IMPAC MORTGAGE HOLDINGS INC
Form 10-Q
May 11, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007 or

o 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: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**33-0675505**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

19500 Jamboree Road, Irvine, California 92612
(Address of principal executive offices)

(949) 475-3600
(Registrant s telephone number, including area code)

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

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

There were 76,083,865 shares of common stock outstanding as of May 8, 2007.

IMPAC MORTGAGE HOLDINGS, INC.

FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

ITEM 1. **CONSOLIDATED FINANCIAL STATEMENTS**

IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollar amounts in thousands, except share data)

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash and cash equivalents	$ 181,202	$ 179,677
Restricted cash	439	617
Securitized mortgage collateral	21,462,312	21,050,829
Finance receivables	262,667	306,294
Mortgages held-for-investment	1,156	1,880
Allowance for loan losses	(102,838)	(91,775)
Mortgages held-for-sale	857,222	1,561,919
Accrued interest receivable	116,974	115,054
Derivative assets	102,441	147,291
Real estate owned, net	251,943	161,538
Other assets	149,767	165,631
Total assets	$ 23,283,285	$ 23,598,955
LIABILITIES		
Securitized mortgage borrowings	$ 20,998,378	$ 20,526,369
Reverse repurchase agreements	1,233,334	1,880,395
Trust preferred securities	97,863	97,661
Other liabilities	94,882	85,000
Total liabilities	22,424,457	22,589,425
Minority interest	1,000	
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Series-A junior participating preferred stock, $0.01 par value; 2,500,000 shares authorized; none issued and outstanding as of March 31, 2007 and December 31, 2006, respectively		
Series-B 9.375% cumulative redeemable preferred stock, $0.01 par value; liquidation value $50,000; 2,000,000 shares authorized, 2,000,000 shares issued and outstanding as of March 31, 2007 and December 31, 2006, respectively	20	20
Series-C 9.125% cumulative redeemable preferred stock, $0.01 par value; liquidation value $111,765; 5,500,000 shares authorized; 4,470,600 and 4,444,000 shares outstanding as of March 31, 2007 and December 31, 2006, respectively	45	44
Common stock, $0.01 par value; 200,000,000 shares authorized; 76,083,865 shares issued and outstanding as of March 31, 2007 and December 31, 2006	761	761
Additional paid-in capital	1,172,261	1,170,872
Accumulated other comprehensive income	1,294	2,357
Net accumulated deficit:		
Cumulative dividends declared	(792,743)	(762,382)
Retained earnings	476,190	597,858
Net accumulated deficit	(316,553)	(164,524)
Total stockholders equity	857,828	1,009,530
Total liabilities and stockholders equity	$ 23,283,285	$ 23,598,955

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE EARNINGS
(in thousands, except per share data)
(unaudited)

	For the Three Months Ended March 31, 2007	2006
INTEREST INCOME:		
Mortgage assets	$ 340,771	$ 333,376
Other	2,050	1,828
Total interest income	342,821	335,204
INTEREST EXPENSE:		
Securitized mortgage borrowings	293,377	295,475
Reverse repurchase agreements	33,736	25,873
Other borrowings	2,253	2,382
Total interest expense	329,366	323,730
Net interest income	13,455	11,474
Provision for loan losses	29,374	150
Net interest (expense) income after provision for loan losses	(15,919)	11,324
NON-INTEREST INCOME:		
Realized gain from derivative instruments	37,459	40,136
Change in fair value of derivative instruments	(58,761)	51,429
Gain (loss) on sale of loans	(9,131)	14,193
Provision for repurchases	(11,828)	(10,336)
Gain (loss) on lower of cost or market writedown	(24,694)	3,496
Amortization and impairment of mortgage servicing rights	(209)	(351)
Gain on sale of other real estate owned	844	354
Provision for REO losses	(9,890)	
Other income	5,648	8,821
Total non-interest income	(70,562)	107,742
NON-INTEREST EXPENSE:		
Personnel expense	18,388	18,621
General and administrative and other expense	5,124	5,073
Professional services	2,693	2,317
Equipment expense	1,558	1,510
Occupancy expense	3,820	1,368
Data processing expense	1,738	1,366
Total non-interest expense	33,321	30,255
Net (loss) earnings before income taxes	(119,802)	88,811
Income tax expense	1,866	3,245
Net (loss) earnings	(121,668)	85,566
Cash dividends on cumulative redeemable preferred stock	(3,722)	(3,672)
Net (loss) earnings available to common stockholders	$ (125,390)	$ 81,894

See accompanying notes to consolidated financial statements.

