Great Ajax Corp.
Form 10-Q
November 12, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from __________________ to __________________

001-36844
(Commission file number)

GREAT AJAX CORP.
(Exact name of registrant as specified in its charter)

Maryland	47-1271842
State or other jurisdiction of incorporation or organization	**(I.R.S. Employer Identification No.)**

9400 SW Beaverton-Hillsdale Hwy, Suite 131 Beaverton, OR 97005	97005
(Address of principal executive offices)	**(Zip Code)**

503-505-5670
Registrant's telephone number, including area code

Indicate by check mark whether the Registrant (1) has filed all reports 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 report(s), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x 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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer x (Do not check if a smaller reporting company) Smaller reporting company ¨

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

As of November 12, 2015, 15,926,052 shares of the Registrant's common stock, par value $0.01 per share, were outstanding which includes 624,106 of operating partnership units that are redeemable on a one-for-one basis into shares of the registrant's common stock.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Interim Financial Statements

GREAT AJAX CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except shares and per share data)

	September 30, 2015 (unaudited)	**December 31, 2014**
ASSETS		
Cash and cash equivalents	$ 28,507	$ 53,099
Mortgage loans, net(1)	510,594	211,159
Property held-for-sale	9,168	1,316
Rental property, net	121	290
Receivable from servicer	6,458	1,340
Investment in affiliate	2,532	2,237
Prepaid expenses and other assets	8,218	3,317
Total Assets	$ 565,598	$ 272,758
LIABILITIES AND EQUITY		
Liabilities:		
Secured borrowings(1)	$ 197,836	$ 84,679
Borrowings under repurchase agreement	130,798	15,249
Management fee payable	646	258
Accrued expenses and other liabilities	3,209	1,292
Total liabilities	332,489	101,478
Commitments and contingencies – see Note 7		
Equity:		
Preferred stock $.01 par value; 25,000,000 shares authorized, none issued or outstanding	-	-
Common stock $.01 par value; 125,000,000 shares authorized, 15,285,528 shares at September 30, 2015 and 11,223,984 shares at December 31, 2014 issued and outstanding	152	112
Additional paid-in capital	211,595	158,951
Retained earnings	11,530	2,744
Equity attributable to common stockholders	223,277	161,807

Noncontrolling interests	9,832	9,473
Total equity	233,109	171,280
Total Liabilities and Equity	$ 565,598	$ 272,758

(1) Mortgage loans includes $291,314 and $127,559 of loans at September 30, 2015 and December 31, 2014, respectively, transferred to securitization trusts that are variable interest entities ("VIEs"); these loans can only be used to settle obligations of the VIEs. Secured borrowings consist of notes issued by VIEs that can only be settled with the assets and cash flows of the VIEs. The creditors do not have recourse to the primary beneficiary (Great Ajax Corp.). See Note 8—Debt.

The accompanying notes are an integral part of the consolidated interim financial statements.

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GREAT AJAX CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands except shares and per share data)

	Three months ended September 30, 2015	Period from commenced operations (July 8, 2014) to September 30, 2014	Nine months ended September 30, 2015	Period from inception (January 30, 2014) to September 30, 2014
INCOME				
Loan interest income	$ 14,440	$ 2,266	$ 32,116	$ 2,266
Interest expense	(3,849)	-	(7,192)	-
Net interest income	10,591	2,266	24,924	2,266
Other income	217	25	663	25
Total income	10,808	2,291	25,587	2,291
EXPENSE				
Related party expense – management fee	861	439	2,464	439
Related party expense – loan servicing fees	1,196	157	2,703	157
Loan transaction expense	310	129	1,299	129
Professional fees	278	200	1,019	200
Other expense	230	142	679	142
Total expense	2,875	1,067	8,164	1,067
Income before provision for income taxes	7,933	1,224	17,423	1,224
Provision for income taxes	8	-	24	-
Consolidated net income	7,925	1,224	17,399	1,224
Less: consolidated net income attributable to the non-controlling interest	311	228	709	228
Consolidated net income attributable to common stockholders	$ 7,614	$ 996	$ 16,690	$ 996
Basic earnings per common share	$ 0.50	$ 0.13	$ 1.15	$ 0.13

Diluted earnings per common share	$ 0.50	$ 0.13	$ 1.15	$ 0.13
Weighted average shares - basic	15,273,818	7,762,963	14,514,907	7,762,963
Weighted average shares - diluted	15,926,052	8,207,705	15,180,350	8,207,705

The accompanying notes are an integral part of the consolidated interim financial statements.

