

RARE HOSPITALITY INTERNATIONAL INC  
Form PRE 14A  
March 30, 2001

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**SCHEDULE 14A  
(RULE 14a-101)**

**INFORMATION REQUIRED IN PROXY STATEMENT**

**SCHEDULE 14A INFORMATION  
PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES  
EXCHANGE ACT OF 1934 (AMENDMENT NO. \_\_\_\_\_)**

Filed by the Registrant   
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement       Confidential, for Use of the Commission Only (as permitted  
Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

**RARE HOSPITALITY INTERNATIONAL, INC.**

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**(Name of Registrant as Specified in Its Charter)**

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**(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)**

Payment of Filing Fee (Check the appropriate box):

- No fee required.  
 Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1. Title of each class of securities to which transaction applies:
2. Aggregate number of securities to which transaction applies:
3. Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
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(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

1. Amount Previously Paid:
2. Form, Schedule or Registration Statement No.:
3. Filing Party:
4. Date Filed:

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**[RARE HOSPITALITY INTERNATIONAL, INC. LOGO]**

**8215 ROSWELL ROAD  
BUILDING 600  
ATLANTA, GEORGIA 30350**

April 12, 2001

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of RARE Hospitality International, Inc., which will be held at the Crowne Plaza Ravinia, 4355 Ashford-Dunwoody Road, Atlanta, Georgia, on Monday, May 14, 2001 at 2:00 p.m. local time.

I hope you are planning to attend the meeting so that you can become acquainted with the members of our Board of Directors and our management team. The items of business that will be considered and voted upon this year are explained in the accompanying Proxy Statement. Even if you are planning to attend in person, please complete the enclosed proxy card and return it to us.

If you have any questions about the Proxy Statement or the 2000 Annual Report to Shareholders, please contact Ms. Joia M. Johnson at (770) 399-9595.

We look forward to seeing you on May 14, 2001.

Sincerely,

/s/ Philip J. Hickey, Jr.

PHILIP J. HICKEY, JR.  
Chairman of the Board of Directors

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**RARE HOSPITALITY INTERNATIONAL, INC.  
8215 ROSWELL ROAD  
BUILDING 600  
ATLANTA, GEORGIA 30350**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD ON MAY 14, 2001**

Notice is hereby given that the Annual Meeting of Shareholders (the "Meeting") of RARE Hospitality International, Inc. (the "Company"), will be held at the Crowne Plaza Ravinia, 4355 Ashford-Dunwoody Road, Atlanta, Georgia, on Monday, May 14, 2001, at 2:00 p.m. local time, for the following purposes:

1. To elect one director in Class II to serve until the 2003 Annual Meeting of Shareholders, and two directors in Class III to serve until the 2004 Annual Meeting of Shareholders.

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2. To approve a proposal to amend Article Four of the Company's Articles of Incorporation to increase the authorized number of shares of Common Stock, no par value, from 25,000,000 to 60,000,000.
3. To ratify the selection of KPMG LLP as the Company's independent auditors to serve for the fiscal year ending December 30, 2001.
4. To transact such other business as may properly come before the Meeting or any adjournments thereof.

Only those shareholders of record at the close of business on March 20, 2001, are entitled to notice of and to vote at the Meeting and any adjournments thereof. The transfer books will not be closed. A complete list of shareholders entitled to vote at the Meeting will be available at the Meeting.

By Order of the Board of Directors,

/s/ Joia M. Johnson

JOIA M. JOHNSON  
Secretary

Atlanta, Georgia  
April 12, 2001

**WHETHER OR NOT YOU EXPECT TO BE PRESENT AT THE MEETING IN PERSON, PLEASE VOTE, SIGN, DATE, AND RETURN THE ENCLOSED PROXY PROMPTLY IN THE ENCLOSED BUSINESS REPLY ENVELOPE. IF YOU DO ATTEND THE MEETING YOU MAY, IF YOU WISH, WITHDRAW YOUR PROXY AND VOTE IN PERSON.**

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**RAREHOSPITALITY INTERNATIONAL, INC.  
8215 ROSWELL ROAD  
BUILDING 600  
ATLANTA, GEORGIA 30350  
April 12, 2001**

**PROXY STATEMENT  
FOR ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON MAY 14, 2001**

**INTRODUCTION**

This Proxy Statement is furnished to shareholders of RARE Hospitality International, Inc., a Georgia corporation (herein, unless the context otherwise requires, the "Company"), in connection with the solicitation of proxies by the Company's Board of Directors from holders of the outstanding shares of common stock of the Company ("Common Stock") for use at the Annual Meeting of Shareholders to be held at the Crowne Plaza Ravinia, 4355 Ashford-Dunwoody Road, Atlanta, Georgia, on Monday, May 14, 2001, at 2:00 p.m. local time, and at any adjournments thereof (the "Meeting").

