

LUMINENT MORTGAGE CAPITAL INC

Form 10-Q

December 27, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**FORM 10-Q**

(Mark One)

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2007**

**OR**

☐ **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: 000-31828**

**LUMINENT MORTGAGE CAPITAL, INC.**  
(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**06-1694835**  
(I.R.S. Employer  
Identification No.)

**101 California Street, Suite 1350, San Francisco,  
California**  
(Address of principal executive offices)

**94111**  
(Zip Code)

**(415) 217-4500**

(Registrant's telephone number, including area code)  
(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The number of shares of common stock outstanding on December 24, 2007 was 43,172,839.

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains or incorporates by reference certain forward-looking statements under the Private Securities Litigation Reform Act of 1995. Forward-looking statements convey our current expectations or forecasts of future events. All statements contained in this Form 10-Q other than statements of historical fact are forward-looking statements. Words such as anticipates, estimates, expects, projects, intends, plans, believes and words and similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements.

We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995. These statements may be made directly in this Form 10-Q and they may also be incorporated by reference in this Form 10-Q to other documents we file with the SEC. We base our forward-looking statements upon the current beliefs and expectations of our management and they are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are difficult to predict and generally beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. Actual results may differ materially from the anticipated results discussed in these forward-looking statements. These forward-looking statements include, among other things, statements about:

- our ability to meet margin calls on our repurchase agreement financing that may be required due to further declines in the value of the mortgage-backed securities collateralizing the agreements;

- our ability to obtain or renew sufficient funding to maintain our leverage strategies and support our liquidity position;

- the continued creditworthiness of the holders of mortgages underlying our mortgage-related assets;

- our ability to purchase sufficient mortgages for our securitization business;

- the effect of the flattening of, or other changes in, the yield curve on our investment strategies;

- changes in interest rates and mortgage prepayment rates;

- the possible effect of negative amortization of mortgages on our financial condition and REIT qualification;

- the possible impact of our failure to regain or maintain exemptions under the 1940 Act;

- potential impacts of our leveraging policies on our net income and cash available for distribution;

- the power of our board of directors to change our operating policies and strategies without stockholder approval;

- the effects of interest rate caps and or proposed federal legislation on our adjustable-rate and hybrid adjustable-rate loans and mortgage-backed securities;

- the degree to which our hedging strategies may or may not protect us from interest rate volatility;

- our ability to invest up to 10% of our investment portfolio in residuals, leveraged mortgage derivative securities and shares of other REITs as well as other investments;

- our current inability to make cash distributions to our stockholders because of our liquidity concerns; and

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the other factors described in this Form 10-Q, including those under the captions Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors and Quantitative and Qualitative Disclosures about Market Risk.

We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this Form 10-Q or the date of any document incorporated by reference in this Form 10-Q. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable law or regulation, we undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events.

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PART I  
FINANCIAL INFORMATION

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**LUMINENT MORTGAGE CAPITAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                                                                                                                | <b>September<br/>30,<br/>2007<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2006</b> |
|--------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------|----------------------------------|
| <b>(in thousands, except share and per share amounts)</b>                                                                      |                                                   |                                  |
| <b>Assets:</b>                                                                                                                 |                                                   |                                  |
| Cash and cash equivalents                                                                                                      | \$ 8,285                                          | \$ 5,902                         |
| Restricted cash                                                                                                                | 8,396                                             | 7,498                            |
| Loans held-for-investment, net of allowance for loan losses of \$21,282 at September 30, 2007 and \$5,020 at December 31, 2006 | 4,369,019                                         | 5,591,717                        |
| Mortgage-backed securities, at fair value                                                                                      |                                                   | 141,556                          |
| Mortgage-backed securities pledged as collateral, at fair value                                                                | 907,005                                           | 2,789,382                        |
| Debt securities, at fair value                                                                                                 | 1,006                                             |                                  |
| Equity securities, at fair value                                                                                               | 413                                               | 1,098                            |
| Interest receivable                                                                                                            | 24,023                                            | 36,736                           |
| Principal receivable                                                                                                           | 1,771                                             | 1,029                            |
| Derivatives, at fair value                                                                                                     | 201                                               | 13,021                           |
| Other assets                                                                                                                   | 52,318                                            | 25,856                           |
| <br>Total assets                                                                                                               | <br>\$ 5,372,437                                  | <br>\$ 8,613,795                 |
| <br><b>Liabilities:</b>                                                                                                        |                                                   |                                  |
| Mortgage-backed notes                                                                                                          | \$ 4,030,643                                      | \$ 3,917,677                     |
| Repurchase agreements                                                                                                          | 792,231                                           | 2,707,915                        |
| Warehouse lending facilities                                                                                                   |                                                   | 752,777                          |
| Commercial paper                                                                                                               |                                                   | 637,677                          |
| Collateralized debt obligations                                                                                                | 294,529                                           |                                  |
| Junior subordinated notes                                                                                                      | 92,788                                            | 92,788                           |
| Convertible senior notes                                                                                                       | 90,000                                            |                                  |
| Derivatives, at fair value                                                                                                     | 2,623                                             |                                  |
| Revolving line of credit                                                                                                       | 43,256                                            |                                  |
| Cash distributions payable                                                                                                     | 13,857                                            | 14,343                           |
| Accrued interest expense                                                                                                       | 14,231                                            | 12,094                           |
| Warrant liability, at fair value                                                                                               | 68,910                                            |                                  |
| Accounts payable and accrued expenses                                                                                          | 19,854                                            | 6,969                            |
| <br>Total liabilities                                                                                                          | <br>5,462,922                                     | <br>8,142,240                    |
| <br><b>Stockholders Equity:</b>                                                                                                |                                                   |                                  |
| Preferred stock, par value \$0.001:                                                                                            |                                                   |                                  |
| 10,000,000 shares authorized; no shares issued and outstanding at September 30, 2007 and December 31, 2006                     |                                                   |                                  |
| Common stock, par value \$0.001:                                                                                               |                                                   |                                  |

