash	Received as Collateral	Received as Collateral	Net Amount

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

September 30, 2014

Derivative assets - Payer swaptions	\$3,906	\$-	\$3,906	\$-	\$(3,776	) \$130
-------------------------------------	---------	-----	---------	-----	----------	---------

December 31, 2013

Derivative asset	\$-	\$-	\$-	\$-	\$-	\$-
------------------	-----	-----	-----	-----	-----	-----

(in thousands)

	Offsetting of Liabilities			Gross Amount Not Offset in the Balance Sheet		
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Financial Instruments Posted as Collateral		Net Amount
September 30, 2014						
Repurchase Agreements	\$1,255,978	\$-	\$1,255,978	\$(1,251,197)	\$(4,781)	\$-
December 31, 2013						
Repurchase Agreements	\$318,557	\$-	\$318,557	\$(318,557)	\$-	\$-

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 balance sheet. The fair value of the actual collateral received by or posted to the same counterparty typically exceeds the amounts presented. See Notes 3 and 4 for a discussion of collateral posted or received against or for repurchase obligations and derivative instruments.

#### NOTE 6. CAPITAL STOCK

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

#### Common Stock Issuances

During 2014 and 2013, the Company completed the following public offerings of shares of its common stock.

(\$ in thousands, except per share amounts)

Type of Offering	Period	Price Received Per Share(1)	Shares	Net Proceeds(2)
2014				
Secondary Offering	First Quarter	\$12.50	2,070,000	\$24,174
Secondary Offering(3)	First Quarter	12.55	3,680,000	43,989
At-the-Market Offering Program(4)	Second Quarter	13.14	537,499	6,914

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

At-the-Market Offering Program(4) Third Quarter	13.99	3,389,441	46,372
At-the-Market Offering Program(4) Fourth Quarter	13.90	52,532	716
		9,729,472	\$ 122,165

14

---

(\$ in thousands, except per share amounts)

Type of Offering	Period	Price Received Per Share(1)	Shares	Net Proceeds(2)
2013				
Initial Public Offering	First Quarter	\$ 15.00	2,360,000	\$ 35,400 (5)
			2,360,000	\$ 35,400

(1) Price received per share is gross of underwriters' discount, if applicable, and other offering costs.

(2) Net proceeds are net of the underwriters' discount, if applicable, and other offering costs.

(3) Includes net proceeds received of \$5.7 million and 480,000 shares issued to the underwriters in April 2014 pursuant to the exercise of their overallotment option related to the March 2014 offering.

(4) The Company has entered into two Equity Distribution Agreements, one of which was replaced with the current agreement, to publicly offer and sell shares of the Company's common stock in at-the-market and privately negotiated transactions from time to time. The net proceeds and shares issued in the fourth quarter of 2014 under this program are not reflected in the Company's financial statements as of September 30, 2014. As of September 30, 2014, shares with a value of \$55.5 million remain available for issuance under the September Equity Distribution Agreement.

(5) Bimini Advisors has paid, or has reimbursed the Company for all offering expenses in connection with the Company's IPO. The Company has no obligation or intent to reimburse Bimini Advisors, either directly or indirectly, for the offering costs; therefore they are not included in the Company's financial statements.

#### Stock Dividend

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

#### Cash Dividends

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

Declaration Date	Record Date	Payment Date	Per Share Amount	Total
2014				
October 9, 2014(1)	October 28, 2014	October 31, 2014	\$0.180	\$2,358,177
September 9, 2014	September 25, 2014	September 30, 2014	0.180	2,348,198
August 12, 2014	August 26, 2014	August 29, 2014	0.180	1,998,506
July 10, 2014	July 28, 2014	July 31, 2014	0.180	1,758,965
June 11, 2014	June 25, 2014	June 30, 2014	0.180	1,711,531
May 8, 2014	May 27, 2014	May 30, 2014	0.180	1,640,820
April 8, 2014	April 25, 2014	April 30, 2014	0.180	1,636,500
March 11, 2014	March 26, 2014	March 31, 2014	0.180	1,550,100
February 11, 2014	February 25, 2014	February 28, 2014	0.180	974,100
January 9, 2014	January 27, 2014	January 31, 2014	0.180	925,500
Totals			\$1.800	\$16,902,397



Declaration Date	Record Date	Payment Date	Per Share Amount	Total
2013				
December 11, 2013	December 26, 2013	December 30, 2013	\$0.180	\$601,497
November 12, 2013	November 25, 2013	November 27, 2013	0.135	451,125
October 10, 2013	October 25, 2013	October 31, 2013	0.135	451,125
September 10, 2013	September 25, 2013	September 30, 2013	0.135	451,125
August 12, 2013	August 26, 2013	August 30, 2013	0.135	451,125
July 9, 2013	July 25, 2013	July 31, 2013	0.135	451,125
June 10, 2013	June 25, 2013	June 28, 2013	0.135	451,125
May 9, 2013	May 28, 2013	May 31, 2013	0.135	451,125
April 10, 2013	April 25, 2013	April 30, 2013	0.135	451,125
March 8, 2013	March 25, 2013	March 27, 2013	0.135	451,125
Totals			\$1.395	\$4,661,622

(1) The effect of the dividend declared in October 2014 is not reflected in the Company's financial statements as of September 30, 2014.

#### NOTE 7. 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.

A summary of incentive share activity during the nine months ended September 30, 2014 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Life
Restricted common stock, at January 1, 2014	-	\$-	-
Restricted common stock granted during the period	29,844	12.41	-
Vested during the period	(5,844 )	13.16	-
Restricted common stock, at September 30, 2014	24,000	\$12.23	2.6 Years

On April 25, 2014, our Compensation Committee granted each of our non-employee directors 6,000 shares of restricted common stock subject to a three year vesting schedule whereby 2,000 shares of the award vest on the first, second and third anniversaries of the award date. Directors will have all the rights of a stockholder with respect to the awards, including the right to receive dividends and vote the shares. The awards are subject to forfeiture should the

director no longer be a member of the Board of Directors of the Company prior to the respective vesting dates.

## NOTE 8. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at September 30, 2014.

## NOTE 9. INCOME TAXES

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

## NOTE 10. EARNINGS PER SHARE (EPS)

The Company had dividend eligible shares of restricted common stock that were outstanding during the nine and three months ended September 30, 2014. The basic and diluted per share computations include these unvested shares of restricted common stock if there is income available to Common Stock, as they have dividend participation rights. The shares of restricted common stock have no contractual obligation to share in losses. Because there is no such obligation, the shares of restricted common stock 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.

The table below reconciles the numerator and denominator of EPS for the nine and three months ended September 30, 2014 and 2013.

(in thousands, except per-share information)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	2013	2014	2013
Basic and diluted EPS per common share:				
Numerator for basic and diluted EPS per common share:				
Net income (loss) - Basic and diluted	\$20,999	\$(2,143 )	\$6,768	\$(997 )
Weighted average common shares:				
Common shares outstanding at the balance sheet date	13,024	3,342	13,024	3,342
Unvested dividend eligible shares of restricted common stock				
outstanding at the balance sheet date	24	-	24	-
Effect of weighting	(4,733 )	(441 )	(2,338 )	-
Weighted average shares-basic and diluted	8,315	2,901	10,710	3,342
Income (loss) per common share:				
Basic and diluted	\$2.53	\$(0.74 )	\$0.63	\$(0.30 )

On February 14, 2013, Orchid's Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed as the dividend were issued to Bimini on February 20, 2013, immediately prior to Orchid's IPO. For the nine months ended September 30, 2013, the 827,555 shares distributed as a stock dividend were treated as if outstanding for the entire period, as Bimini was

the sole stockholder during the entire period prior to Orchid's IPO.

## NOTE 11. FAIR VALUE

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

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

The Company's RMBS and interest rate swaptions 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 our positions in RMBS and interest rate swaptions determined by either an independent third-party or do so internally.