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GREAT AJAX CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine months ended September 30, 2015	Period from inception (January 30, 2014) to September 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	$ 17,399	$ 1,224
Adjustments to reconcile net income to net cash from operating activities		
Stock-based management fee and compensation expense	1,155	260
Non-cash interest income accretion	(21,008)	(1,471)
Gain on sale of property	(131)	-
Depreciation of property	1	1
Amortization of prepaid financing costs	991	-
Net change in operating assets and liabilities		
Prepaid expenses and other assets	(5,892)	(679)
Receivable from servicer	(5,118)	(722)
Undistributed income from investment in affiliate	(410)	(20)
Accrued expenses and other liabilities	2,305	2,822
Net cash from operating activities	(10,708)	1,415
CASH FLOWS FROM INVESTING ACTIVITES		
Purchase of mortgage loans and related balances	(300,379)	(104,394)
Principal paydowns on mortgage loans	16,440	782
Purchase of property held-for-sale and related balances	(2,888)	(124)
Purchase of rental property and related balances	-	(278)
Proceeds from sale of property held-for-sale	1,081	-
Distribution from affiliate	115	-
Renovations of rental property and property held for sale	(234)	-
Net cash from investing activities	(285,865)	(104,014)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from repurchase agreement	202,996	-
Proceeds from sale or issuance of secured notes	136,939	-
Repayments on repurchase agreement	(87,447)	-
Repayments on secured notes	(23,782)	-
Sale of common stock, net of offering costs	51,529	119,605
Sale of operating units of subsidiary	-	7,022

Distribution to non-controlling interest	(350)	(178)
Dividends paid on common stock	(7,904)	-
Net cash from financing activities	271,981	126,449
NET CHANGE IN CASH AND CASH EQUIVALENTS	(24,592)	23,850
CASH AND CASH EQUIVALENTS, beginning of period	53,099	-
CASH AND CASH EQUIVALENTS, end of period	$ 28,507	$ 23,850
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 5,817	$ -
Cash paid for income taxes	$ -	$ -
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Transfer of loans to rental property or property held for sale	$ 5,813	$ -
Issuance of common stock for management fee and compensation expense	$ 1,155	$ -
Property sold to borrowers under installment method	$ 132	$ -
Exchange of membership interest in Little Ajax II for mortgage loans	$ -	$ 48,280
Loan acquisition payable	$ -	$ 11,401

The accompanying notes are an integral part of the consolidated interim financial statements.

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GREAT AJAX CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)

(Dollars in thousands)

From inception (January 30, 2014) through September 30, 2014

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity	Noncontrolling Interest	Total Equity
Initial capitalization	-	$ 2	-	$ 2	-	$2
Consolidation of majority-owned subsidiary	-	-	-	-	$ 10,598	10,598
Issuance of shares	$ 85	119,520	-	119,605	-	119,605
Issuance of operating partnership units	-	-	-	-	7,022	7,022
Net income	-	-	$ 996	996	228	1,224
Stock-based management fee expense	-	219	-	219	-	219
Stock-based compensation expense	-	41	-	41	-	41
Dissolution of majority-owned subsidiary	-	-	-	-	(10,598)	(10,598)
Distribution to non-controlling interest	-	-	-	-	(178)	(178)
Balance at September 30, 2014	$ 85	$ 119,782	$ 996	$ 120,863	$ 7,072	$127,935

For the nine months ended September 30, 2015

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2014	$ 112	$ 158,951	$ 2,744	$ 161,807	$ 9,473	$171,280
Issuance of shares	40	51,489	-	51,529	-	51,529
Net income	-	-	16,690	16,690	709	17,399

Stock-based management fee expense	-	1,016	-	1,016	-	1,016
Stock-based compensation expense	-	139	-	139	-	139
Dividends and distributions	-	-	(7,904)	(7,904)	(350)	(8,254)
Balance at September 30, 2015	$ 152	$ 211,595	$ 11,530	$ 223,277	$ 9,832	$ 233,109

The accompanying notes are an integral part of the consolidated interim financial statements.