The Meeting will be held for the following purposes: (i) to elect one director in Class II to serve until the 2003 Annual Meeting of Shareholders, and two directors in Class III to serve until the 2004 Annual Meeting of Shareholders; (ii) to approve a proposal to amend Article Four of the Company's Articles of Incorporation to increase the authorized number of shares of Common Stock, no par value, from 25,000,000 to 60,000,000; (iii) to ratify the selection of KPMG LLP as the Company's independent auditors for the fiscal year ending December 30, 2001; and (iv) to transact such other business as may properly come before the Meeting.

The Company's mailing address and the location of its principal executive offices is 8215 Roswell Road, Building 600, Atlanta, Georgia 30350. This Proxy Statement and the accompanying Proxy are first being mailed to shareholders of the Company on or about April 12, 2001.

## SHAREHOLDERS ENTITLED TO VOTE

Only shareholders of record of the Company at the close of business on March 20, 2001 (the Record Date), will be entitled to notice of, and to vote at, the Meeting. On the Record Date, there were 21,237,694 shares of Common Stock issued and outstanding held by approximately 407 shareholders of record. Notwithstanding the Record Date specified above, the Company's stock transfer books will not be closed and shares may be transferred subsequent to the Record Date. However, all votes must be cast in the names of shareholders of record on the Record Date.

## QUORUM AND VOTING REQUIREMENTS

The presence, in person or by proxy, of the holders of a majority of the votes entitled to be cast on a matter at the Meeting will constitute a quorum to conduct business at the Meeting. Pursuant to the Bylaws of the Company, holders of Common Stock will be entitled to one vote for each share held.

The election of directors will require the affirmative vote of a majority of the shares represented at the Meeting and entitled to vote, provided a quorum is present. With respect to the election of directors, shareholders may: (1) vote for all of the director nominees; (2) withhold authority to vote for all of the nominees; or (3) withhold authority to vote for any individual nominee or nominees but vote for all other nominees. In the election of directors, votes to withhold authority and broker nonvotes (which occur when shares held by brokers or nominees for beneficial owners are voted on some matters but not on others), both of which are considered present at the Meeting and counted for purposes of establishing a quorum, will have the same effect as a vote against the nominee.

The amendment to Article Four of the Articles of Incorporation to increase the authorized number of shares of Common Stock, no par value, from 25,000,000 to 60,000,000 will require the approval of a majority of the votes entitled to be cast by the holders of all outstanding shares of Common Stock. Abstentions and broker non-votes on this proposal will have the same effect as negative votes.

The ratification of the appointment of KPMG LLP as independent auditors will require that votes cast in favor of the proposal exceed the votes cast against the proposal, provided a quorum is present. With respect to the approval of the auditors, shareholders may: (1) vote for approval; (2) vote against approval; or (3) abstain from voting on the proposal. Abstentions and broker nonvotes will have no effect on the ratification of the auditors.

## PROXIES

If the enclosed Proxy is executed, returned in time and not revoked, the shares represented thereby will be voted in accordance with the instructions indicated in such Proxy. IF NO INSTRUCTIONS ARE INDICATED, SUCH PROXIES WILL BE VOTED (I) FOR THE ELECTION OF THE NOMINEES FOR DIRECTOR OF THE COMPANY, (II) FOR THE PROPOSED AMENDMENT TO ARTICLE FOUR OF THE COMPANY'S ARTICLES OF INCORPORATION, (III) FOR RATIFICATION OF THE SELECTION OF KPMG LLP AS THE COMPANY'S INDEPENDENT AUDITORS FOR THE FISCAL YEAR ENDING DECEMBER 30, 2001, AND (IV) IF THE COMPANY DID NOT HAVE NOTICE ON OR BEFORE FEBRUARY 21, 2001 OF ANY MATTERS PROPERLY BROUGHT BEFORE THE MEETING, IN THE SOLE DISCRETION OF THE PROXIES AS TO SUCH MATTERS.

A shareholder who has given a Proxy may revoke it at any time prior to its exercise at the Meeting by (i) giving written notice of revocation to the Secretary of the Company, (ii) properly submitting to the Company a duly executed Proxy bearing a later date, or (iii) appearing at the Meeting and voting in person. All written notices of revocation of Proxies should be addressed as follows: RARE Hospitality International, Inc., 8215 Roswell Road, Building 600, Atlanta, Georgia 30350, Attention: Ms. Joia M. Johnson, Secretary.

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## PROPOSAL I

### ELECTION OF DIRECTORS

The Company's Board of Directors has nominated Carolyn H. Baldwin for election as a Class II director to hold office until the 2003 Annual Meeting of Shareholders of the Company and until her successor shall have been elected and qualified, and Ronald W. San Martin and Eugene I. Lee, Jr. for election as Class III directors to hold office until the 2004 Annual Meeting of Shareholders of the Company and until their successors shall have been elected and qualified.

