Altisource Asset Management Corp
Form 10-Q
July 23, 2013

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 JUNE 30, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR TRANSITION PERIOD FROM __________ TO __________

COMMISSION FILE NUMBER: 000-54809

Altisource Asset Management Corporation
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| UNITED STATES VIRGIN ISLANDS | 66-0783125 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

402 Strand Street
Frederiksted, United States Virgin Islands 00840-3531
(Address of principal executive office)

(340) 692-1055
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

| | | | | |
|---|---|---|---|---|
| Large Accelerated Filer | o | | Accelerated Filer | o |
| Non-Accelerated Filer | o | (Do not check if a smaller reporting company) | Smaller Reporting Company | x |

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

As of July 18, 2013, 2,345,620 shares of our common stock were outstanding.

Altisource Asset Management Corporation
June 30, 2013
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References in this report to "we," "our," "us," or the "Company" refer to Altisource Asset Management Corporation and its consolidated subsidiaries, unless otherwise indicated. References in this report to “Residential” refer to Altisource Residential Corporation, unless otherwise indicated. References in this report to “Altisource” refer to Altisource Portfolio Solutions S.A. and its consolidated subsidiaries, unless otherwise indicated. References in this report to “Ocwen” refer to Ocwen Financial Corporation and its consolidated subsidiaries, unless otherwise indicated.

Special note on forward-looking statements

Our disclosure and analysis in this quarterly report on Form 10-Q contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, which we refer to as the “Securities Act,” and Section 21E of the Securities Exchange Act of 1934, as amended, which we refer to as the “Exchange Act.” In some cases, you can identify forward-looking statements by the use of forward-looking terminology such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” or “potential” or the negative of thes and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans or intentions.

The forward-looking statements contained in this quarterly report reflect our current views about future events and are subject to numerous known and unknown risks, uncertainties, assumptions and changes in circumstances that may cause our actual results to differ significantly from those expressed in any forward-looking statement. Factors that may materially affect such forward-looking statements include, but are not limited to:

- our ability to implement our business strategy and the business strategy of Residential;
- our ability to retain and maintain our strategic relationships with related parties;
- the ability of Residential to generate cash available for distribution to its stockholders under our management;
- our ability to effectively compete with our competitors;
- our clients' and our future or pending transactions;
- our projected operating results including receipt of incentive management fees under the terms of the Residential asset management agreement;
- our ability to retain Residential as a client;
- Residential's ability to effectively leverage its investments;
- the failure of Altisource to effectively perform its obligations under various agreements with us;
- general economic and market conditions; and
- governmental regulations, taxes and policies.

While forward-looking statements reflect our good faith beliefs, assumptions and expectations, they are not guarantees of future performance. Such forward-looking statements speak only as of their respective dates, and we assume no obligation to update them to reflect changes in underlying assumptions or factors, new information or otherwise. For a further discussion of these and other factors that could cause our future results to differ materially from any forward-looking statements, please see the risk factors set forth in our annual report on Form 10-K for the year ended December 31, 2012 and in our quarterly report on Form 10-Q for the first quarter of 2013.

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Part I

Item 1. Financial statements (unaudited)

Certain information contained herein is presented as of July 18, 2013, which we have concluded is the latest practicable date for financial information prior to the filing of this quarterly report.

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Altisource Asset Management Corporation
Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Assets: | | |
| Real estate assets: | | |
| Land (from consolidated VIE) | $4 | $— |
| Rental residential properties, net (from consolidated VIE) | 54 | — |
| Real estate owned (from consolidated VIE) | 3,749 | — |
| | 3,807 | — |
| Real estate assets held for sale (from consolidated VIE) | 901 | — |
| Mortgage loans (from consolidated VIE) | 163,520 | — |
| Cash and cash equivalents (including from consolidated VIE $223,315 and $100,005, respectively) | 227,846 | 105,014 |
| Related party receivables (including from consolidated VIE $2,931 and $0, respectively) | 3,220 | 361 |
| Deferred leasing and financing costs, net (from consolidated VIE) | 868 | — |
| Prepaid expenses and other assets (including from consolidated VIE $20,262 and $6, respectively) | 20,857 | 440 |
| Total assets | 421,019 | 105,815 |
| Liabilities: | | |
| Repurchase agreement (from consolidated VIE) | 472 | — |
| Accounts payable and accrued liabilities (including from consolidated VIE $1,138 and $46, respectively) | 2,113 | 406 |
| Related party payables (including from consolidated VIE $149 and $5, respectively) | 762 | 528 |
| Total liabilities | 3,347 | 934 |
| Commitments and contingencies (Note 6) | | |
| Equity: | | |
| Common stock, $.01 par value, 5,000,000 authorized shares; and 2,345,425 and 2,343,213 shares issued and outstanding, respectively | 23 | 23 |
| Additional paid-in capital | 6,289 | 4,993 |
| Accumulated deficit | (2,385) | (46) |
| Total stockholders' equity | 3,927 | 4,970 |
| Noncontrolling interest in consolidated affiliate | 413,745 | 99,911 |
| Total equity | 417,672 | 104,881 |
| Total liabilities and equity | $421,019 | $105,815 |

See accompanying notes to Consolidated Financial Statements.