RMBS, interest rate swaptions and Eurodollar futures contracts were recorded at fair value on a recurring basis during the nine and three months ended September 30, 2014 and 2013. When determining fair value measurements, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset. When possible, the Company looks to active and observable markets to price identical assets. When identical assets are not traded in active markets, the Company looks to market observable data for similar assets.

The following table presents financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013:

(in thousands)

Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
------------	---	--	---------------------------------------

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

	Measurements	(Level 1)	(Level 2)	(Level 3)
September 30, 2014				
Mortgage-backed securities	\$ 1,175,532	\$-	\$1,175,532	\$ -
Eurodollar futures contracts	3,000	3,000	-	-
Payer swaptions	3,906	-	3,906	-
December 31, 2013				
Mortgage-backed securities	\$ 351,223	\$-	\$351,223	\$ -
Eurodollar futures contracts	2,446	2,446	-	-

During the nine and three months ended September 30, 2014 and 2013, there were no transfers of financial assets or liabilities between levels 1, 2 or 3.

#### NOTE 12. RELATED PARTY TRANSACTIONS

##### Management Agreement

The Company entered into a management agreement with Bimini, which provided for an initial term through December 31, 2011 with automatic one-year extension options. The agreement was extended under the option to December 31, 2013, but was terminated at the completion of the Company's IPO on February 20, 2013. At the completion of the IPO, the Company entered into a management agreement with Bimini Advisors (the "Manager"), which provides for an initial term through February 20, 2016 with automatic one-year extensions and is subject to certain termination rights. Under the terms of the management agreement, Bimini Advisors is responsible for administering the business activities and day-to-day operations of the Company. Bimini Advisors 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 Bimini Advisors for any direct expenses incurred on its behalf. In addition, Bimini Advisors began allocating to the Company its pro rata portion of certain overhead costs set forth in the management agreement commencing with the calendar quarter beginning July 1, 2014. Should the Company terminate the management agreement without cause, it shall pay to Bimini Advisors a termination fee equal to three times the average annual management fee, as defined in the management agreement, before or on the last day of the initial term or automatic renewal term.

The Company was obligated to reimburse Bimini for its costs incurred under the original management agreement. In addition, the Company was required to pay Bimini a monthly fee of \$7,200, which represents an allocation of overhead expenses for items that included, but were not limited to, occupancy costs, insurance and administrative expenses. These expenses were allocated based on the ratio of the Company's assets and Bimini's consolidated assets.

Total expenses recorded during the nine and three months ended September 30, 2014 for the management fee and costs incurred were approximately \$1,474,000 and \$741,000, respectively, compared to \$504,000 and \$180,000, respectively, for the same time periods in 2013.

At September 30, 2014 and December 31, 2013, the net amount due to affiliates was approximately \$303,000 and \$82,000, respectively.

##### Payment of Certain Offering Expenses

Bimini Advisors has paid, or has reimbursed Orchid, for all offering expenses in connection with the Company's IPO. During the nine months ended September 30, 2013, Bimini Advisors paid expenses related to this offering of approximately \$3.0 million. The Company has no obligation or intent to reimburse Bimini Advisors, either directly or indirectly, for the offering costs; therefore, they are not included in the Company's financial statements.



Other Relationships with Bimini

John B. Van Heuvelen, one of our independent director nominees, owns shares of common stock of 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. Hunter 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.

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

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

### Overview

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

We were formed by Bimini in August 2010 and commenced operations on November 24, 2010. At December 31, 2012, Bimini was our sole stockholder. We completed our initial public offering ("IPO") on February 20, 2013. In that offering we raised gross proceeds of \$35.4 million from the sale of 2,360,000 shares of our common stock. We completed secondary offerings in January and March 2014, raising aggregate net proceeds of approximately \$68.2 million from the sale of 5,750,000 shares of our common stock inclusive of the \$5.7 million of net proceeds received from the exercise of the underwriters' overallotment option, which was closed in April 2014.

On June 17, 2014, Orchid entered into an equity distribution agreement (the "June 2014 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 \$35,000,000 of shares of the Company's common stock in transactions that are deemed to be "at-the-market" offerings and privately negotiated transactions. Through September 2, 2014, with final settlement on September 5, 2014, the Company issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees.

On September 3, 2014, Orchid entered into a second equity distribution agreement (the "September 2014 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 \$75,000,000 of shares of the Company's common stock in transactions that are deemed to be "at-the-market" offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. Through September 30, 2014, the Company issued a total of 1,398,524 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$19.1 million, net of commissions and fees. After September 30, 2014, the Company issued an additional 52,532 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$0.7 million, net of commissions and fees.

On October 3, 2014, Orchid received approval to list its common stock on the New York Stock Exchange ("NYSE"). The Company's common stock began trading on the NYSE at the commencement of trading on October 8, 2014 under the symbol "ORC".



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

We have qualified and elected to be taxed as a REIT under the Code commencing with our short taxable year ended December 31, 2013 and filed a REIT tax return for that year. 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 to our stockholders and maintain our REIT qualification.

#### 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 investments in Agency RMBS;
  - recent actions taken by the Federal Reserve 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 nine and three months ended September 30, 2014, as compared to the Company's results of operations for the nine and three months ended September 30, 2013.



## Net Income (Loss) Summary

Net income for the nine months ended September 30, 2014 was \$21.0 million, or \$2.53 per share. Net loss for the nine months ended September 30, 2013 was \$2.1 million, or \$0.74 per share. Net income for the three months ended September 30, 2014 was \$6.8 million, or \$0.63 per share. Net loss for the three months ended September 30, 2013 was \$1.0 million, or \$0.30 per share. The components of net income (loss) for the nine and three months ended September 30, 2014 and 2013, along with the changes in those components are presented in the table below:

(in thousands)

	Nine Months Ended September 30,			Three Months Ended, September 30,		
	2014	2013	Change	2014	2013	Change
Interest income	\$19,658	\$6,393	\$13,265	\$9,286	\$2,551	\$6,735
Interest expense	(1,905 )	(817 )	(1,088 )	(818 )	(294 )	(524 )
Net interest income	17,753	5,576	12,177	8,468	2,257	6,211
Gains (losses) on RMBS and derivative contracts	6,288	(6,468 )	12,756	(307 )	(2,853 )	2,546
Net portfolio income (deficiency)	24,041	(892 )	24,933	8,161	(596 )	8,757
Expenses	(3,042 )	(1,251 )	(1,791 )	(1,393 )	(401 )	(992 )
Net income (loss)	\$20,999	\$(2,143 )	\$23,142	\$6,768	\$(997 )	\$7,765

## GAAP and Non-GAAP Reconciliation

To date, the Company has used derivatives, specifically Eurodollar and T-Note futures contracts and interest rate swaptions, to hedge a portion of the interest rate risk on repurchase agreements in a rising rate environment. Each interest rate futures contract covers a specific period, but the Company typically has many contracts in place at any point in time—usually covering several years in the aggregate. We currently have interest rate swaption agreements in place, giving us the option to enter into swaps covering future periods.

The Company has not elected to designate its 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 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. In the future, the Company may use other derivative instruments to hedge its interest expense and/or elect to designate its derivative holdings for hedge accounting treatment.

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. As of September 30, 2014, the Company had Eurodollar futures contracts in place through 2018, and interest rate swaption agreements in place covering periods beginning in 2015 through 2025. 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, the Company has combined the effects of the derivative financial instruments in place for the respective period with the actual interest expense incurred on repurchase agreements to reflect total 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.

However, because the Company has not elected hedging treatment under ASC 815, the gains or losses on all of the Company's derivative instruments held during the period are reflected in our statements of operations. 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.

The Company believes that economic interest expense and economic net interest income provides meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The non-GAAP measures help the Company to evaluate its financial position and performance without the effects of certain transactions and GAAP adjustments that are not necessarily indicative of its current investment portfolio or operations. The realized and unrealized gains or losses presented in the Company's statements of operations are not necessarily representative of the total interest rate expense that the Company will ultimately realize. This is because as interest rates move up or down in the future, the gains or losses the Company ultimately realizes, and which will affect the Company's total interest rate expense in future periods, may differ from the unrealized gains or losses recognized as of the reporting date.