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GREAT AJAX CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015

(Unaudited)

Note 1 — Organization and basis of presentation

Great Ajax Corp., a Maryland corporation (the “Company”), is an externally managed real estate company formed on January 30, 2014 and capitalized on March 28, 2014 by its then sole stockholder, Aspen Yo LLC (“Aspen Yo”), a company affiliated with the Aspen Capital companies (“Aspen Capital”). The Company was formed to facilitate capital raising activities and to operate as a mortgage real estate investment trust. The Company focuses primarily on acquiring, investing in and managing a portfolio of re-performing (“RPL”) and non-performing (“NPL”) mortgage loans secured by single-family residences and, to a lesser extent, single-family properties. Re-performing loans are loans on which at least five of the seven most recent payments have been made, or the most recent payment has been made and accepted pursuant to an agreement, or the full dollar amount to cover at least five payments has been paid in the last seven months. Non-performing loans are those loans on which the most recent three payments have not been made. The Company also invests in loans secured by smaller multi-family residential and commercial mixed use retail/residential properties, as well as in the properties directly. The Company’s manager is Thetis Asset Management LLC (the “Manager” or “Thetis”), an affiliated company. The Company owns 19.8% of the Manager. The Company’s mortgage loans and real properties are serviced by Gregory Funding LLC (“Gregory” or “Servicer”), also an affiliated company. The Company has elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the “Code”), commencing with the year ended December 31, 2014.

The Company conducts substantially all of its business through its operating partnership, Great Ajax Operating Partnership L.P., a Delaware limited partnership, and its subsidiaries. The Company, through a wholly owned subsidiary, is the sole general partner of the operating partnership. GA-TRS LLC, or Thetis TRS, is a wholly owned subsidiary of the operating partnership that owns the equity interest in the Manager. The Company elected to treat Thetis TRS as a “taxable REIT subsidiary” (“TRS”) under the Code. In September 2014, the Company formed Great Ajax Funding LLC, a wholly owned subsidiary of the operating partnership, to act as the depositor of mortgage loans into securitization trusts and to hold the subordinated securities issued by such trusts and any additional trusts the Company may form for additional securitizations. The Company generally securitizes its mortgage loans and retains subordinated securities from the securitizations. In November 2014, the Company formed AJX Mortgage Trust I, a wholly owned subsidiary of the operating partnership, in connection with a repurchase agreement. In addition, the Company, through its operating partnership, holds real estate owned properties (“REO”) acquired upon the foreclosure or other settlement of its owned non-performing loans, as well as through outright purchases. On February 1, 2015, the Company formed GAJX Real Estate LLC, as a wholly owned subsidiary of the operating partnership, to own, maintain, improve and sell REO properties. The Company has elected to treat GAJX Real Estate LLC as a TRS under the Code.

The Company commenced its operations following the completion of its initial private offering in July 2014. On July 8, 2014, the Company closed a private offering, pursuant to which the Company sold 8,213,116 shares of common stock and 453,551 Class A Units of the operating partnership (the “OP Units”), which are redeemable on a 1-for-1 basis into shares of its common stock after one year of ownership. On August 1, 2014, the Company closed the sale of an additional 263,570 shares of common stock and 14,555 OP Units pursuant to the exercise of the option to purchase additional shares granted to the initial purchaser and placement agent. The purchase price per share and per OP Unit was $15.00. In these offerings, which are referred to collectively as the “Original Private Placement,” the net proceeds, including from the additional shares purchased pursuant to the option to purchase additional shares and OP Units, after deducting the initial purchaser’s discount and placement fee and estimated offering expenses payable, was approximately $128.4 million. The Original Private Placement was made in reliance on the exemptions from registration set forth in Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), and Rule 506 of Regulation D thereunder and Rule 144A under the Securities Act.

