

LUMINENT MORTGAGE CAPITAL INC

Form 10-Q

September 26, 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 June 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 August 31, 2007 was 43,303,004.

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INTRODUCTORY NOTE

The consolidated financial statements of Luminent Mortgage Capital, Inc. (our , we or us) as of June 30, 2007 and for the three and six months ended June 30, 2007, have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01, of Regulation S-X for interim financial statements.

Subsequent to June 30, 2007, a number of material and adverse changes in the availability of financing for prime quality mortgage-related securities occurred. These changes accelerated in an unprecedented manner in early August 2007, when traditional lenders to the mortgage industry substantially reduced and, in some cases, eliminated debt financing to the industry. These changes also included a significant reduction in the availability of various types of short-term financing, including repurchase agreements and asset-backed commercial paper. Lenders have also increased their margin requirements, which has resulted in numerous margin calls and distressed prices for mortgage-backed securities. These market conditions have created a liquidity crisis that has materially adversely affected many companies in the mortgage business, including us.

As reported in greater detail in Note 1 and Note 12 to our consolidated financial statements, subsequent to June 30, 2007 we have incurred significant losses from the sale of assets at distressed prices to meet margin calls, seizure of certain assets by creditors and defaults under our financing agreements, among other events. As a result, our current consolidated financial condition and results of operations are materially different from our consolidated financial condition and results of operations at June 30, 2007 and for the three and six months then ended as presented in the accompanying consolidated financial statements.

We caution you to bear these developments in mind when reading this Form 10-Q Report and to await further financial and strategic information that we will publish when we have completed the analysis of our current financial condition.

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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:

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;

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

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

the possible impact of our failure to 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;

effects of interest rate caps 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;

volatility in the timing and amount of our cash distributions; and

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.

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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
(Unaudited)

(in thousands, except share and per share amounts)	June 30, 2007	December 31, 2006
Assets:		
Cash and cash equivalents	\$ 13,254	\$ 5,902
Restricted cash	14,559	7,498
Loans held-for-investment, net of allowance for loan losses of \$12,297 at June 30, 2007 and \$5,020 at December 31, 2006	5,934,480	5,591,717
Mortgage-backed securities, at fair value	84,602	141,556
Mortgage-backed securities pledged as collateral, at fair value	3,309,437	2,789,382
Debt securities, at fair value	1,157	
Equity securities, at fair value	831	1,098
Interest receivable	38,347	36,736
Principal receivable	2,515	1,029
Derivatives, at fair value	59,766	13,021
Other assets	40,798	25,856
Total assets	\$ 9,499,746	\$ 8,613,795
Liabilities:		
Mortgage-backed notes	\$ 4,515,197	\$ 3,917,677
Repurchase agreements	2,868,572	2,707,915
Warehouse lending facilities	573,658	752,777
Commercial paper	573,385	637,677
Collateralized debt obligations	295,013	
Junior subordinated notes	92,788	92,788
Convertible senior notes	90,000	
Unsettled security purchases	4,572	
Cash distributions payable	13,857	14,343
Accrued interest expense	15,436	12,094
Accounts payable and accrued expenses	22,156	6,969
Total liabilities	9,064,634	8,142,240
Stockholders Equity:		
Preferred stock, par value \$0.001: 10,000,000 shares authorized; no shares issued and outstanding at June 30, 2007 and December 31, 2006		
Common stock, par value \$0.001:	43	48

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100,000,000 shares authorized; 43,303,004 and 47,808,510 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively

Additional paid-in capital	543,859	583,492
Accumulated other comprehensive income	12,122	3,842
Accumulated distributions in excess of accumulated earnings	(120,912)	(115,827)
Total stockholders' equity	435,112	471,555
Total liabilities and stockholders' equity	\$ 9,499,746	\$ 8,613,795

See notes to condensed consolidated financial statements

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(in thousands, except share and per share amounts)	2007	2006	2007	2006
Net interest income:				
Interest income:				
Mortgage loan and securitization portfolio	\$ 95,967	\$ 45,398	\$ 194,658	\$ 68,009
Spread portfolio	31,775	19,845	62,151	50,810
Credit sensitive bond portfolio	18,727	9,667	35,226	17,683
Total interest income	146,469	74,910	292,035	136,502
Interest expense	122,222	53,513	237,426	99,484
Net interest income	24,247	21,397	54,609	37,018
Other income:				
Gains on derivatives, net	20,617	7,183	35,882	15,776
Impairment losses on securities	(18,740)	(462)	(18,745)	(2,179)
Gains (losses) on sales of mortgage-backed securities	4	(1,240)	(15,449)	823
Other expense	(19)	(131)	(99)	(608)
Total other income	1,862	5,350	1,589	13,812
Expenses:				
Servicing expense	6,730	2,538	12,716	4,020
Provision for loan losses	4,645	1,525	8,188	1,525
Salaries and benefits	3,551	2,018	6,635	4,441
Professional services	997	471	1,841	1,093
Management compensation expense to related party		854		1,665
Other general and administrative expenses	1,889	1,136	3,674	2,091
Total expenses	17,812	8,542	33,054	14,835
Income before income taxes	8,297	18,205	23,144	35,995
Income taxes (benefit)	(506)	641	(45)	652