The Company's presentation of the economic value of its hedging strategy has important limitations. First, other market participants may calculate economic interest expense and economic net interest income differently than the Company calculates them. Second, while the Company believes 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 the Company's 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 the nine months ended September 30, 2014 and 2013 and each quarter during 2014 and 2013.

## Gains (Losses) on Derivative Instruments

(in thousands)

	Recognized in Income Statement (GAAP)	Attributed to Current Period (Non-GAAP)	Attributed to Future Periods (Non-GAAP)
<b>Three Months Ended</b>			
September 30, 2014	\$3,058	\$ (25 )	\$ 3,083
June 30, 2014	(5,728 )	(3 )	(5,725 )
March 31, 2014	(1,693 )	(30 )	(1,663 )
December 31, 2013	733	(42 )	775
September 30, 2013	(2,272 )	(28 )	(2,244 )
June 30, 2013	6,852	(4 )	6,856
March 31, 2013	(484 )	(65 )	(419 )
<b>Nine Months Ended</b>			
September 30, 2014	\$(4,363 )	\$ (58 )	\$( 4,305 )
September 30, 2013	4,096	(97 )	4,193

## Economic Interest Expense and Economic Net Interest Income

(in thousands)

	Interest Expense on Repurchase Agreements			Economic Interest Expense(2)	Net Interest Income	
	GAAP Interest Income	GAAP Interest Expense	Gains (Losses) on Derivative Instruments Attributed to Current Period(1)		GAAP Net Interest Income	Economic Net Interest Income(3)
<b>Three Months Ended</b>						
September 30, 2014	\$9,286	\$818	\$(25)	\$843	\$8,468	\$8,443
June 30, 2014	6,589	676	(3)	679	5,913	5,910
March 31, 2014	3,783	411	(30)	441	3,372	3,342
December 31, 2013	2,806	309	(42)	351	2,497	2,455
September 30, 2013	2,551	294	(28)	322	2,257	2,229
June 30, 2013	2,429	322	(4)	326	2,107	2,103
March 31, 2013	1,413	201	(65)	266	1,212	1,147
<b>Nine Months Ended</b>						
September 30, 2014	\$19,658	\$1,905	\$(58)	\$1,963	\$17,753	17,695
September 30, 2013	6,393	817	(97)	914	5,576	5,479

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

(2) Calculated by subtracting the effect of derivative instrument hedges attributed to the period presented from 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 nine months ended September 30, 2014, we generated \$17.8 million of net interest income, consisting of \$19.7 million of interest income from RMBS assets offset by \$1.9 million of interest expense on repurchase liabilities. For the comparable period ended September 30, 2013, we generated \$5.6 million of net interest income, consisting of \$6.4 million of interest income from RMBS assets offset by \$0.8 million of interest expense on repurchase liabilities. The \$13.3 million increase in interest income and \$1.1 million increase in interest expense for the nine months ended September 30, 2014 primarily reflects the deployment of the proceeds from our 2014 capital raising activities into the RMBS portfolio on a leveraged basis.

On an economic basis, our interest expense on repurchase liabilities for the nine months ended September 30, 2014 and 2013 was \$2.0 million and \$0.9 million, respectively, resulting in \$17.7 million and \$5.5 million of economic net interest income, respectively.

During the three months ended September 30, 2014, we generated \$8.5 million of net interest income, consisting of \$9.3 million of interest income from RMBS assets offset by \$0.8 million of interest expense on repurchase liabilities. For the three months ended September 30, 2013, we generated \$2.3 million of net interest income, consisting of \$2.6 million of interest income from RMBS assets offset by \$0.3 million of interest expense on repurchase liabilities. The deployment of the proceeds from our capital raising activities in 2014 on a leveraged basis was the main driver for the increase in both interest income and interest expense for the three months ended September 30, 2014 as compared to the same period in 2013.

On an economic basis, our interest expense on repurchase liabilities for the three months ended September 30, 2014 and 2013 was \$0.8 million and \$0.3 million, respectively, resulting in \$8.4 million and \$2.2 million of economic net interest income, respectively.

The tables below provide information on our portfolio average balances, interest income, yield on assets, average repurchase agreement balances, interest expense, cost of funds, net interest income and net interest spread for the nine months ended September 30, 2014 and 2013 and each quarter during 2014 and 2013 on both a GAAP and economic basis.

(\$ in thousands)

	Average		Yield on		Interest Expense		Average Cost of Funds			
	RMBS Securities Held(1)	Interest Income	Average RMBS Securities	Average Repurchase Agreements(1)	GAAP Basis	Economic Basis(2)	GAAP Basis	Economic Basis(3)		
<b>Three Months Ended</b>										
September 30, 2014	\$1,025,768	\$9,286	3.62 %	\$ 1,019,839	\$818	\$ 843	0.32 %	0.33 %		
June 30, 2014	811,881	6,589	3.25 %	717,474	676	679	0.38 %	0.38 %		
March 31, 2014	549,490	3,783	2.75 %	484,902	411	441	0.34 %	0.36 %		
December 31, 2013	341,505	2,806	3.29 %	310,107	309	351	0.40 %	0.45 %		
September 30, 2013	335,467	2,551	3.04 %	305,196	294	322	0.39 %	0.42 %		
June 30, 2013	349,704	2,429	2.78 %	312,591	322	326	0.41 %	0.42 %		
March 31, 2013	237,820	1,413	2.38 %	210,194	201	266	0.38 %	0.51 %		
<b>Nine Months Ended</b>										
September 30, 2014	\$795,713	\$19,658	3.29 %	\$ 740,738	\$1,905	\$ 1,963	0.34 %	0.35 %		
September 30, 2013	307,664	6,393	2.77 %	275,993	817	914	0.39 %	0.44 %		

(\$ in thousands)

	Net Interest Income		Net Interest Spread			
	GAAP Basis	Economic Basis(2)	GAAP Basis	Economic Basis(4)		
<b>Three Months Ended</b>						
September 30, 2014	\$8,468	\$8,443	3.30 %	3.29 %		
June 30, 2014	5,913	5,910	2.87 %	2.87 %		
March 31, 2014	3,372	3,342	2.41 %	2.39 %		
December 31, 2013	2,497	2,455	2.89 %	2.84 %		
September 30, 2013	2,257	2,229	2.65 %	2.62 %		
June 30, 2013	2,107	2,103	2.37 %	2.36 %		
March 31, 2013	1,212	1,147	2.00 %	1.87 %		
<b>Nine Months Ended</b>						
September 30, 2014	\$17,753	\$17,695	2.95 %	2.94 %		
September 30, 2013	5,576	5,479	2.38 %	2.33 %		

(1) Portfolio yields and costs of borrowings presented in the tables above and the tables on pages 27 and 28 are calculated based on the average balances of the underlying investment portfolio/repurchase agreement 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 28 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 instruments hedges attributed to the period divided by Average RMBS Held.
- (4) Economic Net Interest Spread is calculated by subtracting Average Economic Cost of Funds from Yield on Average RMBS Securities.

## Interest Income and Average Asset Yield

Our interest income for the nine months ended September 30, 2014 and 2013 was \$19.7 million and \$6.4 million, respectively. We had average RMBS holdings of \$795.7 million and \$307.7 million for the nine months ended September 30, 2014 and 2013, respectively. The yield on our portfolio was 3.29% and 2.77% for the nine months ended September 30, 2014 and 2013, respectively. For the nine months ended September 30, 2014 as compared to the nine months ended September 30, 2013, there was a \$13.3 million increase in interest income due to a \$488.0 million increase in average RMBS, combined with a 52 basis point increase in the yield on average RMBS. The increase in average RMBS during the nine months ended September 30, 2014 reflects the deployment of the proceeds of our capital raising activities during 2014, on a leveraged basis.