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Altisource Asset Management Corporation
Consolidated Statements of Operations
(In thousands, except share and per share amounts)
(Unaudited)

| | Three months ended June 30, 2013 | Six months ended June 30, 2013 |
|---|---|---|
| Net gain on investments: | | |
| Net unrealized gain on mortgage loans | $7,165 | $8,293 |
| Net realized gain on mortgage loans | 1,719 | 2,106 |
| Total net gain on investments | 8,884 | 10,399 |
| Expenses: | | |
| Residential rental property operating expenses | 84 | 84 |
| Related party mortgage loan servicing costs | 1,242 | 1,634 |
| Interest expense | 654 | 696 |
| General and administrative | 3,369 | 6,067 |
| Related party general and administrative | — | 207 |
| Total expenses | 5,349 | 8,688 |
| Other income | 193 | 193 |
| Net income | 3,728 | 1,904 |
| Net income attributable to noncontrolling interest in consolidated affiliate | (5,227) | (4,243) |
| Net loss attributable to common stockholders | $(1,499) | $(2,339) |
| | | |
| Loss per share of common stock – basic: | | |
| Loss per basic share | $(0.64) | $(1.00) |
| Weighted average common stock outstanding – basic | 2,343,462 | 2,343,338 |
| Loss per share of common stock – diluted: | | |
| Loss per diluted share | $(0.64) | $(1.00) |
| Weighted average common stock outstanding – diluted | 2,343,462 | 2,343,338 |

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Consolidated Statements of Equity
(In thousands, except share amounts)
(Unaudited)

| | Common stock | | | | | |
|---|---|---|---|---|---|---|
| | Number of shares | Amount | Additional paid-in capital | Accumulated deficit | Noncontrolling interest in consolidated affiliate | Total equity |
| December 31, 2012 | 2,343,213 | $23 | $4,993 | $(46) | $99,911 | $104,881 |
| Issuance of common stock, including option exercises | 2,212 | — | 2 | — | — | 2 |
| Capital contribution from noncontrolling interest | — | — | — | — | 309,591 | 309,591 |
| Share-based compensation | — | — | 1,294 | — | — | 1,294 |
| Net income/(loss) | — | — | — | (2,339) | 4,243 | 1,904 |
| June 30, 2013 | 2,345,425 | $23 | $6,289 | $(2,385) | $413,745 | $417,672 |

| | Common stock | | | | | |
|---|---|---|---|---|---|---|
| | Number of shares | Amount | Additional paid-in capital | Accumulated deficit | Noncontrolling interest in consolidated affiliate | Total |
| March 15, 2012 (inception) | — | $— | $— | $— | $— | $— |
| Issuance of common stock, including option exercises | 100,000 | 1 | 499 | — | — | 500 |
| Capital contribution from noncontrolling interest | — | — | — | — | 500 | 500 |
| June 30, 2012 | 100,000 | $1 | $499 | $— | $500 | $1,000 |

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

| | Six months ended June 30, 2013 | March 15, 2012 (inception) to June 30, 2012 |
|---|---|---|
| Operating activities: | | |
| Net income | $1,904 | $— |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Net unrealized gain on mortgage loans | (8,293) | — |
| Net realized gain on mortgage loans | (2,106) | — |
| Amortization of deferred financing costs | 322 | — |
| Share-based compensation | 1,294 | — |
| Changes in operating assets and liabilities: | | |
| Related party receivables | 724 | — |
| Prepaid expenses and other assets | (280) | — |
| Accounts payable and accrued liabilities | 1,012 | — |
| Related party payables | 234 | — |
| Net cash used in operating activities | (5,189) | — |
| Investing activities: | | |
| Investment in mortgage loans | (168,165) | — |
| Investment in real estate | (278) | — |
| Investment in renovations | (22) | — |
| Acquisition-related deposits | (20,142) | — |
| Mortgage loan dispositions and repayments | 7,062 | — |
| Net cash used in investing activities | (181,545) | — |
| Financing activities: | | |
| Issuance of common stock, including stock option exercises | 123 | 500 |
| Payment of tax withholdings on exercise of stock options | (121) | — |
| Capital contribution from noncontrolling interest | 310,254 | 500 |
| Proceeds from repurchase agreement | 79,761 | — |
| Repayments of repurchase agreement | (79,289) | — |
| Payment of deferred financing costs | (1,162) | — |
| Net cash provided by financing activities | 309,566 | 1,000 |
| Net increase in cash and cash equivalents | 122,832 | 1,000 |
| Cash and cash equivalents as of beginning of the period | 105,014 | — |
| Cash and cash equivalents as of end of the period | $227,846 | $1,000 |
| | | |
| Supplemental disclosure of non-cash investing and financing activity: | | |
| Transfer of mortgage loans to real estate owned | $4,399 | $— |
| Changes in Residential's accrued equity issuance costs | $663 | $— |
| Changes in related party receivable from mortgage loan dispositions and repayments | $3,583 | $— |

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Notes to Consolidated Financial Statements
June 30, 2013
(Unaudited)

1. Organization and basis of presentation

We were incorporated in the United States Virgin Islands on March 15, 2012, which we refer to as "inception." Our primary business is to provide asset management and certain corporate governance services under a 15-year asset management agreement beginning December 21, 2012, which we refer to as the “Residential asset management agreement,” to Altisource Residential Corporation, which we refer to as “Residential,” a Maryland corporation that acquires and manages single-family rental properties by acquiring sub-performing and non-performing mortgages throughout the United States. Subsequent to our separation from Altisource on December 21, 2012, we immediately commenced operations and began to incur costs as a result of becoming an independent publicly traded company.

Residential is currently our primary source of revenue and will drive our potential future growth. The Residential asset management agreement entitles us to incentive fees, which we refer to as our “incentive management fee,” that gives us an increasing share of Residential's cash flow available for distribution to its stockholders as well as reimbursement for certain overhead and operating expenses. Accordingly, our operating results are highly dependent on Residential's ability to achieve positive operating results.

We have concluded that Residential is a variable interest entity ("VIE") because Residential's equity holders lack the ability through voting rights to make decisions about Residential's activities that have a significant effect on the success of Residential. We have also concluded that we are the primary beneficiary of Residential because under the Residential asset management agreement we have the power to direct the activities of Residential that most significantly impact Residential's economic performance including establishing Residential's investment and business strategy. As a result, we consolidate Residential in our consolidated financial statements.