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	For the Three Months Ended March 31, 2007			2006		
Net (loss) earnings	$	(121,668	)	$	85,566	
Net unrealized gains (losses) on securities:						
Unrealized holding gains (losses) arising during year	(1,063		)	264		
Reclassification of losses included in net earnings				(853		)
Net unrealized losses	(1,063		)	(589		)
Comprehensive (loss) earnings	$	(122,731	)	$	84,977	
Net (loss) earnings per share:						
Basic	$	(1.65	)	$	1.08	
Diluted	$	(1.65	)	$	1.07	
Dividends declared per common share	$	0.10		$	0.25	

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Three Months Ended March 31, 2007	2006 restated
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) earnings	$ (121,668)	$ 85,566
Adjustments to reconcile net earnings to net cash used in operating activities:		
Provision for loan losses	29,374	150
Amortization of deferred charge, net	4,101	5,096
Amortization of premiums, securitization costs and debt issuance costs	42,499	62,742
Gain on sale of other real estate owned	(844)	(354)
(Gain) loss on sale of loans	9,131	(14,193)
Provision for repurchases	11,828	10,336
Loss (gain) on lower of cost or market writedown	24,694	(3,496)
Change in fair value of derivative instruments	58,761	(51,429)
Purchase of mortgages held-for-sale	(2,503,337)	(2,335,169)
Sale and principal reductions on mortgages held-for-sale	731,955	2,910,149
Net change in deferred taxes	20,060	84
Stock-based compensation	869	666
Depreciation and amortization	1,451	1,309
Amortization and impairment of mortgage servicing rights	209	351
Net change in accrued interest (receivable) payable	(1,920)	12,046
Net change in restricted cash	178	(245)
Net change in other assets and liabilities	(25,983)	4,907
Net cash used in operating activities	(1,718,642)	(688,516)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in securitized mortgage collateral	1,853,081	2,260,335
Finance receivable advances to customers	(1,107,857)	(991,768)
Repayments of finance receivables	1,151,484	1,050,035
Purchase of premises and equipment	(1,107)	(980)
Minority interest	1,000	
Net change in mortgages held-for-investment	346	26,330
Sale of investment securities available-for-sale		5,022
Distribution of deferred compensation plan benefits		8,041
Net principal reductions on investment securities available-for-sale	593	(638)
Proceeds from the sale of other real estate owned	29,952	14,175
Net cash provided by used in investing activities	1,927,492	2,370,552
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash disbursements under reverse repurchase agreements	(4,016,885)	(5,278,171)
Cash receipts from reverse repurchase agreements	3,369,824	3,840,624
Proceeds from securitized mortgage borrowings	2,384,131	919,932
Repayment of securitized mortgage borrowings	(1,918,567)	(2,434,672)
Common stock dividends paid	(22,714)	(15,225)
Preferred stock dividends paid	(3,722)	(3,672)
Proceeds from sale of cumulative redeemable preferred stock	608	272
Net cash used in financing activities	(207,325)	(2,970,912)

Net change in cash and cash equivalents	1,525	88,156
Cash and cash equivalents at beginning of period	179,677	146,621
Cash and cash equivalents at end of period	$ 181,202	$ 234,777

See accompanying notes to consolidated financial statements.

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	For the Three Months Ended March 31, 2007	2006 restated
SUPPLEMENTARY INFORMATION:		
Interest paid	$ 387,072	$ 202,787
Taxes paid	81	32
NON-CASH TRANSACTIONS:		
Accumulated other comprehensive loss	$ (1,063)	$ (589)
Dividends declared but unpaid	7,608	19,028
Transfer of mortgages to other real estate owned	11,761	1,456
Transfer of securitized mortgage collateral to other real estate owned	111,316	27,921
Transfer of loans held-for-sale to securitized mortgage collateral	2,430,042	694,336
Transfer of loans held-for-investment to securitized mortgage collateral		225,764
Transfer of securitized mortgage collateral to loans held-for-investment		114,358

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Note A Summary of Business and Significant Accounting Policies

1. Business Summary and Financial Statement Presentation

Business Summary

Impac Mortgage Holdings, Inc. (the Company or IMH), is a Maryland corporation incorporated in August 1995, and has the following subsidiaries, IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG), and Impac Funding Corporation (IFC), together with its wholly-owned subsidiaries Impac Secured Assets Corp. (ISAC), and Impac Commercial Capital Corporation (ICCC).

We are a mortgage real estate investment trust, or REIT, that is a nationwide acquirer, originator, seller and investor of non-conforming Alt-A residential mortgages, or Alt-A mortgages, and to a lesser extent, small-balance, commercial and multi-family mortgages, or commercial mortgages. We also provide warehouse financing to originators of mortgages.