Upon the closing of the Original Private Placement, the Company used $48.8 million of the proceeds to acquire its initial mortgage portfolio through the acquisition of 82% of the equity interests in Little Ajax II, LLC

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("Little Ajax II"). Little Ajax II was an affiliated entity that acquired primarily re-performing mortgage loans and a number of non-performing mortgage loans in a series of transactions between December 1, 2013 and July 7, 2014. In September 2014, the Company completed a transaction to acquire the remaining interests in this initial mortgage-related asset portfolio. The transaction initially had Little Ajax II redeem the 82% membership interest of the operating partnership by distributing to the operating partnership 82% of all Little Ajax II loans, participation interests and real property. The operating partnership then purchased for cash the remaining 18% interest in such real estate assets for an aggregate purchase price of approximately $11.4 million. The operating partnership also purchased from Gregory its 5% interest in the 43 loans in which Little Ajax II held a 95% participation interest for approximately $0.2 million.

On December 16, 2014, the Company closed an additional private placement (the "Second Private Placement"), pursuant to which it sold 2,725,326 shares of common stock and 156,000 OP Units. The purchase price per share was $15.00. The net proceeds from the private placement after deducting the placement fee and offering expenses paid by the Company, was approximately $41.2 million. The Company used the proceeds of the Original Private Placement and the Second Private Placement, referred to collectively as the Private Placements, to purchase re-performing and non-performing loans. The Company completed its initial public offering, or IPO, in February 2015 in which the Company and selling stockholders sold an aggregate of 5,276,797 shares of common stock, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. The Company sold 3,976,464 shares of common stock and selling stockholders sold 1,300,333 shares of common stock, in each case, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. The Company used the approximately $53.9 million of proceeds (after deducting the underwriting discount but before deducting estimated offering expenses) to acquire additional mortgage loans and mortgage-related assets.

Basis of presentation and use of estimates

These interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and the notes thereto for the period ended December 31, 2014 included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on March 26, 2015.

Interim financial statements are prepared in accordance with accounting principles generally accepted in the United States (" U.S. GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Regulation S-X. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of financial statements for the interim period presented, have been included. The current period's results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2015.

The consolidated financial statements have been prepared in accordance with U.S. GAAP, as contained within the Accounting Standards Codification (“ASC”) of the Financial Accounting Standards Board (“FASB”) and the rules and regulations of the SEC, as applied to interim financial statements. Since the Company commenced operations in July 2014, the Company’s results of operations for the periods from inception and commenced operations through September 30, 2014 reflect its results for partial periods only. As a result, a comparison of the results of operations between the 2014 and the 2015 periods may not be comparable and is not indicative of the expected period to period variations.

All controlled subsidiaries are included in the consolidated financial statements and all intercompany accounts and transactions have been eliminated in consolidation. The operating partnership is a majority owned partnership that has a non-controlling ownership interest that is included in non-controlling interests on the consolidated balance sheet. As of September 30, 2015, the Company owned 96.1% of the outstanding OP Units and the remaining 3.9% of the OP Units were owned by an unaffiliated holder.

The Company’s 19.8% investment in the Manager is accounted for using the equity method because it exercises significant influence on the operations of the Manager through common officers and directors. There is no traded or quoted price for the interests in the Manager since it is privately held.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company considers significant estimates to include expected cash flows from mortgage loans and fair value measurements.

Note 2 — Summary of significant accounting policies

Cash and cash equivalents

Highly liquid investments with an original maturity of three months or less when purchased are considered cash equivalents. The Company maintains cash and cash equivalents at insured banking institutions. Certain account balances exceed Federal Deposit Insurance Corporation (“FDIC”) insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage.

Organizational expenses

Organizational expenses are expensed as incurred or when they become reimbursable. Organizational expenses consisted mainly of legal fees.

Offering costs

Costs associated with the Company’s completed offering of shares of common stock have been netted against, and are reflected as a reduction in additional paid-in capital.