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Net income		\$	8,803	\$	17,564	\$	23,189	\$	35,343
Net income per share	basic	\$	0.20	\$	0.45	\$	0.50	\$	0.90
Net income per share	diluted	\$	0.20	\$	0.45	\$	0.50	\$	0.90
Weighted-average number of shares outstanding	basic		44,774,340		38,609,963		46,038,178		39,060,284
Weighted-average number of shares outstanding	diluted		44,898,778		38,834,435		46,220,019		39,337,203
Dividend per share		\$	0.32	\$	0.20	\$	0.62	\$	0.25

See notes to condensed consolidated financial statements

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

(in thousands)	Common Stock Shares	Par Value	Additional Paid-in Capital	Other Comprehensive Income/(Loss)	Accumulated Distributions in Excess of Accumulated Earnings	Comprehensive Income/(Loss)	Total
Balance, January 1, 2007	47,809	\$ 48	\$ 583,492	\$ 3,842	\$ (115,827)		\$ 471,555
Net income					23,189	\$ 23,189	23,189
Securities available-for-sale, fair value adjustment				9,116		9,116	9,116
Amortization of derivative gains				(836)		(836)	(836)
Comprehensive income						\$ 31,469	
Repurchases of common stock	(4,775)	(5)	(41,118)				(41,123)
Distributions to stockholders					(28,274)		(28,274)
Issuance and amortization of restricted common stock	269		1,485				1,485
Balance, June 30, 2007	43,303	\$ 43	\$ 543,859	\$ 12,122	\$ (120,912)		\$ 435,112

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 Six Months Ended June	
	2007	30, 2006
Cash flows from operating activities:		
Net income	\$ 23,189	\$ 35,343
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of premium/(discount) on loans held-for-investment and mortgage-backed securities and depreciation	11,800	(1,416)
Impairment losses on securities	18,745	2,179
Provision for loan losses	8,188	1,525
Negative amortization of loans held-for-investment	(52,196)	(16,969)
Share-based compensation	1,485	1,676
Net realized and unrealized gains on derivative instruments	(20,906)	(14,759)
Net (losses) on mortgage backed securities held as trading	(9)	
Net gain (losses) on sales of mortgage-backed-securities available-for-sale	15,449	(823)
Changes in operating assets and liabilities:		
(Increase) decrease in interest receivable, net of purchased interest	(1,320)	1,130
(Increase) decrease in other assets	1,171	(15,305)
Increase in accounts payable and other liabilities	14,798	310
Increase (decrease) in accrued interest expense	3,342	(11,527)
Increase in management compensation payable, incentive compensation payable and other related-party payable		588
 Net cash provided by (used in) operating activities	 23,736	 (18,048)
 Cash flows from investing activities:		
Purchases of mortgage-backed securities	(790,866)	(1,449,385)
Proceeds from sales of mortgage-backed securities	31,348	3,619,558
Principal payments of mortgage-backed securities	280,454	289,359
Purchases of loans held-for-investment, net	(1,262,734)	(3,143,481)
Principal payments of loans held-for-investment	940,605	106,707
Purchases of derivative instruments	(32,979)	(1,555)
Proceeds from derivative instruments	7,331	2,326
Purchase of debt securities	(1,271)	
Net change in restricted cash	(7,061)	747
Other	(176)	
 Net cash used in investing activities	 (835,349)	 (575,724)
 Cash flows from financing activities:		

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Repurchases of common stock	(41,123)	(15,534)
Capitalized financing costs	(7,122)	
Borrowings under repurchase agreements	21,901,406	19,794,029
Principal payments on repurchase agreements	(21,740,749)	(21,414,302)
Borrowings under warehouse lending facilities	1,651,917	2,468,843
Paydown of warehouse lending facilities	(1,830,852)	(2,467,969)
Borrowings under commercial paper facility	2,838,460	
Paydown of commercial paper facility	(2,902,752)	
Distributions to stockholders	(28,760)	(3,202)
Proceeds from issuance of mortgage-backed notes	1,359,447	2,324,948
Principal payments on mortgage-backed notes	(761,934)	(94,196)
Proceeds from issuance of collateralized debt obligations	291,027	
Principal payments on margin debt		(3,548)
Proceeds from issuance of convertible senior notes	90,000	