Our interest income for the three months ended September 30, 2014 and 2013 was \$9.3 million and \$2.6 million, respectively. We had average RMBS holdings of \$1,025.8 million and \$335.5 million for the three months ended September 30, 2014 and 2013, respectively. The yield on our portfolio was 3.62% and 3.04% for the three months ended September 30, 2014 and 2013, respectively. For the three months ended September 30, 2014 as compared to the three months ended September 30, 2013, there was a \$6.7 million increase in interest income due to a \$690.3 million increase in average RMBS, combined with a 58 basis point increase in the yield on average RMBS. The increase in average RMBS during the three months ended September 30, 2014 reflects the deployment of the proceeds of the 2014 capital raising activities, on a leveraged basis.

The table below presents the average portfolio size, income and yields of our respective sub-portfolios, consisting of structured RMBS and pass-through RMBS (“PT RMBS”) for the nine months ended September 30, 2014 and 2013 and each quarter during 2014 and 2013.

(\$ 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
<b>Three Months Ended</b>									
<b>September</b>									
30, 2014	\$969,034	\$56,734	\$1,025,768	\$9,482	\$(196)	\$9,286	3.91 %	(1.39)%	3.62 %
<b>June 30,</b>									
2014	764,199	47,682	811,881	7,674	(1,085)	6,589	4.02 %	(9.10)%	3.25 %
<b>March 31,</b>									
2014	514,226	35,264	549,490	4,402	(619)	3,783	3.42 %	(7.02)%	2.75 %
<b>December</b>									
31, 2013	318,996	22,509	341,505	2,726	80	2,806	3.42 %	1.42 %	3.29 %
<b>September</b>									
30, 2013	314,096	21,371	335,467	2,412	139	2,551	3.07 %	2.60 %	3.04 %
<b>June 30,</b>									
2013	326,977	22,727	349,704	2,514	(85)	2,429	3.08 %	(1.51)%	2.78 %
<b>March 31,</b>									
2013	223,191	14,629	237,820	1,416	(3)	1,413	2.54 %	(0.06)%	2.38 %
<b>Nine Months Ended</b>									
<b>September</b>									
30, 2014	\$749,153	\$46,560	\$795,713	\$21,558	\$(1,900)	\$19,658	3.84 %	(5.44)%	3.29 %
<b>September</b>									
30, 2013	288,088	19,576	307,664	6,342	51	6,393	2.94 %	0.35 %	2.77 %

### Interest Expense and the Cost of Funds

We had average outstanding repurchase agreements of \$740.7 million and \$276.0 million and total interest expense of \$1.9 million and \$0.8 million for the nine months ended September 30, 2014 and 2013, respectively. Our average cost of funds was 0.34% and 0.39% for nine months ended September 30, 2014 and 2013, respectively. There was a 5 basis point decrease in the average cost of funds and a \$464.7 million increase in average outstanding repurchase agreements during the nine months ended September 30, 2014 as compared to the nine months ended September 30, 2013. The increase in average outstanding repurchase agreements, and the corresponding increase in interest expense, reflects the leveraging of the proceeds of our capital raising activities in 2014.

Our economic interest expense was \$2.0 million and \$0.9 million for the nine months ended September 30, 2014 and 2013, respectively. There was an 9 basis point decrease in the average economic cost of funds to 0.35% for the nine months ended September 30, 2014 from 0.44% for the nine months ended September 30, 2013. The increase in economic interest expense was primarily due to the increase in average outstanding repurchase agreements during the nine months ended September 30, 2014.

We had average outstanding repurchase agreements of \$1,019.8 million and \$305.2 million and total interest expense of \$0.8 million and \$0.3 million for the three months ended September 30, 2014 and 2013, respectively. Our average cost of funds was 0.32% and 0.39% for three months ended September 30, 2014 and 2013, respectively. There was a 7 basis point decrease in the average cost of funds and a \$714.6 million increase in average outstanding repurchase agreements during the three months ended September 30, 2014 as compared to the three months ended September 30, 2013. The increase in average outstanding repurchase agreements reflects the leveraging of the proceeds of our capital raising activities in 2014.

Our economic interest expense was \$0.8 million and \$0.3 million for the three months ended September 30, 2014 and 2013, respectively. There was a 9 basis point decrease in the average economic cost of funds to 0.33% for the three months ended September 30, 2014 from 0.42% for the three months ended September 30, 2013. The increase in economic interest expense was primarily due to the increase in average outstanding repurchase agreements during the three months ended September 30, 2014.

Because 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 17 basis points above the average one-month LIBOR and 1 basis points below the average six-month LIBOR for the quarter ended September 30, 2014. Our average economic cost of funds was 18 basis points above the average one-month LIBOR and 0 basis points above the average six-month LIBOR for the quarter ended September 30, 2014. The average term to maturity of the outstanding repurchase agreements increased to 38 days at September 30, 2014 from 15 days at December 31, 2013.

The tables below presents the average balance of repurchase agreements outstanding, interest expense and average cost of funds, and average one-month and six-month LIBOR rates for the nine months ended September 30, 2014 and 2013 and each quarter in 2014 and 2013 on both a GAAP and economic basis.

(\$ in thousands)

	Average Balance of Repurchase Agreements	Interest Expense GAAP Basis	Economic Basis	Average Cost of Funds GAAP Basis	Economic Basis
<b>Three Months Ended</b>					
September 30, 2014	\$ 1,019,839	\$818	\$843	0.32 %	0.33 %
June 30, 2014	717,474	676	679	0.38 %	0.38 %
March 31, 2014	484,902	411	441	0.34 %	0.36 %
December 31, 2013	310,107	309	351	0.40 %	0.45 %
September 30, 2013	305,196	294	322	0.39 %	0.42 %
June 30, 2013	312,591	322	326	0.41 %	0.42 %
March 31, 2013	210,194	201	266	0.38 %	0.51 %
<b>Nine Months Ended</b>					
September 30, 2014	\$ 740,738	\$ 1,905	\$ 1,963	0.34 %	0.35 %
September 30, 2013	275,993	817	914	0.39 %	0.44 %

	Average LIBOR		Average GAAP Cost of Funds Relative to Average				Average Economic Cost of Funds Relative to Average			
	One-Month	Six-Month	One-Month LIBOR	Six-Month LIBOR	One-Month LIBOR	Six-Month LIBOR	One-Month LIBOR	Six-Month LIBOR		
<b>Three Months Ended</b>										
September 30, 2014	0.15 %	0.33 %	0.17 %	(0.01) %	0.18 %	0.00 %	0.17 %	(0.01) %	0.18 %	0.00 %
June 30, 2014	0.15 %	0.33 %	0.23 %	0.05 %	0.23 %	0.05 %	0.23 %	0.05 %	0.23 %	0.05 %
March 31, 2014	0.16 %	0.34 %	0.18 %	0.00 %	0.20 %	0.02 %	0.20 %	0.02 %	0.20 %	0.02 %
December 31, 2013	0.17 %	0.36 %	0.23 %	0.04 %	0.28 %	0.09 %	0.28 %	0.09 %	0.28 %	0.09 %
September 30, 2013	0.19 %	0.40 %	0.20 %	(0.01) %	0.23 %	0.02 %	0.23 %	0.02 %	0.23 %	0.02 %
June 30, 2013	0.20 %	0.43 %	0.21 %	(0.02) %	0.22 %	(0.01) %	0.22 %	(0.01) %	0.22 %	(0.01) %
March 31, 2013	0.21 %	0.48 %	0.17 %	(0.10) %	0.30 %	0.03 %	0.30 %	0.03 %	0.30 %	0.03 %

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

Nine Months Ended												
September 30, 2014	0.16	%	0.33	%	0.18	%	0.01	%	0.19	%	0.02	%
September 30, 2013	0.20	%	0.44	%	0.19	%	(0.05)	%	0.24	%	0.00	%

28

---

Gains or Losses

The table below presents our gains or losses for the nine and three months ended September 30, 2014 and 2013.