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|                                                                                                                                                  |                  |                  |
|--------------------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| 100,000,000 shares authorized; 43,172,839 and 47,808,510 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively | 43               | 48               |
| Additional paid-in capital                                                                                                                       | 548,459          | 583,492          |
| Accumulated other comprehensive income                                                                                                           | 2,560            | 3,842            |
| Accumulated distributions in excess of accumulated earnings                                                                                      | (641,547)        | (115,827)        |
| <br>Total stockholders' equity (deficit)                                                                                                         | <br>(90,485)     | <br>471,555      |
| <br>Total liabilities and stockholders' equity (deficit)                                                                                         | <br>\$ 5,372,437 | <br>\$ 8,613,795 |

See notes to condensed consolidated financial statements

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**LUMINENT MORTGAGE CAPITAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

| (in thousands, except share and per share amounts)         | For the Three Months<br>Ended<br>September 30, |              | For the Nine Months<br>Ended<br>September 30, |             |
|------------------------------------------------------------|------------------------------------------------|--------------|-----------------------------------------------|-------------|
|                                                            | 2007                                           | 2006         | 2007                                          | 2006        |
| <b>Net interest income:</b>                                |                                                |              |                                               |             |
| Interest income:                                           |                                                |              |                                               |             |
| Mortgage loan and securitization portfolio                 | \$ 86,869                                      | \$ 65,658    | \$ 281,527                                    | \$ 133,667  |
| Spread portfolio                                           | 21,850                                         | 18,947       | 84,001                                        | 69,757      |
| Credit sensitive bond portfolio                            | 25,268                                         | 10,493       | 60,495                                        | 28,176      |
| <br>Total interest income                                  | <br>133,987                                    | <br>95,098   | <br>426,023                                   | <br>231,600 |
| <br>Interest expense                                       | <br>112,392                                    | <br>73,149   | <br>349,819                                   | <br>172,633 |
| <br>Net interest income                                    | <br>21,595                                     | <br>21,949   | <br>76,204                                    | <br>58,967  |
| <b>Other income (expenses):</b>                            |                                                |              |                                               |             |
| Gains (losses) on derivative instruments, net              | 6,524                                          | (11,689)     | 42,406                                        | 4,087       |
| Gains (losses) on sales of mortgage-backed securities, net | (137,959)                                      | 167          | (153,409)                                     | 990         |
| Losses on sales of loans held-for-investment               | (46,477)                                       |              | (46,477)                                      |             |
| Impairment losses on mortgage-backed securities            | (268,877)                                      |              | (287,622)                                     | (2,179)     |
| Mortgage-backed securities, trading change in fair value   | (18,209)                                       |              | (18,200)                                      |             |
| Warrants, change in fair value                             | (46,569)                                       |              | (46,569)                                      |             |
| Other expense                                              | (49)                                           |              | (156)                                         | (608)       |
| <br>Total other income (expenses)                          | <br>(511,616)                                  | <br>(11,522) | <br>(510,027)                                 | <br>2,290   |
| <b>Operating Expenses:</b>                                 |                                                |              |                                               |             |
| Servicing expense                                          | 5,389                                          | 3,526        | 18,104                                        | 7,546       |
| Provision for loan losses                                  | 10,247                                         | 1,779        | 18,434                                        | 3,304       |
| Salaries and benefits                                      | 8,363                                          | 2,934        | 14,998                                        | 7,375       |
| Professional services                                      | 3,171                                          | 1,088        | 5,012                                         | 2,181       |
| Management compensation expense to related party           |                                                | 6,048        |                                               | 7,712       |
| Other general and administrative expenses                  | 1,690                                          | 1,242        | 5,366                                         | 3,334       |
| <br>Total operating expenses                               | <br>28,860                                     | <br>16,617   | <br>61,914                                    | <br>31,452  |
| <br>Income (loss) before income taxes                      | <br>(518,881)                                  | <br>(6,190)  | <br>(495,737)                                 | <br>29,805  |