Earnings per share

Basic earnings per share is computed by dividing consolidated net income attributable to common stockholders by the weighted average common stock outstanding during the period. The Company treats unvested restricted stock issued under its stock-based compensation plan, which are entitled to non-forfeitable dividends, as participating securities and applies the two-class method in calculating basic earnings per share. Diluted earnings per share is computed by dividing consolidated net income attributable to common stockholders and dilutive securities by the weighted average common stock outstanding for the period plus other potentially dilutive securities, such as stock grants, shares that would be issued in the event that OP Units are redeemed for shares of common stock of the Company and shares issued in respect of the stock-based portion of the base fee payable to the Manager and directors' fees.

Stock-based payments

The Management Agreement (as defined below) provides for the payment to the Manager of a management fee. The Company pays a portion of the management fee in cash, and a portion of the management fee in shares of the Company's common stock, which are issued to the Manager in a private placement and are restricted securities under the Securities Act. On October 27, 2015, the Company entered into an amended and restated management agreement with the Manager (the "Amended and Restated Agreement"), which amended the portion of the Base Management Fee and Manager's Incentive Fee to be payable in cash and shares of the Company's common stock retroactive to July 1, 2015. (For more information see Note 13-Subsequent events.) Shares issued to the Manager are determined based on the higher of the most recently reported book value or the average of the closing prices of our common stock on the NYSE on the five business days after the date on which the most recent regular quarterly dividend to holders of our common stock is paid. Management fees paid in common stock are expensed in the quarter incurred and recorded in equity at quarter end.

Pursuant to the Company's 2014 Director Equity Plan (the "Director Plan"), the Company may make stock-based awards. The Company has issued to each of the independent directors restricted stock awards of 2,000 shares of its common stock, which are subject to a one-year vesting period. In addition, each of the Company's independent directors receives an annual retainer of $50,000, payable quarterly, half of which is paid in shares of the Company's common stock on the same basis as the stock portion of the management fee payable to the Manager, and half in cash. Stock-based expense for the directors' annual retainer is expensed as earned, in equal quarterly amounts during the year, and recorded in equity at quarter end.

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Directors’ fees

The expense related to directors’ fees is accrued and reflected in stockholders’ equity in the period in which it is incurred.

Management fee and expense reimbursement

Under the management agreement with the Manager, the Company pays a quarterly base management fee based on its stockholders’ equity and a quarterly incentive management fee based on its cash distributions to its stockholders. Manager fees are expensed in the quarter incurred and the portion payable in common stock is included in stockholders’ equity at quarter end. See Note 9 — Related party transactions.

Servicing fees

Under the servicing agreement, Gregory receives servicing fees ranging from 0.65% – 1.25% annually of unpaid principal balance (“UPB”) (or the fair market value or purchase price of REO that the Company owns or acquires). Gregory is reimbursed for all customary, reasonable and necessary out-of-pocket costs and expenses incurred in the performance of its obligations, including the actual cost of any repairs and renovations undertaken on the Company’s behalf. The total fees incurred by the Company for these services will be dependent upon the UPB and type of mortgage loans that Gregory services, property values, previous UPB of the relevant loan, and the number of REO properties. The agreement will automatically renew for successive one-year terms, subject to prior written notice of non-renewal. In certain cases, the Company may be obligated to pay a termination fee. The Management Agreement will automatically terminate at the same time as the servicing agreement if the servicing agreement is terminated for any reason. See Note 9 — Related party transactions.

Fair value of financial instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- **Level 1** — Quoted prices in active markets for identical assets or liabilities.

- **Level 2** — Observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- **Level 3** — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The degree of judgment utilized in measuring fair value generally correlates to the level of pricing observability. Assets and liabilities with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, assets and liabilities rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of asset or liability, whether it is new to the market and not yet established, and the characteristics specific to the transaction.

Property held-for-sale is measured at cost at acquisition for purchased REO, or at the present value of future cash flows for foreclosed REO, and is subsequently measured at the lower of acquisition basis or fair value less cost to sell on a nonrecurring basis. The fair value of property held-for-sale is generally based on estimated market prices from an independently prepared appraisal, an independent broker price opinion (“BPO”), or management’s judgment as to the selling price of similar properties.