On March 22, 2013, Residential's operating partnership entered into a master repurchase agreement with a major financial institution to finance the acquisition and ownership of residential mortgage loans and REO properties. The maximum funding available to Residential under the repurchase agreement is $100.0 million, subject to certain sublimits.

On May 1, 2013, Residential completed a public offering of 17,250,000 shares of its common stock at $18.75 per share and received net proceeds of $309.5 million. Residential has used or intends to use the net proceeds of this offering to purchase additional sub-performing and non-performing residential mortgage loans, pay servicing fees for its mortgage loan portfolios, renovate the single-family rental properties it acquires, pay rental and property management expenses, pay fees and expenses to us under the asset management agreement, fund its investment in NewSource Reinsurance Company, a title insurance and reinsurance company we refer to as "NewSource," and for working capital.

Because we commenced operations on December 21, 2012, we have no comparable results for the three and six months ended June 30, 2012. Accordingly, we have not included the comparative three and six month periods from 2012 in our consolidated statement of operations. Additionally, because Residential's operating partnership was organized on June 7, 2012, our consolidated statement of cash flows and consolidated statement of stockholders' equity for the six months ended June 30, 2012 do not include six full months of operating activities.

We ceased to be a development stage enterprise in the second quarter of 2013.

Basis of presentation and use of estimates

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States which we refer to as "U.S. GAAP." All intercompany accounts and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. GAAP requires us 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. Actual results could differ materially from those estimates.

The unaudited consolidated financial statements and accompanying unaudited consolidated financial information, in our opinion, contain all adjustments (including normal recurring accruals) necessary for a fair presentation of our financial position,

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results of operations and cash flows. We have omitted certain notes and other information from the interim consolidated financial statements presented in this Quarterly Report as permitted by SEC rules and regulations. These consolidated financial statements should be read in conjunction with our 2012 annual report on Form 10-K.

Recently issued accounting standards

In accordance with ASU 2011-11, Disclosures about Offsetting Assets and Liabilities, beginning in the first quarter of 2013 we are required to provide additional disclosures about the nature of our rights of offset and the related arrangements associated with our financial instruments. As a result, we have included additional disclosures pertaining to the collateral arrangement related to our repurchase agreement in this quarterly report.

2. Mortgage loans at fair value

Acquisitions

During the six months ended June 30, 2013, Residential completed the acquisition of the following portfolios of non-performing residential mortgage loans:

- On February 14, 2013, a portfolio of first lien residential mortgage loans, substantially all of which are non-performing, having aggregate collateral market value of $94.2 million as of the February 1, 2013 cut-off date for the transaction.
- On March 21, 2013, a portfolio of first lien residential mortgage loans, substantially all of which are non-performing, having aggregate collateral market value of $38.7 million as of the March 18, 2013 cut-off date for the transaction.
- On April 5, 2013, a portfolio of first lien residential mortgage loans, substantially all of which are non-performing, having aggregate collateral market value of $122.1 million as of the March 28, 2013 cut-off date for the transaction.

During the three and six months ended June 30, 2013, Residential expensed $0.1 million and $0.4 million, respectively, for due diligence costs related to these and other transactions.

Transfer of mortgage loans to real estate owned

During the three and six months ended June 30, 2013, Residential transferred 33 and 34 mortgage loans, respectively, at fair value based on broker price opinion (BPO) of $4.2 million and $4.4 million, respectively, to real estate owned.

Dispositions

During the three and six months ended June 30, 2013, Residential disposed of 28 and 38 mortgage loans, respectively, primarily through short sales and foreclosure sales. As a result, Residential recorded $1.7 million and $2.1 million, respectively, of net realized gains on mortgage loans.

3. Real estate assets, net

Acquisitions

During the six months ended June 30, 2013, Residential acquired six residential properties, or "real estate owned," as part of the loan portfolio acquisitions described above which were converted to properties on foreclosure of the mortgage loans prior to the acquisition closing date. The aggregate purchase price attributable to these properties was $0.3 million. Residential acquired no residential properties in this manner during the three months ended June 30, 2013.

Real estate held for sale

As of June 30, 2013, Residential classified eight properties having carrying value of $0.9 million as real estate held for sale because it intends to sell the properties which do not meet its residential rental property investment criteria. The real estate held for sale balance is composed solely of real estate owned. These properties have had no significant operations, and, therefore, we are not presenting discontinued operations related to these properties.

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4. Fair value of financial instruments

The following table sets forth the financial assets and liabilities that Residential measures at fair value by level within the fair value hierarchy as of June 30, 2013 ($ in thousands):

| | Level 1<br>Quoted prices in active markets | Level 2<br>Observable inputs other than Level 1 prices | Level 3<br>Unobservable inputs |
|---|---|---|---|
| Recurring basis (assets) | | | |
| Mortgage loans | $— | $— | $163,520 |
| Nonrecurring basis (assets) | | | |
| Transfer of mortgage loans to real estate owned | $— | $— | $4,399 |
| Not recognized on consolidated balance sheets at fair value (liabilities) | | | |
| Repurchase agreement at fair value | $— | $472 | $— |

There were no corresponding financial assets or liabilities measured at fair value as of December 31, 2012 because Residential did not own any mortgage loans or residential properties at that time. Additionally, there have been no transfers between levels for the three or six months ended June 30, 2013.

The carrying values of our cash and cash equivalents, related party receivables, accounts payable and accrued liabilities and related party payables are equal to or approximate fair value. The fair value of the repurchase agreement that Residential entered into on March 22, 2013 was estimated using the income approach to approximate the price that would be paid in an orderly transaction between market participants on the measurement date for similar floating rate debt.