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|                                                       |            |              |            |              |           |
|-------------------------------------------------------|------------|--------------|------------|--------------|-----------|
| Income taxes                                          |            | 1,755        | 405        | 1,709        | 1,057     |
| Net income (loss)                                     |            | \$ (520,636) | \$ (6,595) | \$ (497,446) | \$ 28,748 |
| Net income (loss) per share basic                     |            | \$ (12.17)   | \$ (0.17)  | \$ (11.07)   | \$ 0.74   |
| Net income (loss) per share diluted                   |            | \$ (12.17)   | \$ (0.17)  | \$ (11.07)   | \$ 0.74   |
| Weighted-average number of shares outstanding basic   | 42,790,740 | 38,695,800   | 44,943,803 | 38,937,454   |           |
| Weighted-average number of shares outstanding diluted | 42,790,740 | 38,695,800   | 44,943,803 | 39,066,406   |           |
| Dividends per share                                   |            | \$           | \$ 0.30    | \$ 0.62      | \$ 0.55   |

See notes to condensed consolidated financial statements

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**LUMINENT MORTGAGE CAPITAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**(Unaudited)**

| (in thousands)                                                | Common Stock<br>Shares | Par<br>Value | Additional<br>Paid-in<br>Capital | Other<br>Comprehensive<br>Income/(Loss) | Accumulated<br>Distributions<br>in Excess<br>of<br>Accumulated<br>Earnings | Comprehensive<br>Income/(Loss) | Total       |
|---------------------------------------------------------------|------------------------|--------------|----------------------------------|-----------------------------------------|----------------------------------------------------------------------------|--------------------------------|-------------|
| Balance, January 1, 2007                                      | 47,809                 | \$ 48        | \$ 583,492                       | \$ 3,842                                | \$ (115,827)                                                               |                                | \$ 471,555  |
| Net income (loss)                                             |                        |              |                                  |                                         | (497,446)                                                                  | \$ (497,446)                   | (497,446)   |
| Securities<br>available-for-sale, fair<br>value adjustment    |                        |              |                                  | (105)                                   |                                                                            | (105)                          | (105)       |
| Amortization of<br>derivative gains                           |                        |              |                                  | (1,177)                                 |                                                                            | (1,177)                        | (1,177)     |
| Comprehensive<br>income (loss)                                |                        |              |                                  |                                         |                                                                            | \$ (498,728)                   |             |
| Repurchases and<br>retirement of<br>common stock              | (4,905)                | (5)          | (41,290)                         |                                         |                                                                            |                                | (41,295)    |
| Distributions to<br>stockholders                              |                        |              |                                  |                                         | (28,274)                                                                   |                                | (28,274)    |
| Issuance and<br>amortization of<br>restricted common<br>stock | 269                    |              | 6,257                            |                                         |                                                                            |                                | 6,257       |
| Balance,<br>September 30, 2007                                | 43,173                 | \$ 43        | \$ 548,459                       | \$ 2,560                                | \$ (641,547)                                                               |                                | \$ (90,485) |