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Realized gains (losses) on sales of RMBS	\$1,932	\$(1,491)	\$3,423	\$(1,960)	\$(667)	\$(1,293)
Unrealized gains (losses) on RMBS	8,720	(9,073)	17,793	(1,404)	86	(1,490)
Total gains (losses) on RMBS	10,652	(10,564)	21,216	(3,364)	(581)	(2,783)
(Losses) gains on interest rate futures	(3,244)	4,096	(7,340)	2,892	(2,272)	5,164
(Losses) gains on payer swaptions	(1,120)	-	(1,120)	166	-	166

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 purposes 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 nine months ended September 30, 2014 and 2013, the Company received proceeds of \$470.0 million and \$237.4 million, respectively, from the sales of RMBS.

The increase in sales volume reflects the repositioning of our portfolio following our capital raising activities in 2014. The net realized and unrealized gains (losses) on RMBS for the nine and three months ended September 30, 2014 and 2013 were the result of sales executed to replace securities that no longer offered attractive risk adjusted returns with those that did. Gains (losses) on interest rate futures contracts are a result of higher / lower short and intermediate term rates and the resulting impact on implied forward rates during the nine and three months ended September 30, 2014 and 2013. The table below presents historical interest rate data for each quarter end during 2014 and 2013.

	10 Year Treasury Rate(1)	15 Year Fixed-Rate Mortgage Rate(2)	30 Year Fixed-Rate Mortgage Rate(2)	Three Month LIBOR(3)
September 30, 2014	2.51 %	3.31 %	4.16 %	0.23 %
June 30, 2014	2.52 %	3.27 %	4.16 %	0.23 %
March 31, 2014	2.72 %	3.36 %	4.34 %	0.23 %
December 31, 2013	3.03 %	3.48 %	4.46 %	0.24 %
September 30, 2013	2.62 %	3.52 %	4.49 %	0.25 %
June 30, 2013	2.48 %	3.17 %	4.07 %	0.27 %
March 31, 2013	1.85 %	2.76 %	3.57 %	0.28 %

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

(2)

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

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

## Expenses

For the nine and three months ended September 30, 2014, the Company's total operating expenses were approximately \$3.0 million and \$1.4 million, respectively, compared to approximately \$1.3 million and \$0.4 million, respectively, for the nine and three months ended September 30, 2013. The table below presents a breakdown of operating expenses for the nine and three months ended September 30, 2014 and 2013.

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Management fees	\$ 1,276	\$ 490	\$ 786	\$ 543	\$ 180	\$ 363
Accrued incentive compensation	450	-	450	225	-	225
Directors fees and liability insurance	405	207	198	165	83	82
Legal fees	102	71	31	39	11	28
Other professional fees	304	250	54	121	60	61
Other direct REIT operating expenses	124	133	(9 )	36	37	(1 )
Other expenses	381	100	281	264	30	234
Total expenses	\$ 3,042	\$ 1,251	\$ 1,791	\$ 1,393	\$ 401	\$ 992

Under the terms of a management agreement that was in effect until the completion of our initial public offering, we paid Bimini a monthly management fee equal to 1/12 of 1.50% per annum of our Stockholders' Equity (as defined in the management agreement). In addition, we paid Bimini a monthly fee of \$7,200, which represented an allocation of overhead expenses for items that included, but were not limited to, occupancy costs, insurance and administrative expenses. These expenses were allocated based on the ratio of our assets and Bimini's consolidated assets. At the completion of our IPO, we entered into a management agreement with Bimini Advisors, LLC, a wholly owned subsidiary of Bimini, which provides for an initial term through February 20, 2016 with automatic one-year extensions and is subject to certain termination rights. Under the terms of the management agreement, Bimini Advisors is responsible for administering the business activities and day-to-day operations of the Company. Bimini Advisors 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 Bimini Advisors for any direct expenses incurred on its behalf. In addition, beginning July 1, 2014, Bimini Advisors began allocating to the Company its pro rata portion of certain overhead costs in accordance with the management agreement.

## Financial Condition:

## Mortgage-Backed Securities

As of September 30, 2014, our RMBS portfolio consisted of \$1,175.5 million of Agency RMBS at fair value and had a weighted average coupon on assets of 4.29%. During the nine months ended September 30, 2014, we received principal repayments of \$52.3 million compared to \$22.6 million for the nine months ended September 30, 2013. The average prepayment speeds for the quarters ended September 30, 2014 and 2013 were 12.5% and 12.6%, respectively.

The following table presents the 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 RMBS Portfolio (%)	Structured RMBS Portfolio (%)	Total Portfolio (%)
September 30, 2014	8.1	18.8	12.5
June 30, 2014	4.1	15.9	8.1
March 31, 2014	4.2	14.9	9.1
December 31, 2013	5.3	17.9	9.9
September 30, 2013	6.5	28.2	12.6
June 30, 2013	6.5	29.8	16.3
March 31, 2013	9.2	33.0	20.0

The following tables summarize certain characteristics of the Company’s PT RMBS and structured RMBS mortgage related securities as of September 30, 2014 and December 31, 2013:

(\$ in thousands)

Asset Category	Fair Value	Percentage of Entire Portfolio	Weighted Average Coupon	Weighted Average Maturity in Months	Longest Maturity	Weighted Average		Weighted Average Periodic Cap	
						Reset in Months	Weighted Average Lifetime Cap		
September 30, 2014									
Adjustable Rate RMBS	\$ 3,847	0.3%	3.56%	239	1-Sep-35	5.71	10.05%	2.00%	
Fixed Rate RMBS	1,035,857	88.1%	4.38%	320	1-Oct-44	NA	NA	NA	
Hybrid Adjustable Rate RMBS	71,442	6.1%	2.54%	341	1-Aug-43	100.75	7.54%	2.00%	
Total Mortgage-backed Pass-through	1,111,146	94.5%	4.26%	321	1-Oct-44	95.89	7.67%	2.00%	
Interest-Only Securities	45,947	3.9%	4.12%	260	25-Jan-43	NA	NA	NA	
Inverse Interest-Only Securities	18,439	1.6%	6.23%	311	25-Apr-41	NA	6.39%	NA	
Total Structured RMBS	64,386	5.5%	4.73%	275	25-Jan-43	NA	NA	NA	
Total Mortgage Assets	\$ 1,175,532	100.0%	4.29%	318	1-Oct-44	NA	NA	NA	
December 31, 2013									
Adjustable Rate RMBS	\$ 5,334	1.5%	3.92%	247	1-Sep-35	3.77	10.13%	2.00%	
Fixed Rate RMBS	245,523	69.9%	4.05%	323	1-Dec-43	NA	NA	NA	
Hybrid Adjustable Rate RMBS	76,118	21.7%	2.56%	350	1-Aug-43	109.60	7.56%	2.00%	
	326,975	93.1%	3.70%	328	1-Dec-43	102.67	7.72%	2.00%	

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

Total Mortgage-backed Pass-through Interest-Only Securities	19,206	5.5%	4.39%	261 25-Nov-40	NA	NA	NA
Inverse Interest-Only Securities	5,042	1.4%	5.92%	317 15-Dec-40	NA	6.08%	NA
Total Structured RMBS	24,248	6.9%	4.71%	272 15-Dec-40	NA	NA	NA
Total Mortgage Assets	\$ 351,223	100.0%	3.77%	324 1-Dec-43	NA	NA	NA

(\$ in thousands)

Agency	September 30, 2014			December 31, 2013		
	Fair Value	Percentage of Entire Portfolio		Fair Value	Percentage of Entire Portfolio	
Fannie Mae	\$798,502	67.93	%	\$211,063	60.09	%
Freddie Mac	367,096	31.23	%	121,842	34.69	%
Ginnie Mae	9,934	0.84	%	18,318	5.22	%
Total Portfolio	\$1,175,532	100.00	%	\$351,223	100.00	%

  

	September 30, 2014	December 31, 2013
Weighted Average Pass Through Purchase Price	\$107.49	\$105.60
Weighted Average Structured Purchase Price	\$13.75	\$12.11
Weighted Average Pass Through Current Price	\$107.83	\$102.83
Weighted Average Structured Current Price	\$14.74	\$14.59
Effective Duration (1)	3.074	4.188

(1) Effective duration is the approximate percentage change in price for a 100 basis point change in rates. An effective duration of 3.074 indicates that an interest rate increase of 1.0% would be expected to cause a 3.074% decrease in the value of the RMBS in the Company's investment portfolio at September 30, 2014. An effective duration of 4.188 indicates that an interest rate increase of 1.0% would be expected to cause a 4.188% decrease in the value of the RMBS in the Company's investment portfolio at December 31, 2013. 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 nine months ended September 30, 2014 and 2013.