The following table sets forth the changes in Residential's level 3 assets that are measured at fair value on a recurring basis ($ in thousands):

| | Three months ended June 30, 2013 | Six months ended June 30, 2013 |
|---|---|---|
| Mortgage loans | | |
| Beginning balance | $87,670 | $— |
| Investment in mortgage loans | 79,908 | 168,165 |
| Net unrealized gain on mortgage loans | 7,165 | 8,293 |
| Net realized gain on mortgage loans | 1,719 | 2,106 |
| Mortgage loan dispositions and repayments | (8,699) | (10,645) |
| Transfer of mortgage loans to real estate owned | (4,243) | (4,399) |
| Ending balance | $163,520 | $163,520 |
| | | |
| Net unrealized gain on mortgage loans held | $7,165 | $8,293 |
| Accumulated unrealized gain on mortgage loans still held | $8,293 | $8,293 |

There was no corresponding activity for level 3 assets for the three and six months ended June 30, 2012 because Residential did not own any such assets at that time.

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The following table sets forth the fair value of Residential's mortgage loans and the related unpaid principal balance and collateral market value by delinquency as of June 30, 2013 ($ in thousands):

| | Number of loans | Carrying value | Unpaid principal balance | Collateral market value |
|---|---|---|---|---|
| Current | 102 | $10,748 | $22,020 | $18,178 |
| 30 | 33 | 2,793 | 6,411 | 4,560 |
| 60 | 30 | 4,299 | 8,093 | 6,449 |
| 90 | 460 | 53,905 | 106,381 | 81,086 |
| Foreclosure | 707 | 91,775 | 185,077 | 134,500 |
| Mortgage loans | 1,332 | $163,520 | $327,982 | $244,773 |

Residential did not hold any corresponding mortgage loans as of December 31, 2012.

The significant unobservable inputs used in the fair value measurement of Residential's mortgage loans are discount rates, home prices, gross rental rates, alternate loan resolution probabilities and timelines. Significant changes in any of these inputs in isolation could result in a significant change to the fair value measurement. A decline in the discount rate in isolation would increase the fair value of an asset. A decrease in the housing pricing index or gross rental rates in isolation would decrease the fair value. Individual loan characteristics such as location and value of underlying collateral affect the loan resolution probabilities and timelines. An increase in the loan resolution timeline in isolation would decrease the fair value. The following table sets forth quantitative information about the significant unobservable inputs used to measure the fair value of our mortgage loans as of June 30, 2013:

| Input | Range |
|---|---|
| Discount rate | 15.0% |
| Gross monthly rental rate | $480 to $5,030 |
| Home pricing index range | -1.8% to 4.6% |
| Loan resolution probabilities - modification | 0% to 22.3% |
| Loan resolution probabilities - rental | 0% to 100.0% |
| Loan resolution probabilities - liquidation | 0% to 100.0% |
| Loan resolution timelines | 1 to 67 months |

There were no corresponding fair value measurements which required significant unobservable inputs as of December 31, 2012 because Residential did not own any such assets at that time.

5. Repurchase agreement

On March 22, 2013, Residential's operating partnership entered into a master repurchase agreement with a major financial institution. The purpose of the repurchase agreement is to finance the purchase and beneficial ownership of mortgage loans and REO properties in its portfolio. Residential has effective control of the assets associated with this agreement and therefore we have concluded this is a financing arrangement. The maximum funding amount available to Residential under the repurchase agreement is $100.0 million, subject to certain sublimits. As of June 30, 2013, an aggregate of $0.5 million was outstanding under the repurchase agreement which was collateralized by mortgage loans and real estate owned with a carrying value of $1.0 million. As of June 30, 2013 the cost of funds for amounts borrowed under the repurchase agreement was approximately 3.5%. As of July 18, 2013, an aggregate of $0.5 million was outstanding under the repurchase agreement. The obligations under the repurchase agreement are fully guaranteed by Residential. The repurchase agreement matures on March 21, 2014.

Under the terms of the repurchase agreement, as collateral for the funds Residential draws thereunder, Residential's operating partnership will sell to the lender equity interests in its Delaware statutory trust subsidiary that owns the underlying mortgage assets on its behalf. In the event the lender determines the value of the collateral has decreased, it has the right to initiate a margin call and require Residential to post additional collateral or to repay a portion of the outstanding borrowings. The price paid by the lender for each underlying mortgage asset Residential finances under the repurchase agreement is based on a percentage of the market value of the underlying mortgage asset and depends on its delinquency status. With respect to funds drawn under the repurchase agreement, Residential's operating partnership is required to pay the lender interest at the lender's

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cost of funds plus a spread calculated based on the type of applicable underlying mortgage assets collateralizing the funding, as well as certain other customary fees, administrative costs and expenses to maintain and administer the repurchase agreement.

The repurchase agreement requires Residential to maintain various financial and other covenants, including maintaining a minimum adjusted tangible net worth, a maximum ratio of indebtedness to adjusted tangible net worth and specified levels of unrestricted cash as well as restrictions on net losses in excess of specified amounts. In addition, the repurchase agreement contains customary events of default.

Residential is currently in compliance with the covenants and other requirements with respect to the repurchase agreement. We monitor Residential's banking partner's ability to perform under the repurchase agreement and have concluded there is currently no reason to doubt that it will continue to perform under the repurchase agreement as contractually obligated.

6. Commitments and contingencies

On December 21, 2012, we entered into a subscription agreement to invest $2.0 million to acquire 100% of the common stock and voting rights of NewSource Reinsurance Company Ltd., a title insurance and reinsurance company. In addition, Residential entered into a subscription agreement to invest $18.0 million in the non-voting preferred stock of NewSource Reinsurance Company Ltd. No amounts have been invested as of June 30, 2013 and therefore the commitments remain $2.0 million and $18.0 million, respectively, as of June 30, 2013.