See notes to condensed consolidated financial statements

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**LUMINENT MORTGAGE CAPITAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

| (in thousands)                                                                                                  | For the Nine Months Ended<br>September 30, |             |
|-----------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------|
|                                                                                                                 | 2007                                       | 2006        |
| <b>Cash flows from operating activities:</b>                                                                    |                                            |             |
| Net income (loss)                                                                                               | \$ (497,446)                               | \$ 28,748   |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:              |                                            |             |
| Amortization of premium/(discount) on loans held-for-investment and mortgage-backed securities and depreciation | 20,652                                     | (941)       |
| Impairment losses on securities                                                                                 | 287,622                                    | 2,179       |
| Provision for loan losses                                                                                       | 18,434                                     | 3,304       |
| Realized loss on real estate owned                                                                              | 491                                        |             |
| Negative amortization of loans held-for-investment                                                              | (86,531)                                   | (35,004)    |
| Share-based compensation                                                                                        | 6,257                                      | 2,594       |
| Net realized and unrealized (gains) losses on derivative instruments                                            | 7,156                                      | (3,459)     |
| Net losses on mortgage backed securities held as trading                                                        | 18,200                                     |             |
| Net change in the fair value of warrants                                                                        | 46,569                                     |             |
| Net (gain) losses on sales of mortgage-backed-securities available-for-sale                                     | 153,409                                    | (990)       |
| Net losses on the sales of loans held-for-investment                                                            | 46,477                                     |             |
| Changes in operating assets and liabilities:                                                                    |                                            |             |
| (Increase) decrease in interest receivable, net of purchased interest                                           | (16,048)                                   | 73          |
| (Increase) decrease in other assets                                                                             | 2,452                                      | (2,042)     |
| Increase in accounts payable and other liabilities                                                              | 12,304                                     | 890         |
| Increase (decrease) in accrued interest expense                                                                 | 2,742                                      | (13,183)    |
| Increase in management compensation payable, incentive compensation payable and other related-party payable     |                                            | 4,949       |
| Net cash provided by (used in) operating activities                                                             | 22,740                                     | (12,882)    |
| <b>Cash flows from investing activities:</b>                                                                    |                                            |             |
| Purchases of mortgage-backed securities                                                                         | (821,436)                                  | (1,849,595) |
| Proceeds from sales of mortgage-backed securities                                                               | 1,863,969                                  | 3,750,554   |
| Principal payments of mortgage-backed securities                                                                | 376,188                                    | 364,781     |
| Purchases of loans held-for-investment, net                                                                     | (1,679,991)                                | (3,949,480) |
| Principal payments of loans held-for-investment                                                                 | 1,295,362                                  | 272,476     |
| Proceeds from the sale of loans held-for-investment                                                             | 957,150                                    |             |
| Purchases of derivative instruments                                                                             | (32,979)                                   | (2,792)     |
| Proceeds from derivative instruments                                                                            | 40,184                                     | 3,484       |
| Purchase of debt securities                                                                                     | (1,271)                                    |             |
| Net change in restricted cash                                                                                   | (8,437)                                    | 671         |
| Other                                                                                                           | (129)                                      |             |
| Net cash provided by (used in) investing activities                                                             | 1,988,610                                  | (1,409,901) |

**Cash flows from financing activities:**

|                                                           |              |               |
|-----------------------------------------------------------|--------------|---------------|
| Proceeds from issuance of common stock                    |              | 11,747        |
| Repurchases of common stock                               | (41,295)     | (15,832)      |
| Capitalized financing costs                               | (2,355)      |               |
| Borrowings under repurchase agreements                    | 31,313,807   | 27,681,403    |
| Principal payments on repurchase agreements               | (33,021,207) | (29,080,973)  |
| Borrowings under warehouse lending facilities             | 2,069,957    | 3,806,251     |
| Paydown of warehouse lending facilities                   | (2,822,551)  | (3,806,251)   |
| Borrowings under commercial paper facility                | 3,849,451    |               |
| Paydown of commercial paper facility                      | (4,487,127)  |               |
| Distributions to stockholders                             | (28,760)     | (11,014)      |
| Proceeds from issuance of mortgage-backed notes           | 1,763,061    | 3,062,397     |
| Principal payments on mortgage-backed notes               | (1,025,663)  | (214,187)     |
| Proceeds from issuance of collateralized debt obligations | 291,027      |               |
| Principal payments on collateralized debt obligations     | (568)        |               |
| Principal payments on margin debt                         |              | (3,548)       |
| Proceeds from issuance of convertible senior notes        | 90,000       |               |
| Proceeds from revolving line of credit                    | 43,256       |               |
| Net cash provided by (used in) financing activities       | (2,008,967)  | 1,429,993     |
| <b>Net increase in cash and cash equivalents</b>          | <b>2,383</b> | <b>7,210</b>  |
| <b>Cash and cash equivalents, beginning of the period</b> | <b>5,902</b> | <b>11,466</b> |