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Income taxes

The Company has elected REIT status upon the filing of its 2014 income tax return, and has conducted its operations in order to satisfy and maintain eligibility for REIT status. Accordingly, the Company does not believe it will be subject to U.S. federal income tax from the year ended December 31, 2014 forward on the portion of the Company's REIT taxable income that is distributed to the Company's stockholders as long as certain asset, income and stock ownership tests are met. If the Company fails to qualify as a REIT in any taxable year, it generally will not be permitted to qualify for treatment as a REIT for U.S. federal income tax purposes for the four taxable years following the year during which qualification is lost. The Company may also be subject to state or local income or franchise taxes.

Thetis TRS, GAJX Real Estate LLC and any other TRS that the Company forms, will be subject to U.S. federal and state income taxes. On January 13, 2015, the Company applied for a private letter ruling from the Internal Revenue Service that would allow it to exclude its proportionate share of gross income from the Manager if it held its interest in the Manager through the operating partnership. If the Company receives such a ruling, it expects that it will hold its interest in the Manager through the operating partnership, instead of through Thetis TRS; however, there is no assurance that such a ruling will be issued. Income taxes are provided for using the asset and liability method. Provisions for income taxes of $8,000 and $24,000, respectively, were recorded for the three- and nine-month periods ended September 30, 2015. No provision for income taxes was recorded for the period from inception (January 30, 2014) through September 30, 2014. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which management expects those temporary differences to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period in which the change occurs. Subject to the Company's judgment, it reduces a deferred tax asset by a valuation allowance if it is "more–likely-than-not" that some or all of the deferred tax asset will not be realized. Tax laws are complex and subject to different interpretations by the taxpayer and respective governmental taxing authorities. Significant judgment is required in evaluating tax positions, and the Company recognizes tax benefits only if it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority.

The Company evaluates tax positions taken in its consolidated financial statements under the interpretation for accounting for uncertainty in income taxes. As a result of this evaluation, the Company may recognize a tax benefit from an uncertain tax position only if it is "more-likely-than-not" that the tax position will be sustained on examination by taxing authorities.

The Company's tax returns remain subject to examination and consequently, the taxability of the distributions and other tax positions taken by the Company may be subject to change. Distributions to stockholders generally will be taxable as ordinary income, although a portion of such distributions may be designated as long-term capital gain or qualified dividend income, or may constitute a return of capital. The Company will furnish annually to each stockholder a statement setting forth distributions paid during the preceding year and their U.S. federal income tax treatment.

Mortgage loans

Purchased mortgage loans are initially recorded at the purchase price, net of any acquisition fees or costs at the time of acquisition and are considered asset acquisitions. As part of the determination of the purchase price for mortgage loans, the Company uses a discounted cash flow valuation model to model expected cash flows, and which considers alternate loan resolution probabilities, including liquidation or conversion to real estate owned. Observable inputs to the model include current interest rates, loan amounts, status of payments and property types. Unobservable inputs to the model include discount rates, forecast of future home prices, alternate loan resolution probabilities, resolution timelines, the value of underlying properties and other economic and demographic data.

Under ASC 310-30, acquired loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have some degree of credit quality deterioration since origination and have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Re-performing mortgage loans have been determined to have common risk characteristics

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and are accounted for as a single loan pool for loans acquired within each three-month fiscal quarter. Similarly, non-performing mortgage loans have been determined to have common risk characteristics and are accounted for as a single non-performing pool for loans acquired within each three-month fiscal quarter. Under ASC 310-30, the Company estimates cash flows expected to be collected, adjusted for expected prepayments and defaults expected to be incurred over the life of the loan pool. The Company determines the excess of the loan pool's contractually required principal and interest payments over the expected cash flows as an amount that should not be accreted, referred to as the non-accretable yield. The difference between expected cash flows and the purchase price (at acquisition) or the present value of the expected cash flows is referred to as the accretable yield, which represents the amount that is expected to be recorded as interest income over the remaining life of the loan pool. For the three-and nine-months ended September 30, 2015, the Company recognized no provision for loan loss. For the period from inception (January 30, 2014) through September 30, 2014, the Company recognized no provision for loan loss. For the three- and nine-months ended September 30, 2015, the Company accreted $14.4 million and $32.1 million, respectively, into interest income with respect to its loan portfolio. For the periods from commenced operations (July 8, 2014) and inception (January 30, 2014) through September 30, 2014, the Company accreted $2.3 million and $2.3 million, respectively, into interest income with respect to its loan portfolio. As of September 30, 2015, the Company's loan portfolio had a UPB of $676.6 million and a carrying value of $510.6 million and at December 31, 2014, a UPB of $298.6 million and carrying value of $211.2 million, in each case excluding one loan in which it holds a 40.5% beneficial interest through an equity method investee.