Litigation, claims and assessments

We are not currently the subject of any material legal or regulatory proceedings, and no legal or regulatory proceedings have been threatened against us. We may be involved, from time to time, in legal proceedings that arise in the ordinary course of business.

7. Related party transactions

During the six months ended June 30, 2013, Residential acquired a portfolio from Ocwen of non-performing first lien residential mortgage loans having aggregate collateral market value of $94.2 million as of the February 1, 2013 cut-off date for the transaction. The aggregate purchase price for this portfolio was $64.4 million.

Our Consolidated Statements of Operations included the following significant related party transactions ($ in thousands):

| | Three months ended June 30, 2013 | Six months ended June 30, 2013 | Counter-party | Consolidated Statements of Operations location |
|---|---|---|---|---|
| Related party mortgage loan servicing costs | $1,242 | $1,634 | Ocwen | Mortgage loan servicing costs paid by Residential |
| Due diligence costs | $— | $183 | Altisource | Related party general and administrative expenses |
| Sublease and related occupancy costs | $55 | $79 | Ocwen | Related party general and administrative expenses |
| Expense reimbursements | $1,156 | $2,057 | Residential | Net loss attributable to noncontrolling interest in consolidated affiliate (Residential) |

There were no corresponding related party transactions from March 15, 2012 (inception) to June 30, 2012.

8. Share-based payments

During the six months ended June 30, 2013, we granted 32,197 shares of stock to certain members of executive management with weighted average grant date fair value per share of $63.98. Additionally, we granted 1,470 shares of stock pursuant to our 2013 Director Equity Plan with weighted average grant date fair value per share of $205.27. Of these shares, 660 were issued in connection with our directors' service on the board from January 24, 2013 to our 2013 annual meeting of stockholders and the remaining 810 are expected to be issued for their service from the 2013 annual meeting to the 2014 annual meeting of stockholders. As of June 30, 2013, we had an aggregate of $9.5 million of total unrecognized stock-based compensation costs which will be recognized over a weighted average remaining estimated term of 3.50 years.

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9. Income taxes

We are domiciled in the United States Virgin Islands and under current United States Virgin Islands law are obligated to pay taxes in the United States Virgin Islands on income and/or capital gains. As of February 1, 2013, we were granted status as an economic development company by the United States Virgin Islands Economic Development Commission. Under this designation, we receive tax benefits that allow for our taxable income to be taxed at an effective tax rate of 3.85%. For the three months ended March 31, 2013 we had future taxable income deductions (deferred tax assets) related to initial year expenditures including a cumulative net loss. We have recorded a valuation allowance equal to the resulting gross deferred tax asset because we do not believe it is more likely than not that the deferred tax asset will be realized.

In addition, Residential intends to be taxed as a REIT beginning in the year ending December 31, 2013 and will make an election in 2014 upon filing its 2013 income tax return. Accordingly, Residential believes it will not be subject to federal income tax beginning in 2013 on that portion of its REIT taxable income that is distributed to its shareholders as long as certain asset, income and share ownership tests are met. As a REIT, Residential generally will not be subject to federal income tax to the extent it distributes its REIT taxable income to its shareholders.

As of June 30, 2013, we did not have any unrecognized tax benefits. Additionally, we did not accrue interest or penalties associated with any unrecognized tax benefits, nor was any interest expense or penalty recognized during the year. Our subsidiaries and we remain subject to tax examination for the period from inception to December 31, 2012.

10. Earnings per share

Because we incurred a net loss attributable to common stockholders for the three and six months ended June 30, 2013, basic and diluted earnings per share are equivalent for the periods. For the three and six months ended June 30, 2013, there were 293,760 stock options and 224,944 units of restricted stock excluded from the calculation of diluted earnings per share because inclusion would have been anti-dilutive.

11. Segment information

Our primary business is to provide asset management and certain corporate governance services to Residential. Residential's primary business is the acquisition and ownership of single-family rental assets. Residential's primary sourcing strategy is to acquire these assets by purchasing sub-performing and non-performing mortgages. As a result, we operate in a single segment focused on the management of Residential's resolution of sub-performing and non-performing mortgages with the intent to modify as many loans as possible to keep borrowers in their homes or own the collateral which is suitable as long-term rental properties.

Item 2. Management's discussion and analysis of financial condition and results of operations

Overview

Our primary business is to provide asset management and certain corporate governance services under a 15-year asset management agreement with Residential, which we refer to as the “Residential asset management agreement." Residential is a corporation formed under the laws of the state of Maryland that acquires and manages single-family rental properties by acquiring sub-performing and non-performing mortgages throughout the United States. Residential intends to elect to qualify as a REIT beginning in the year ending December 31, 2013.

We have a capital light operating strategy and will consider using any future profits for share repurchases and dividends, although we have no current plans to repurchase shares or pay dividends. Residential is currently our primary source of revenue and will drive our potential future growth. The Residential asset management agreement entitles us to incentive fees, which we refer to as our “incentive management fees,” that will give us an increasing share of Residential's cash flow available for distribution to its stockholders as well as reimbursement for certain overhead and operating expenses. Accordingly, our operating results are highly dependent on Residential's ability to achieve positive operating results.

We have concluded that Residential is a variable interest entity because Residential's equity holders lack the ability through voting rights to make decisions about Residential's activities that have a significant effect on the success of Residential. We have also concluded that we are the primary beneficiary of Residential's financial condition and results of operations because under the Residential asset management agreement we have the power to direct the activities of Residential that most significantly impact Residential's economic performance including establishing Residential's investment and business strategy. As a result, we consolidate Residential's financial results in our consolidated financial statements.