We operate four core businesses:

- the Long-Term Investment operations conducted by IMH and IMH Assets;
- the Mortgage Operations conducted by IFC and ISAC;
- the Commercial Operations conducted by ICCC; and
- the Warehouse Lending Operations conducted by IWLG.

The long-term investment operations and the warehouse lending operations are conducted by IMH and IWLG at the REIT. The mortgage operations and commercial operations, which are a taxable REIT subsidiary (TRS), are conducted by IFC and ICCC, respectively.

The long-term investment operations generate earnings primarily from net interest income earned on mortgages held as securitized mortgage collateral and mortgages held-for-investment collectively (long-term mortgage portfolio) and associated hedging derivative cash flows. The long-term mortgage portfolio as reported on the Company s consolidated balance sheet consists of mortgages held as securitized mortgage collateral and mortgages held-for-investment. Investments in Alt-A mortgages and commercial mortgages are initially financed with short-term borrowings supported by reverse repurchase agreements that are subsequently converted to long-term financing in the form of securitized mortgage borrowings. Cash flows from the long-term mortgage portfolio, proceeds from the sale of capital stock and the issuance of trust preferred securities also finance the acquisitions of new Alt-A and commercial mortgages.

The mortgage operations acquire, originate, sell and securitize primarily Alt-A adjustable rate mortgages (ARMs) and fixed rate mortgages (FRMs) from correspondents, mortgage brokers and retail customers. Correspondents originate and close mortgages under our mortgage programs and then sell the closed mortgages to the mortgage operations on a flow (loan-by-loan basis) or through bulk sale commitments. Correspondents include savings and loan associations, commercial banks and mortgage bankers. The mortgage operations generate income by securitizing and selling mortgages to permanent investors, including the long-term investment operations. These operations also earn revenue from fees associated with master servicing rights and interest income earned on mortgages held-for-sale. The mortgage operations use warehouse facilities provided by the warehouse lending operations to finance the acquisition and origination of mortgages.

The commercial operations originate commercial mortgages, that are primarily adjustable rate mortgages with initial fixed interest rate periods of two-, three-, five-, seven- and ten-years that subsequently convert to adjustable rate mortgages, or hybrid ARMs, with balances that generally range from $500,000 to $5.0 million or by additional underwriting exception up to $10 million. Commercial mortgages have an interest rate floor, which is the initial start rate and in some circumstances have lock out periods, and prepayment penalty periods of three-, five-, seven- and ten-years. These mortgages provide greater asset diversification on our balance sheet as commercial mortgage borrowers typically have higher credit scores, typically have lower loan-to-value ratios, or LTV ratios, and the mortgages have longer average lives than residential mortgages.

The warehouse lending operations provide short-term financing to mortgage loan originators, including the mortgage and commercial operations, by funding mortgages from their closing date until sale to pre-approved investors. This business earns fees from warehouse transactions as well as net interest income from the difference between its cost of borrowings and the interest earned on warehouse advances, both of which are tied to the one-month London Inter-Bank Offered Rate (LIBOR) rate.

Financial Statement Presentation

The accompanying unaudited consolidated financial statements of IMH and our subsidiaries (as defined above) have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

All significant inter-company balances and transactions have been eliminated in consolidation. In addition, certain amounts in the prior periods consolidated financial statements have been reclassified to conform to the current year presentation. The ownership interest in consolidated subsidiaries from non-controlling shareholders is reflected as minority interest.

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these financial statements in conformity with GAAP. The items affected by management s estimates and assumptions include allowance for loan losses, valuation of derivative financial instruments, repurchase liabilities related to sold loans and the amortization of various loan premiums and discounts due to prepayment estimates. Actual results could differ from those estimates.

Premiums, discounts and securitization costs associated with the securitized mortgage collateral and securitized mortgage borrowing are amortized or accreted into interest income/expense over the projected lives of the securitized mortgage collateral and securitized mortgage borrowings using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, market prepayment speeds, and current conditions. If our estimate of prepayments is incorrect, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

2. Restated Consolidated Cash Flows for 2006 Interim Periods, and Reclassifications

Certain interim amounts in the 2006 Consolidated Statement of Cash Flows have been restated to properly reflect specific intercompany activities related to cash receipts from loan sales and cash disbursements for loan purchases between consolidated companies. Such intercompany loan sale and purchase transaction activities had the effect of presenting separate cash inflows and outflows even though there was no cash inflow or outflow on a consolidated basis. This restatement serves to eliminate this intercompany activity from its Consolidated Statements of Cash Flows and present them as non-cash transactions.

The correction of the error increases cash used in operating activities and increases cash provided by investing activities. The restatement of these transactions does not change total cash and cash equivalents as previously reported. Furthermore, the restatement has no effect on the Company s Consolidated Statements of Operations and Comprehensive Earnings, Consolidated Balance Sheets or Consolidated Statements of Changes in Stockholders Equity.