(\$ in thousands)

	2014			2013		
	Total Cost	Average Price	Weighted Average Yield	Total Cost	Average Price	Weighted Average Yield
Pass-through RMBS	\$1,537,660	\$107.85	2.83 %	\$494,357	\$104.39	2.25 %
Structured RMBS	50,668	15.23	(2.11)%	34,248	15.60	4.21 %

Our portfolio of PT RMBS is typically comprised of adjustable-rate RMBS, 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 IO's 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) cause their price movements - and model duration - to be affected by changes in both prepayments and one month LIBOR - both current and anticipated levels. As a result, the duration of IIO securities will also vary greatly.

Prepayments on the loans underlying our 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 and effective duration using various third party models or obtain these quotes from third parties. However, empirical results and various third party models may produce different duration numbers for the same securities.

The following sensitivity analysis shows the estimated impact on the fair value of our interest rate-sensitive investments and hedge positions as of September 30, 2014, assuming rates instantaneously fall 100 basis points (“bps”), rise 100 bps and rise 200 bps, adjusted to reflect the impact of convexity, which is the measure of the sensitivity of our hedge positions and Agency RMBS’ effective duration to movements in interest rates.

(\$ in thousands)

RMBS Portfolio	Fair Value	\$ Change in Fair Value			% Change in Fair Value		
		-100BPS	+100BPS	+200BPS	-100BPS	+100BPS	+200BPS
Adjustable Rate RMBS	\$3,847	\$13	\$(43)	\$(103)	0.33 %	(1.13)%	(2.69)%
Hybrid Adjustable Rate RMBS	71,442	2,747	(3,966)	(8,133)	3.85 %	(5.55)%	(11.38)%
Fixed Rate RMBS	1,035,857	27,700	(52,903)	(112,745)	2.67 %	(5.11)%	(10.88)%
Interest-Only RMBS	45,947	(12,604)	9,289	13,376	(27.43)%	20.22 %	29.11 %
Inverse Interest-Only RMBS	18,439	(2,403)	(1,450)	(4,690)	(13.03)%	(7.86)%	(25.44)%
Total RMBS Portfolio	\$1,175,532	\$15,453	\$(49,073)	\$(112,295)	1.31 %	(4.17)%	(9.55)%

(\$ in thousands)

Repurchase Agreement Hedges	Notional Amount(1)	\$ Change in Fair Value			% Change in Fair Value		
		-100BPS	+100BPS	+200BPS	-100BPS	+100BPS	+200BPS
Eurodollar Futures Contracts	\$7,200,000	\$(15,262)	\$18,000	\$36,000	(0.86)%	1.02 %	2.04 %
Payer swaptions	275,000	(3,327)	12,417	31,815	(1.21)%	4.52 %	11.57 %
Total Hedges	\$7,475,000	\$(18,589)	\$30,417	\$67,815	(0.25)%	0.41 %	0.91 %

Grand Totals	\$(3,136 )	\$(18,656 )	\$(44,481 )
--------------	------------	-------------	-------------

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

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

#### Repurchase Agreements

As of September 30, 2014, we had established borrowing facilities in the repurchase agreement market with 17 counterparties, which we believe provide borrowing capacity in excess of our needs. None of these lenders are affiliated with the Company. As of September 30, 2014, we had funding in place with 15 of the 17 counterparties. These borrowings are secured by the Company's RMBS and bear interest rates that are based on a spread to LIBOR.

As of September 30, 2014, we had obligations outstanding under the repurchase agreements of approximately \$1,256.0 million with a net weighted average borrowing cost of 0.34%. The remaining maturity of our outstanding repurchase agreements obligations ranged from 1 to 161 days, with a weighted average remaining maturity of 38 days. Securing the repurchase agreement obligations as of September 30, 2014 are RMBS with an estimated fair value, including accrued interest, of approximately \$1,325.7 million and a weighted average maturity of 320 months, and cash pledged to counterparties of approximately \$4.8 million. Included in these amounts are repurchase agreement balances of approximately \$238.5 million secured by assets with a fair value of approximately \$246.9 million sold in September 2014 that settle in October 2014. In September 2014, the Company purchased assets with a fair value of approximately \$67.1 million which settle in October 2014 that are expected to be funded by repurchase agreements. Through October 28, 2014, we have been able to maintain our repurchase facilities with comparable terms to those that existed at September 30, 2014 with maturities through April 6, 2015.

The table below presents information about our period end and average repurchase agreement obligations for each quarter in 2014 and 2013.

(\$ in thousands)

Three Months Ended	Ending Balance of Repurchase Agreements	Average Balance of Repurchase Agreements	Difference Between Ending Repurchase Agreements and Average Repurchase Agreements		
			Amount	Percent	
September 30, 2014	\$ 1,255,978	\$ 1,019,839	\$ 236,139	23.15	%(1)
June 30, 2014	783,701	717,474	66,227	9.23	%
March 31, 2014	651,246	484,902	166,344	34.30	%(2)
December 31, 2013	318,557	310,107	8,450	2.72	%
September 30, 2013	301,657	305,196	(3,539 )	(1.16	)%
June 30, 2013	308,735	312,591	(3,856 )	(1.23	)%
March 31, 2013	316,446	210,194	106,252	50.55	%(3)

- (1) The higher ending balance relative to the average balance during the quarter ended September 30, 2014 reflects the deployment of the proceeds, on a leveraged basis, of the Company's share issuances under the At-the-Market equity offerings. During the quarter ended September 30, 2014, the Company's investment in PT RMBS increased \$284.2 million.
- (2) The higher ending balance relative to the average balance during the quarter ended March 31, 2014 reflects the deployment of the proceeds, on a leveraged basis, of the Company's January and March 2014 equity offerings. During the quarter ended March 31, 2014, the Company's investment in PT RMBS increased \$374.5 million.
- (3) The higher ending balance relative to the average balance during the quarter ended March 31, 2013 reflects the deployment of the proceeds, on a leveraged basis, of the Company's IPO. During the quarter ended March 31, 2013, the Company's investment in PT RMBS increased \$227.2 million.

#### Liquidity and Capital Resources

Liquidity is our ability to turn non-cash assets into cash, purchase additional investments, repay principal and interest on borrowings, fund overhead, fulfill margin calls and pay dividends. Our principal immediate sources of liquidity include cash balances, unencumbered assets and borrowings under repurchase agreements. Our borrowing capacity will vary over time as the market value of our interest earning assets varies. Our balance sheet also generates liquidity on an on-going basis through payments of principal and interest we receive on our 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 master repurchase agreements have no stated expiration, but can be terminated at any time at our option or at the option of the counterparty. However, once a definitive repurchase agreement under a master repurchase agreement has been entered into, it generally may not be terminated by either party. A negotiated termination can occur, but may involve a fee to be paid by the party seeking to terminate the repurchase agreement transaction.

Under our repurchase agreement funding arrangements, we are required to post margin at the initiation of the borrowing. The margin posted represents the haircut, which is a percentage of the market value of the collateral pledged. To the extent the market value of the asset collateralizing the financing transaction declines, the market value of our posted margin will be insufficient and we will be required to post additional collateral. Conversely, if the market value of the asset pledged increases in value, we would be over collateralized and we 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 nine months ended September 30, 2014, haircuts on our pledged collateral remained stable and as of September 30, 2014, our weighted average haircut was approximately 5.5% of the value of our collateral.