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During the quarter we completed the acquisition of a portfolio of NPLs for Residential consisting of 720 loans with approximately $172 million of UPB and $122 million of market value of underlying properties. In addition, we agreed to acquire two separate portfolios for Residential with an aggregate of 2,698 mortgage loans, substantially all of which were NPLs, with approximately $470 million of UPB and $370 million in market value of underlying properties. We currently expect to complete these acquisitions during the third quarter although there can be no assurance that we will be able to complete them on a timely basis or at all.

Operation of our business model

We believe Residential's business model provides it with operating capabilities that are difficult to replicate and positions it to capitalize on substantial market opportunities. Our success will be dependent on our ability to acquire single-family properties for Residential at attractive acquisition basis, effectively manage properties in Residential's rental portfolio and raise capital for Residential at accretive rates, which we believe will help it achieve its business objective of generating attractive risk-adjusted returns for its stockholders through dividends and capital appreciation and incentive management fees for us. As more fully described below, during the quarter we delivered on each of these objectives:

- As described earlier, we have agreed to acquire non-performing loan portfolios for Residential with a total of $470 million in UPB that we believe meet Residential's return targets and other investment criteria. With the closing of these acquisitions, Residential's NPL portfolio will represent approximately 4,100 loans with $820 million in UPB and $625 million in market value of underlying properties;
- We are meeting our initial targets for loan resolutions. While loan resolutions are long lead-time activities, we are to date hitting the targets that we set for Residential's portfolio; and
- We successfully raised $309.5 million in new equity capital for Residential.

Factors affecting our consolidated results

As described above, our operating results depend heavily on Residential's operating results. We expect Residential's operating results to be affected by various factors, many of which are beyond its control, including the following:

Acquisitions

Residential's and our operating results will depend heavily on sourcing sub-performing and non-performing loans. Our results will depend on Residential's success in growing its portfolio of assets. As a result of the economic crisis in 2008, we believe that there is currently a large supply of sub-performing and non-performing loans available to Residential for acquisition. We believe the available supply provides for a steady acquisition pipeline of assets since Residential plans on targeting just a small percentage of the population. We further believe that Residential will be able to purchase residential mortgage loans at lower prices than REO properties because sellers of such loans will be able to avoid paying the costs typically associated with home sales, such as broker commissions and closing costs of up to 10% of gross proceeds of the sale.

Similar to Residential's previous acquisitions described under "– Portfolio size," we expect Residential to acquire single-family rental properties primarily through its acquisition of sub-performing and non-performing loan portfolios. We believe there are fewer participants in the sub-performing and non-performing loan marketplace than in the foreclosure auction and other REO acquisition channels due to the large size of portfolios offered for sale on an “all or none” basis and the required operational infrastructure involved in servicing loans and managing single-family rental properties across various states. We believe the relatively lower level of competition for sub-performing and non-performing loans, combined with a growing supply, provide buyers with the opportunity for a higher discount rate relative to the foreclosure auction and other REO acquisition channels and therefore a relatively lower cost to ultimately acquire single-family rental properties.

Generally, we expect that Residential's residential mortgage loan portfolio may grow at an uneven pace, as opportunities to acquire distressed residential mortgage loans may be irregularly timed and may involve large portfolios of loans, and the timing and extent of Residential's success in acquiring such loans cannot be predicted.

Financing

Residential's ability to grow its business by acquiring sub-performing and non-performing loans is dependent on the availability of adequate financing including additional equity financing, debt financing or both in order to meet its objectives. Residential intends to leverage its investments with debt, the level of which may vary based upon the particular characteristics of its

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portfolio and on market conditions. To the extent available at the relevant time Residential's financing sources may include bank credit facilities, warehouse lines of credit, structured financing arrangements and repurchase agreements, among others. Residential may also seek to raise additional capital through public or private offerings of debt or equity securities, depending upon market conditions. Accordingly, our ability to grow our incentive management fee income will be dependent on Residential's access to adequate financing. To qualify as a REIT under the federal income tax code, Residential generally will need to distribute at least 90% of its taxable income each year (subject to certain adjustments) to its stockholders. This distribution requirement limits Residential's ability to retain earnings and thereby replenish or increase capital to support its activities.

Conversions

We currently expect that a majority of Residential's acquired loans will be converted into rental property. As a result, we believe the key components that will affect Residential's residential rental revenues over the long-term will be average occupancy and rental rates. We expect Residential's timeline to convert acquired loans into single-family rental properties will vary significantly by loan, which could result in variations in our revenue recognition and Residential's operating performance from period to period. There are a variety of factors that may inhibit Residential's ability, through Ocwen, to foreclose upon a residential mortgage loan and get access to the real property within the time frames we model as part of our valuation process. These factors include, without limitation: state foreclosure timelines and deferrals associated therewith (including with respect to litigation); unauthorized occupants living in the property; federal, state or local legislative action or initiatives designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures that may delay the foreclosure process; federal government programs that require specific procedures to be followed to explore the non-foreclosure outcome of a residential mortgage loan prior to the commencement of a foreclosure proceeding; and continued declines in real estate values and sustained high levels of unemployment that increase the number of foreclosures and place additional pressure on the already overburdened judicial and administrative systems.