Generally, the Company acquires loans at a discount associated with some degree of credit impairment. The Company elects to aggregate certain pools of loans with common risk characteristics and accrue interest income thereon at a composite interest rate, based on expectations of cash flows to be collected for the pool. Expectations of pool cash flow are reviewed quarterly. Adjustments to a pool's prospective composite interest rate or an allowance for impairment are made to the extent revised expectations differ from original estimates.

For loans that do not qualify for pool aggregation treatment, including performing loans that are not purchased at discounts resulting from credit-related issues, interest is recognized using the simple-interest method on daily balances of the principal amount outstanding, adjusted for the amortization or accretion of the loan premium or discount over the contractual life of the loan.

Accrual of interest on individual loans is discontinued when management believes that, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful. The Company's policy is to stop accruing interest when a loan's delinquency exceeds 90 days. All interest accrued but not collected for loans that are placed on non-accrual status or subsequently charged-off are reversed against interest income. Income is subsequently recognized on the cash basis until, in management's judgment, the borrower's ability to make periodic principal and interest payments returns and future payments are reasonably assured, in which case the loan is returned to accrual status.

An individual loan is considered to be impaired when, based on current events and conditions, it is probable the Company will be unable to collect all amounts due (both principal and interest) according to the contractual terms of the loan agreement. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral if the loan is collateral dependent.

For individual loans, a troubled debt restructuring is a formal restructuring of a loan where, for economic or legal reasons related to the borrower's financial difficulties, a concession that would not otherwise be considered is granted to the borrower. The concession may be granted in various forms, including providing a below-market interest rate, a reduction in the loan balance or accrued interest, an extension of the maturity date, or a combination of these. An individual loan that has had a troubled debt restructuring is considered to be impaired and is subject to the relevant accounting for impaired loans.

The allowance for loan losses is established through a provision for loan losses charged to expenses. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans.

Purchased non-performing loans that are accounted for as individual loans are recorded at fair value, which is generally the purchase price. Interest income is recognized on a cash basis and loan purchase discount is accreted to income in proportion to the actual principal paid. Loans are tested quarterly for impairment and impairment reserves are recorded to the extent the fair market value of the underlying collateral falls below net book value.

While the Company generally intends to hold its assets as long-term investments, it may sell certain of its loans in order to manage its interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. The timing and impact of future sales of loans, if any, cannot be predicted with any certainty. Since the Company expects that its assets will generally be financed, it expects that a significant portion of the proceeds from sales of its assets (if any), prepayments and scheduled amortization will be used to repay balances under its financing sources.

Residential properties

Property is recorded at cost if purchased, or at the present value of future cash flows of the asset if obtained through foreclosure by the Company. Property that is currently unoccupied and actively marketed for sale is classified as held-for-sale. Property held-for-sale is carried at the lower of its acquisition basis or fair market value. Net unrealized losses due to changes in market value are recognized through a valuation allowance by charges to income.

No depreciation or amortization expense is recognized on properties held-for-sale, while holding costs are expensed as incurred. Rental property is property not held-for-sale. Rental properties are intended to be held as long-term investments but may eventually be held-for-sale. Depreciation is provided for using the straight-line method over the estimated useful lives of the assets of three to 27.5 years.

With respect to residential rental properties not held-for-sale, the Company performs an impairment analysis using estimated cash flows if events or changes in circumstances indicate that the carrying value may be impaired, such as prolonged vacancy, identification of materially adverse legal or environmental factors, changes in expected ownership period or a decline in market value to an amount less than cost. This analysis is performed at the property level. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for rental properties, competition for customers, changes in market rental rates, costs to operate each property and expected ownership periods.