As discussed earlier, we invest a portion of our capital in structured Agency RMBS. We do not fund the purchase of these investments in the repurchase market but instead purchase directly, thus reducing – but not eliminating - the Company's reliance on access to repurchase agreement funding. The leverage inherent in structured securities replaces the leverage obtained by acquiring PT securities and funding them in the repurchase market. This structured 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 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)

	Within One Year	Obligations Maturing			Total
		One to Three Years	Three to Five Years	More than Five Years	
Repurchase agreements	\$1,255,978	\$-	\$-	\$-	\$1,255,978
Interest expense on repurchase agreements(1)	845	-	-	-	845
Unsettled securities purchased	66,812	-	-	-	66,812

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

Totals	\$1,323,635	\$-	\$-	\$-	\$1,323,635
--------	-------------	-----	-----	-----	-------------

(1) Interest expense on repurchase agreements is based on current interest rates as of September 30, 2014 and the remaining term of the liabilities existing at that date.

35

---

In future periods, we expect to continue to finance our activities in a manner that is consistent with our current operations via repurchase agreements. As of September 30, 2014, we had cash and cash equivalents of \$55.0 million. We generated cash flows of \$67.9 million from principal and interest payments on our RMBS and had average repurchase agreements outstanding of \$740.7 million during the nine months ended September 30, 2014.

#### Stockholders' Equity

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

On February 20, 2013, we completed an IPO of our common stock, issuing 2,360,000 shares of common stock at a price of \$15.00 per share. The gross proceeds we received on this sale were \$35.4 million.

In January 2014, we completed a public offering of 2,070,000 shares of our common stock (including 270,000 shares sold pursuant to the full exercise of the overallotment option granted to the underwriters which closed on January 29, 2014) for aggregate net proceeds of approximately \$24.2 million after deducting underwriters' discounts and commissions and offering expenses.

In March 2014, we completed a public offering of 3,680,000 shares of our common stock (including 480,000 shares sold pursuant to the full exercise of the overallotment option granted to the underwriters which closed on April 11, 2014) for aggregate net proceeds of approximately \$44.0 million after deducting underwriters' discounts and commissions and offering expenses.

On June 17, 2014, Orchid entered into an equity distribution agreement (the "June 2014 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 \$35,000,000 of shares of the Company's common stock in transactions that are deemed to be "at-the-market" offerings and privately negotiated transactions. Through September 2, 2014, with final settlement on September 5, 2014, the Company issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees.

On September 3, 2014, Orchid entered into a second equity distribution agreement (the "September 2014 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 \$75,000,000 of shares of the Company's common stock in transactions that are deemed to be "at-the-market" offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. Through September 30, 2014, the Company issued a total of 1,398,524 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$19.1 million, net of commissions and fees. After September 30, 2014, the Company issued an additional 52,532 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$0.7 million, net of commissions and fees.

#### Outlook

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

In response to the credit market disruption and the deteriorating financial conditions of Fannie Mae and Freddie Mac, Congress and the U.S. Treasury undertook a series of actions that culminated with putting Fannie Mae and Freddie

Mac in conservatorship in September 2008. The Federal Housing Finance Agency (“FHFA”) now operates Fannie Mae and Freddie Mac as conservator, in an effort to stabilize the entities. The FHFA also noted that during the conservatorship period, it would work to enact new regulations for minimum capital standards, prudent safety and soundness standards and portfolio limits of Fannie Mae and Freddie Mac.

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

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

The first such goal is to replace the current, outdated infrastructures of Fannie Mae and Freddie Mac with a common, more efficient infrastructure that aligns the standards and practices of the two entities, beginning with core functions performed by both entities such as issuance, master servicing, bond administration, collateral management and data integration. The second goal is to establish an operating framework for Fannie Mae and Freddie Mac that is consistent with the progress of housing finance reform and encourages and accommodates the increased participation of private capital in assuming credit risk associated with the secondary mortgage market. The FHFA recognizes that there are a number of impediments to their goals which may or may not be surmountable, such as the absence of any significant secondary mortgage market mechanisms beyond Fannie Mae, Freddie Mac and Ginnie Mae. The FHFA provided an update on their progress in this regard at an industry conference on October 20, 2014. The Director of the FHFA, Mel Watt, outlined the progress to date associated with representation and warranty practices associated with eligible loans for securitization by the GSEs, the Common Securitization Platform (“CSP”) and Common Securitization Solutions (“CSC”) – a joint venture to house and operate the CSP, which will be designed to allow Fannie Mae and Freddie Mac to securitize loans off of a single platform. As a result, it is still unclear if the proposals will be enacted. If such proposals are enacted, it is unclear how closely what is enacted will resemble the proposals from the FHFA White Paper or what the effects of the enactment will be on housing finance. As the economy has recovered, home prices have increased off the low levels seen in the aftermath of the financial crisis and a significant portion of the shadow inventory of homes that resulted from foreclosures have been worked off. The combination of recovering home prices, attractive financing levels and decreased liquidations of homes via foreclosures have resulted in an acceleration in lending activity.

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

borrowers except in periods of significant credit contraction.

Fannie Mae and Freddie Mac reform regained momentum in the first quarter of 2014 when Senators Tim Johnson (D-SD) and Mike Crapo (R-ID), the two most senior members of the Senate Banking Committee, released a proposed bill (the “Johnson-Crapo Bill”), which is generally based on the Corker-Warner Bill. However, this momentum was lost in the second quarter of 2014 when the Johnson-Crapo Bill was approved by the Senate Banking Committee, but failed to secure enough support to be considered by Congress. The final outcome of the Johnson-Crapo Bill remains uncertain, as reports indicate that the House Republican leadership continues to favor a very different approach. As the FHFA and both houses of Congress are each working on separate measures intended to dramatically restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, we expect debate and discussion on the topic to continue throughout 2014. It is unclear which, if any, of these measures will be enacted, and, if any are enacted, what the effects would be.

The effect of the actions taken and to be taken by the U.S. Treasury, Congress or FHFA remains uncertain. New and recently enacted laws, regulations and programs related to Fannie Mae and Freddie Mac may adversely affect the pricing, supply, liquidity and value of Agency RMBS and otherwise materially harm our business and operations.

The Dodd-Frank Act provides for new regulations on financial institutions and creates new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. Because a significant number of regulations under the Dodd-Frank Act have either not yet been proposed or not yet been adopted in final form, it is not possible for us to predict how the Dodd-Frank Act will impact our business.

#### Interest Rates

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

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

The Federal Reserve provided further guidance to the market in December 2012 by stating that it intended to keep the Federal Funds Rate close to zero while the unemployment rate is above 6.5% and as long as inflation does not rise above 2.5%. In December 2012, the Federal Reserve also announced that it would initially begin buying \$45 billion of long-term Treasury bonds each month and noted that such amount may increase in the future. This bond purchase

program replaced Operation Twist.

The Federal Reserve Open Market Committee (the “FOMC”) meeting minutes released on April 10, 2013 revealed that the FOMC had begun considering when the Federal Reserve should begin tapering the pace of Agency RMBS purchases set in September 2012. The FOMC meeting minutes released on May 22, 2013 announced that the Federal Reserve was considering beginning to taper such purchase as early as June 2013. In minutes released on June 25, 2013, the FOMC stated that the Federal Reserve would begin to scale back Agency RMBS purchases later in 2013 and that such purchases would cease entirely when the unemployment rate reached 7%. On October 30, 2013, the FOMC announced that it would continue reinvesting principal payments from its holdings of agency debt and Agency RMBS into Agency RMBS and U.S. Treasury securities at the current pace indefinitely. The October 30, 2013 announcement provided no additional guidance as to when tapering might begin.