Expenses

Our expenses will consist of largely compensation expense and general and administrative expenses. The general and administrative expenses consist of those costs related to the general operation and overall administration of the business.
Residential reimburses us for the costs we incurred for the services we perform for Residential based on the percentage of time spent for the benefit of Residential. Residential's expenses primarily will consist of loan servicing fees, rental property operating expenses, depreciation and amortization, general and administrative expenses and interest expense. From time to time, expenses also may include impairments of assets. Loan servicing fees are expenses paid to Ocwen to service Residential's acquired loans. Rental property operating expenses are expenses associated with Residential's ownership and operation of rental properties and include expenses that are either impacted by occupancy levels or renovation expenses, such as Altisource's inspection, property preservation and renovation fees, property management fees and turnover costs, and expenses that do not vary based on occupancy, such as property taxes, insurance and HOA dues. Depreciation and amortization is a non-cash expense associated with the ownership of real estate and generally remains relatively consistent each year at an asset level since Residential depreciates its properties on a straight-line basis over a fixed life. The interest expense consists of the costs to borrow money.

Resolution methodologies

Residential employs various loan resolution methodologies with respect to its residential mortgage loans, including loan modification, collateral resolution and collateral disposition. The manner in which a sub-performing or non-performing loan is resolved will impact the amount and timing of revenue Residential will receive. We expect that a portion of our sub-performing and non-performing loans will be returned to performing status primarily through loan modifications. Once successfully modified, we expect that borrowers will typically refinance these loans with other lenders at or near the estimated value of the underlying property or we may also consider selling these modified loans. We believe that a majority of these residential mortgage loans may enter into foreclosure or similar proceedings, ultimately becoming REO. REO property can be converted into single-family rental properties and added to Residential's portfolio if they meet its investment criteria, or they may be sold through REO liquidation and short sale processes. We expect the timelines for each of the different processes to vary significantly, and final resolution could take up to 24 months or longer from the loan acquisition date.

The exact nature of resolution will be dependent on a number of factors that are beyond Residential's control, including borrower willingness, property value, availability of refinancing, interest rates, conditions in the financial markets, regulatory environment and other factors. In addition, we expect that Residential's real estate assets would decline in value in a rising

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interest rate environment and that its net income could decline in a rising interest rate environment to the extent such real estate assets are financed with floating rate debt and there is no accompanying increase in rental yield.

The state of the real estate market and home prices will determine proceeds from any sale of real estate. Although Residential generally intends to own as rental properties the assets it acquires upon foreclosure, Residential may determine to sell such assets if they do not meet its investment criteria. In addition, while we seek to track real estate price trends and estimate the effects of those trends on the valuations of Residential's portfolios of residential mortgage loans, future real estate values are subject to influences beyond our control. Generally, rising home prices are expected to positively affect Residential's results. Conversely, declining real estate prices are expected to negatively affect Residential's results of real estate.

Portfolio size

The size of Residential's investment portfolio will also be a key revenue driver. Generally, as the size of Residential's investment portfolio grows, the amount of revenue we expect Residential to generate will increase and we believe that the amount of incentive management fees that Residential will pay to us will grow as well. The larger investment portfolio, however, will drive increased expenses including servicing fees to Ocwen, property management fees to Altisource and related fees payable to us. Residential may also incur additional interest expense to finance the purchase of its assets.

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As of June 30, 2013, our portfolio of mortgage loans consisted of the following ($ in thousands):

| Location | Loan count | Carrying value (1) | Unpaid principal balance | Collateral market value (2) | Weighted Average LTV (3) | |
|---|---|---|---|---|---|---|
| Alabama | 4 | $399 | $713 | $619 | 122.1 | % |
| Arkansas | 4 | 458 | 744 | 746 | 100.7 | % |
| Arizona | 35 | 4,010 | 8,135 | 5,981 | 157.5 | % |
| California | 202 | 43,955 | 78,392 | 62,008 | 144.6 | % |
| Colorado | 11 | 1,990 | 2,413 | 2,838 | 92.9 | % |
| Connecticut | 18 | 2,339 | 4,724 | 3,408 | 170.5 | % |
| Delaware | 6 | 963 | 1,780 | 1,513 | 120.6 | % |
| Florida | 359 | 34,696 | 77,465 | 49,765 | 183.2 | % |
| Georgia | 52 | 3,749 | 8,507 | 5,297 | 187.0 | % |
| Hawaii | 2 | 554 | 954 | 980 | 100.5 | % |
| Iowa | 2 | 97 | 178 | 158 | 113.8 | % |
| Idaho | 2 | 250 | 515 | 322 | 160.6 | % |
| Illinois | 81 | 8,569 | 19,556 | 13,554 | 164.4 | % |
| Indiana | 12 | 971 | 1,914 | 1,392 | 184.4 | % |
| Kansas | 2 | 109 | 220 | 155 | 144.5 | % |
| Kentucky | 4 | 193 | 366 | 288 | 140.0 | % |
| Louisiana | 10 | 1,179 | 1,912 | 1,801 | 111.1 | % |
| Massachusetts | 25 | 4,059 | 8,299 | 6,839 | 133.4 | % |
| Maryland | 68 | 7,984 | 18,530 | 12,786 | 162.6 | % |
| Maine | 6 | 593 | 1,088 | 944 | 120.9 | % |
| Michigan | 7 | 317 | 915 | 491 | 212.6 | % |
| Minnesota | 2 | 250 | 644 | 420 | 157.1 | % |
| Missouri | 6 | 455 | 774 | 723 | 117.1 | % |
| Mississippi | 5 | 225 | 504 | 334 | 182.4 | % |
| North Carolina | 18 | 2,252 | 4,039 | 3,350 | 123.6 | % |
| Nebraska | 3 | 136 | 311 | 231 | 138.7 | % |
| New Jersey | 79 | 8,301 | 21,882 | 14,314 | 174.2 | % |
| New Mexico | 3 | 290 | 396 | 407 | 98.7 | % |
| Nevada | 33 | 3,221 | 8,189 | 4,529 | 192.3 | % |
| New York | 22 | 2,414 | 5,897 | 5,392 | 125.4 | % |
| Ohio | 21 | 2,004 | 3,551 | 3,208 | 119.9 | % |
| Oklahoma | 4 | 404 | 571 | 572 | 100.2 | % |
| Oregon | 15 | 2,551 | 4,252 | 3,724 | 119.8 | % |
| Pennsylvania | 43 | 4,935 | 8,256 | 7,593 | 117.8 | % |
| Puerto Rico | 3 | 70 | 278 | 322 | 88.2 | % |
| Rhode Island | 1 | 107 | 266 | 190 | 139.9 | % |
| South Carolina | 13 | 1,594 | 2,849 | 2,317 | 134.0 | % |
| South Dakota | 1 | 75 | 141 | 130 | 108.7 | % |
| Tennessee | 11 | 755 | 1,519 | 1,069 | 167.0 | % |
| Texas | 73 | 7,460 | 10,737 | 11,127 | 112.8 | % |
| Utah | 5 | 670 | 976 | 855 | 116.2 | % |
| Virginia | 27 | 4,531 | 7,744 | 6,928 | 123.3 | % |
| Vermont | 2 | 132 | 309 | 340 | 91.1 | % |
| Washington | 25 | 3,004 | 5,992 | 4,351 | 156.8 | % |
| Wisconsin | 5 | 250 | 585 | 462 | 145.6 | % |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total mortgage loans | 1,332 | $163,520 | $327,982 | $244,773 | 156.5 | % |