The Company has reclassified the presentation of the Consolidated Statement of Operations and Comprehensive Income to reflect Amortization and impairment of mortgage servicing rights, Write-down on investment securities available-for-sale, and Loss(gain) on disposition of real estate as other non-interest income rather than non-interest expense, for the first quarter of 2006 to conform to the current period presentation. In addition, the Amortization of deferred charge for 2006 was reclassified as income tax expense (benefit) rather than non-interest expense.

Please refer to the Company s Form 10-K for the year ended December 31, 2006, for more information regarding these reclassifications.

3. Stock Options

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, (SFAS 123R). This Statement requires companies to

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expense the estimated fair value of stock options and similar equity instruments issued to employees over the requisite service period. SFAS 123R eliminates the alternative to use the intrinsic method of accounting provided for in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), which generally resulted in no compensation expense recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

Effective for the first quarter of fiscal 2006, we adopted SFAS 123R using the modified prospective method, which required us to record compensation expense for all awards granted after the date of adoption, and for the unvested portion of previously granted awards that remained outstanding at the date of adoption.

We continue using both the Black-Scholes-Merton option-pricing formula and straight-line amortization of compensation expense over the requisite service period of the grant. We will reconsider use of the Black-Scholes-Merton model if additional information becomes available in the future that indicates another model would be more appropriate for the Company, or if grants issued in future periods have characteristics that cannot be reasonably estimated using this model.

The following table presents a summary of option activity during the first quarter under the Company s stock option plans:

	Number of Shares
Options outstanding at December 31, 2006	7,048,755
Options granted	
Options exercised	
Options forfeited / cancelled	(161,000)
Options outstanding at March 31, 2007	6,887,755

4. Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159) which provides reporting entities an option to report selected financial assets, including investment securities designated as available for sale, and liabilities, including most insurance contracts, at fair value. SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The standard also requires additional information to aid financial statement users understanding of a reporting entity s choice to use fair value on its earnings and also requires entities to display on the face of the balance sheet the fair value of those assets and liabilities which the reporting entity has chosen to measure at fair value. SFAS No. 159 is effective as of the beginning of a reporting entity s first fiscal year beginning after November 15, 2007. The Company is currently assessing the effect that SFAS 159 will have on the consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements* (SAB 108), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 was issued to address diversity in practice in quantifying financial statement misstatements. SAB 108 is currently effective and did not have an effect on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the effect that SFAS 157 will have on the consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* (FIN 48) which expands on the accounting guidance of FASB Statement No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of this interpretation by the Company has not had a significant effect on the consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140* (SFAS 156). This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. This statement also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. An entity should adopt this statement as of the beginning of its first fiscal year that begins after September 15, 2006. The Company has adopted this statement which has not had a material effect on the consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments , an amendment of FASB Statements No. 133 and SFAS No. 140* (SFAS 155). This statement permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It also clarifies which interest-only strips and principal-only strips are not subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of this statement has not had a material effect on the consolidated financial statements.

5. Legal Proceedings

The Company is party to litigation and claims which are normal in the course of our operations. While the results of such litigation and claims can not be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on our financial condition or results of operations.

Note B Reconciliation of Earnings Per Share

The following table presents the computation of basic and diluted net earnings per share including the dilutive effect of stock options and cumulative redeemable preferred stock outstanding for the periods indicated:

	For the Three Months Ended March 31, 2007			2006		
Numerator for basic earnings per share:						
Net (loss) earnings	$	(121,668	)	$	85,566	
Less: Cash dividends on cumulative redeemable preferred stock	(3,722		)	(3,672		)
Net (loss) earnings available to common stockholders	$	(125,390	)	$	81,894	
Denominator for basic earnings per share:						
Basic weighted average number of common shares outstanding during the period	76,084			76,113		
Denominator for diluted earnings per share:						
Diluted weighted average number of common shares outstanding during the period	76,084			76,113		
Net effect of dilutive stock options				266		
Diluted weighted average common shares	76,084			76,379		
Net (loss) earnings per share:						
Basic	$	(1.65	)	$	1.08	
Diluted	$	(1.65	)	$	1.07	

For the three month periods ended March 31, 2007 and 2006, stock options to purchase 6.9 million and 4.4 million shares, respectively, were outstanding but not included in the above weighted average calculations because they were anti-dilutive.

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Note C Segment Reporting

The following tables present reporting segments for the three month periods ended March 31, 2007 and 2006:

Reporting Segments as of and for the Three Months Ended March 31, 2007		
Long-Term	**Warehouse**	**Mortgage**