If the carrying amount of a held-for-investment asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the carrying amount. The Company generally estimates the fair value of assets held for use by using BPOs. In some instances, appraisal information may be available and is used in addition to BPOs.

The Company performs property renovations to maximize the value of the property for its rental strategy. Such expenditures are part of its initial investment in a property and, therefore, are capitalized as part of the basis of the property. Subsequently, the residential property, including any renovations that improve or extend the life of the asset, are accounted for at cost. The cost basis is depreciated using the straight-line method over an estimated useful life of three to 27.5 years. Interest and other carrying costs incurred during the renovation period are capitalized until the property is ready for its intended use. Expenditures for ordinary maintenance and repairs are charged to expense as incurred.

Segment information

The Company's primary business is acquiring, investing in and managing a portfolio of mortgage loans. The Company operates in a single segment focused on non-performing mortgages and re-performing mortgages.

Emerging growth company

Section 107 of the Jumpstart Our Business Startups Act (the "JOBS Act") provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company has elected to take advantage of the benefits of this extended transition period. Its

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consolidated financial statements may, therefore, not be comparable to those of companies that comply with such new or revised accounting standards.

Reclassifications

Certain amounts in the Company's 2014 Consolidated Financial Statements have been reclassified to conform to the current period presentation. Specifically, on the Company's Consolidated Statement of Cash Flows for the period from inception (January 30, 2014) to September 30, 2014, approximately $1.5 million was reclassified from Cash Flows From Operating Activities to Cash Flows from Investing Activities.

The December 31, 2014 amounts included in the delinquency table in Note 3 – Mortgage loans have been reclassified from delinquent to current to reflect a correction of an error in the presentation of the disclosure that is immaterial to the consolidated financial statements taken as a whole. Such reclassifications did not affect cash flows, net revenues, net income, total assets, total liabilities or total equity.

Recently issued accounting standards

In January 2014, FASB issued Accounting Standards Update ("ASU") 2014-04, Troubled Debt Restructurings by Creditors. It provides that if a repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amended guidance may be applied using either a prospective transition method or a modified retrospective transition method and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The Company adopted this standard in the first quarter of 2015 and it did not have a material impact on its financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers. ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. ASU 2014-09 may be applied using either a full retrospective or a modified retrospective approach. In August 2015, the FASB issued ASU 2015-14 deferring the effective date for ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is not permitted. The Company is evaluating the impact of this amendment on its financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02 Amendments to the Consolidation Analysis. These amendments: (1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities; (2) eliminate the presumption that a general partner should consolidate a limited partnership; (3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU 2015-02 is effective for interim and annual reporting periods beginning after December 15, 2015. The Company is evaluating the impact of this amendment on its financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03 Interest – Imputation of Interest. The amendments in this update require that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of a debt liability, consistent with debt discounts. This guidance is effective for interim and annual reporting

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periods beginning after December 15, 2015, with early adoption permitted. This guidance may be adopted retrospectively or under a modified retrospective method where the cumulative effect is recognized at the date of initial application. The Company is evaluating the impact of this amendment on its financial position and results of operations.

Note 3 — Mortgage loans

The following tables present information regarding the contractually required payments and the estimated cash flows expected to be collected as of the date of the acquisition, and changes in the balance of the accretable yield, for loans acquired during the following periods ($ in thousands):

	Three months ended September 30, 2015		**Period from commenced operations (July 8, 2014) to December 31, 2014**		**Nine months ended September 30, 2015**		**Period from inception (January 30, 2014) to December 31, 2014**	
	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans
Contractually required principal and interest	$ 157,868	$ -	$ 393,657	$ 257,790	$ 644,471	$ 65,675	$ 393,657	$ 257,790
Non-accretable yield	(62,289)	-	(173,502)	(184,096)	(260,993)	(38,317)	(173,502)	(184,096)
Expected cash flows to be collected	95,579	-	220,155	73,694	383,478	27,358	220,155	73,694
Accretable yield	(28,727)	-	(60,495)	(22,071)	(102,407)	(8,038)	(60,495)	(22,071)
Fair value at acquisition	$ 66,852	$ -						