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(1) The carrying value of an asset is based on our fair value model. The significant unobservable inputs used in the fair value measurement of our mortgage loans are discount rates, forecasts of future home prices, gross rental rates, alternate resolution probabilities and timelines. Significant changes in any of these inputs in isolation could result in a significant change to the fair value measurement. For a more complete description of the fair value measurements and the factors that may significantly affect the Carrying Value of our assets, please see Note 4 to our consolidated financial statements.

(2) Collateral market value is based on the most recent BPO provided to us within 180 days of the balance sheet date or provided to us by the applicable sellers as of the respective cut-off dates for each transaction if the transaction was consummated within the last 180 days. Although we performed diligence on a representative sample of the properties in each portfolio to confirm the accuracy of the BPOs provided to us by the sellers, we cannot assure you that the BPOs set forth in this table accurately reflected the actual market value of the related property at the purported time or accurately reflect such market value today.

(3) Weighted average loan to value (LTV) is based on the loan to value weighted by unpaid principal balance for each state.

Summary Management Reporting Information

In addition to evaluating our consolidated financial performance, we also evaluate the operations of AAMC on a stand-alone basis because our financial statements consolidate the results of Residential under U.S. GAAP. We also look at our stand-alone results because the effect of amounts received from Residential are still recognized in net income attributable to our stockholders through the adjustment for earnings attributable to our noncontrolling interest in Residential.

In evaluating our operating performance and managing our business, we consider the incentive management fees and reimbursement of expenses paid to us by Residential under our asset management agreement as well as our stand-alone operating expenses. We maintain our internal management reporting on this basis. The following table presents our consolidating balance sheet and statement of operations which are reconciled to U.S. GAAP.

The following table represents non-GAAP performance measures, but we believe it is useful to assist investors in gaining an understanding of the trends and operating results for our business. This information should be considered in addition to, and not as a substitute for our financial results determined in accordance with U.S. GAAP.

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Altisource Asset Management Corporation
Consolidating Statement of Operations
Three months ended June 30, 2013
(In thousands)

| | Residential (GAAP) | AAMC Stand-alone (Non-GAAP) | Consolidating Entries | AAMC Consolidated (GAAP) |
|---|---|---|---|---|
| Net gain on investments: | | | | |
| Net unrealized gain on mortgage loans | $7,165 | $— | $— | $7,165 |
| Net realized gain on mortgage loans | 1,719 | — | — | 1,719 |
| Expense reimbursements | — | 1,156 | (1,156) | — |
| Total net gain on investments | 8,884 | 1,156 | (1,156) | 8,884 |
| Expenses: | | | | |
| Residential rental property operating expenses | 84 | — | — | 84 |
| Related party mortgage loan servicing costs | 1,242 | — | — | 1,242 |
| Interest expense | 654 | — | — | 654 |
| General and administrative | 714 | 2,655 | — | 3,369 |
| Related party general and administrative | 1,156 | — | (1,156) | — |
| Total expenses | 3,850 | 2,655 | (1,156) | 5,349 |
| Other income | 193 | — | — | 193 |
| Net income (loss) | 5,227 | (1,499) | — | 3,728 |
| Net income attributable to noncontrolling interest in consolidated affiliate | — | — | (5,227) | (5,227) |
| Net income (loss) attributable to common stockholders | $5,227 | $(1,499) | $(5,227) | $(1,499) |

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Altisource Asset Management Corporation
Consolidating Statement of Operations
Six months ended June 30, 2013
(In thousands)

| | Residential (GAAP) | AAMC Stand-alone (Non-GAAP) | Consolidating Entries | AAMC Consolidated (GAAP) |
|---|---|---|---|---|
| Net gain on investments: | | | | |
| Net unrealized gain on mortgage loans | $8,293 | $— | $— | $8,293 |
| Net realized gain on mortgage loans | 2,106 | — | — | 2,106 |
| Expense reimbursements | — | 2,057 | (2,057) | — |
| Total net gain on investments | 10,399 | 2,057 | (2,057) | 10,399 |
| Expenses: | | | | |
| Residential rental property operating expenses | 84 | — | — | 84 |
| Related party mortgage loan servicing costs | 1,634 | — | — | 1,634 |
| Interest expense | 696 | — | — | 696 |
| General and administrative | 1,701 | 4,366 | — | 6,067 |
| Related party general and administrative | 2,234 | 30 | (2,057) | 207 |
| Total expenses | 6,349 | | | |