At its December 18, 2013 meeting, the FOMC indicated that it saw improvement in economic activity and labor market conditions. As a result, the FOMC announced that, beginning in January 2014, it would reduce its monthly purchases of Agency RMBS from \$40 billion to \$35 billion and U.S. Treasury securities from \$45 billion to \$40 billion. The FOMC further stated that it would continue reinvesting principal payments from its holdings of these securities in Agency RMBS and rolling over maturing Treasury bonds at auction. Subsequently, the FOMC has announced additional \$5 billion reductions to its monthly purchases of both Agency RMBS and Treasury bonds. Beginning in September 2014, the FOMC’s purchases will be reduced to a pace of \$5 billion per month of Agency RMBS and \$10 billion of U.S. Treasury securities. The FOMC has indicated that it will end its bond buying program in October 2014. The FOMC announced they would continue to reinvest principal and interest payments received from their RMBS portfolio in additional RMBS. The FOMC expects even the lower level of purchases to maintain downward pressure on longer-term interest rates, support mortgage markets and make broader financial conditions more accommodative, which it believes should promote economic recovery and control inflation.

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

Although long-term interest rates are currently at historically low levels, they are still high relative to short-term interest rates. We believe that the relationship between long and short-term interest rates will remain relatively unchanged so long as neither the U.S. economic recovery or inflation rates accelerate to levels unacceptable to the FOMC. The FOMC also recently reiterated its continued long-term goals of reaching maximum employment and inflation at 2% before adjusting the target Federal Funds Rate. If the economic recovery were to strengthen or inflation rates increase, the Federal Reserve may decide to abandon its current low-interest rate policies and/or increase interest rates. Although an increase in the Federal Funds Rate would most likely result in an increase in LIBOR, other European-specific factors, such as a credit disruption in the European inter-bank credit market, could cause an increase in LIBOR independent of movements in the Federal Funds Rate.

Effect on Us

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

Effects on our Assets

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

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

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

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

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

#### Effects on our borrowing costs

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

In order to protect our net interest margin against increases in short-term interest rates, we may enter into interest rate swaps, which effectively convert our floating-rate repurchase agreement debt to fixed-rate debt, or utilize other hedging instruments such as Eurodollar and T-Note futures contracts or interest rate swaptions.



## Summary

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

## Critical Accounting Policies

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

### Mortgage-Backed Securities

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

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

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

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

- First, our Manager obtains fair values from subscription-based independent pricing sources. These prices are used by both our Manager as well as many of our repurchase agreement counterparty on a daily basis to establish margin requirements for our borrowings.
- Second, our Manager requests non-binding quotes from one to four broker-dealers for certain Agency RMBS in order to validate the values obtained by the pricing service. Our Manager requests these quotes from broker-dealers that actively trade and make markets in the respective asset class for which the quote is requested.
- Third, our Manager reviews the values obtained by the pricing source and the broker-dealers for consistency across similar assets.
- Finally, if the data from the pricing services and broker-dealers is not homogenous or if the data obtained is inconsistent with our Manager's market observations, our Manager makes a judgment to determine which price appears the most consistent with observed prices from similar assets and selects that price. To the extent our Manager believes that none of the prices are consistent with observed prices for similar assets, which is typically the case for only an immaterial portion of our portfolio each quarter, our Manager may use a third price that is consistent with observed prices for identical or similar assets. In the case of assets that have quoted prices such as Agency RMBS backed by fixed-rate mortgages, our Manager generally uses the quoted or observed market price. For assets such as Agency RMBS backed by ARMs or structured Agency RMBS, our Manager may determine the price based on the yield or spread that is identical to an observed transaction or a similar asset for which a dealer mark or subscription-based price has been obtained.

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

#### Derivative Financial Instruments

The Company has entered into Eurodollar and T-Note futures contracts and interest rate swaptions to manage interest rate risk, facilitate asset/liability strategies and manage other exposures, and it may continue to do so in the future. The Company has elected to not treat any of its derivative financial instruments as hedges. FASB ASC Topic 815, Derivatives and Hedging, requires that all derivative instruments be carried at fair value. Changes in fair value are recorded in earnings for each period.

#### Repurchase Agreements

We finance the acquisition of a portion of our Agency RMBS through repurchase transactions under master repurchase agreements. Repurchase transactions are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, which due to their short term nature approximate fair value.

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

#### Income Recognition

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

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

## Capital Expenditures

At September 30, 2014, we had no material commitments for capital expenditures.

## Off-Balance Sheet Arrangements

At September 30, 2014, we did not have any off-balance sheet arrangements.

## Dividends

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

Declaration Date	Record Date	Payment Date	Per Share Amount	Total
<b>2014</b>				
October 9, 2014	October 28, 2014	October 31, 2014	\$0.180	\$2,358,177
September 9, 2014	September 25, 2014	September 30, 2014	0.180	2,348,198
August 12, 2014	August 26, 2014	August 29, 2014	0.180	1,998,506
July 10, 2014	July 28, 2014	July 31, 2014	0.180	1,758,965
June 11, 2014	June 25, 2014	June 30, 2014	0.180	1,711,531
May 8, 2014	May 27, 2014	May 30, 2014	0.180	1,640,820
April 8, 2014	April 25, 2014	April 30, 2014	0.180	1,636,500
March 11, 2014	March 26, 2014	March 31, 2014	0.180	1,550,100
February 11, 2014	February 25, 2014	February 28, 2014	0.180	974,100
January 9, 2014	January 27, 2014	January 31, 2014	0.180	925,500
Totals			\$1.800	\$16,902,397
<b>2013</b>				
December 11, 2013	December 26, 2013	December 30, 2013	\$0.180	\$601,497
November 12, 2013	November 25, 2013	November 27, 2013	0.135	451,125
October 10, 2013	October 25, 2013	October 31, 2013	0.135	451,125
September 10, 2013	September 25, 2013	September 30, 2013	0.135	451,125
August 12, 2013	August 26, 2013	August 30, 2013	0.135	451,125
July 9, 2013	July 25, 2013	July 31, 2013	0.135	451,125
June 10, 2013	June 25, 2013	June 28, 2013	0.135	451,125
May 9, 2013	May 28, 2013	May 31, 2013	0.135	451,125
April 10, 2013	April 25, 2013	April 30, 2013	0.135	451,125
March 8, 2013	March 25, 2013	March 27, 2013	0.135	451,125
Totals			\$1.395	\$4,661,622

## Inflation

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

## Jumpstart Our Business Startups Act of 2012

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

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

Not Applicable.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

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

### Changes in Internal Controls over Financial Reporting

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not party to any material pending legal proceedings 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 21, 2014.

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

The Company did not issue or sell equity securities that were not registered under the Securities Act during the three months ended September 30, 2014.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.

- 1.1 Equity Distribution Agreement, dated September 3, 2014, by and between Orchid Island Capital, Inc., Bimini Advisors, LLC, Ladenburg Thalmann & Co., Inc. and Mitsubishi UFJ Securities (USA), Inc. (incorporated by reference to Exhibit 1.1 to the Registrant's Form 8-K filed with the Securities Exchange Commission on September 3, 2014).
- 3.1 Articles of Amendment and Restatement of Orchid Island Capital, Inc. (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws of Orchid Island Capital, Inc. (filed as Exhibit 3.2 to the Company's Registration 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 G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 32.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*\*
- 32.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*\*

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

\* Filed herewith.

\*\* Furnished herewith.

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

Signatures

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

Orchid Island Capital, Inc.  
Registrant

Date: October 28,  
2014

By: /s/ Robert E. Cauley

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

Date: October 28,  
2014

By: /s/ G. Hunter Haas, IV

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

INDEX TO EXHIBITS

Exhibit No.

- 1.1 Equity Distribution Agreement, dated September 3, 2014, by and between Orchid Island Capital, Inc., Bimini Advisors, LLC, Ladenburg Thalmann & Co., Inc. and Mitsubishi UFJ Securities (USA), Inc. (incorporated by reference to Exhibit 1.1 to the Registrant's Form 8-K filed with the Securities Exchange Commission on September 3, 2014).
- 3.1 Articles of Amendment and Restatement of Orchid Island Capital, Inc. (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws of Orchid Island Capital, Inc. (filed as Exhibit 3.2 to the Company's Registration 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 G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 32.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*\*
- 32.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*\*

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

\* Filed herewith.

\*\* Furnished herewith.

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