It is believed that all of the nominees will be available and able to serve as directors. It is anticipated that management shareholders of the Company will grant authority to vote for the election of the three nominees.

The Company's Board of Directors currently consists of nine directors divided into three classes, with three directors currently in each Class. The term of the Class III directors, composed of Messrs. San Martin, Lee and Pawly expires at the Meeting. Mr. Pawly is not standing for re-election and the Board of Directors has set the size of the Board from and after this meeting at eight directors with two directors in Class III and three

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directors in each of Classes I and II. The terms of the Class I and Class II directors expire at the Annual Meetings of Shareholders in 2002 and 2003, respectively. Directors hold office until the Annual Meeting of Shareholders of the Company in the year in which the term of their Class expires and until their successors have been duly elected and qualified.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE THREE NOMINEES FOR ELECTION AS DIRECTORS. THE AFFIRMATIVE VOTE OF A MAJORITY OF THE SHARES REPRESENTED AND ENTITLED TO VOTE AT THE MEETING AT WHICH A QUORUM IS PRESENT IS REQUIRED FOR THE ELECTION OF THE NOMINEES.**

**CERTAIN INFORMATION CONCERNING NOMINEES AND DIRECTORS**

The table on the following page sets forth the names of the nominees and of the directors continuing in office, their ages, the year in which each was first elected a director, their position(s) with the Company, their principal occupations and employers for at least the last five years, and any other directorships held by them in certain other companies. For information concerning membership on committees of the Board of Directors, see Meetings of the Board of Directors and Committees below. For information concerning directors' ownership of Common Stock, see Beneficial Owners of More Than Five Percent of the Company's Common Stock; Shares Held by Directors and Executive Officers below.

**NOMINEES TO THE BOARD OF DIRECTORS**

**CLASS II - TERM EXPIRING ANNUAL MEETING 2003**

NAME AND YEAR FIRST ELECTED A DIRECTOR -----	AGE ---	POSITIONS WITH THE COMPANY, PRINCIPAL OCCUPATIONS DURING AT LEAST THE PAST FIVE YEARS, AND OTHER DIRECTORSHIPS -----
Carolyn H. Baldwin 2000	52	Ms. Baldwin is Chairman and Chief Executive Officer of GlobalTech Financial, LLC, a financial services company established in May 2000. From 1977 until September 2000, Ms. Baldwin held various positions of increasing responsibility, including Chief of Internal Audits, Director of the Corporate Auditing Department and, most recently, President of Coca-Cola Financial Corporation and Vice President of The Coca-Cola Company. Ms. Baldwin is currently a director of ReliaStar Financial Corp., Vice Chairman of the Teachers Retirement System of Georgia, a director of the Executive Leadership Foundation and a member of the Board of Trustees at Fisk University, Nashville, Tennessee.

**CLASS III - TERM EXPIRING ANNUAL MEETING 2004**

NAME AND YEAR FIRST ELECTED A DIRECTOR -----	AGE ---	POSITIONS WITH THE COMPANY, PRINCIPAL OCCUPATIONS DURING AT LEAST THE PAST FIVE YEARS, AND OTHER DIRECTORSHIPS -----
Ronald W. San Martin 1985	53	Mr. San Martin serves as President of 490 East Paces Ferry, Inc., Chief Financial Officer of Fishbone LLC, and has held the position of Chief Financial Officer (since June 1999) and Secretary (since January 1996) of We're Cookin' Inc., all of which are restaurant development and operating companies. Mr. San Martin was the Chief Financial Officer and the Secretary of the Company from May 1985 until June 1995 and was Chief Operating Officer from August 1997 until December 1997. Prior to joining the Company, Mr. San Martin was a tax manager at Evans, Snyder & Co., Certified Public Accountants.
Eugene I. Lee, Jr. 2001	39	Mr. Lee became the Company's President and Chief Operating Officer in January 2001. From January 1999 until January 2001, Mr. Lee served as the Company's Executive Vice President and Chief Operating Officer. Prior to that, he was

Executive Vice President, Operations - LongHorn Steakhouse Division from October 1997 until January 1999, and was the Company's Executive Vice President, Operations - Bugaboo Cre Steak House Division from January 1997 until October 1997. For more than five years prior to joining the Company, he occupied various positions with Uno Restaurant Corporation, an operator of restaurants, including Senior Vice President - Operations

**MEMBERS OF BOARD OF DIRECTORS CONTINUING IN OFFICE**

**CLASS I - TERM EXPIRING ANNUAL MEETING 2002**

NAME AND YEAR FIRST ELECTED A DIRECTOR -----	AGE ---	POSITIONS WITH THE COMPANY, PRINCIPAL OCCUPATIONS DURING AT LEAST THE PAST FIVE YEARS, AND OTHER DIRECTORSHIPS -----
George W. McKerrow, Sr. 1982	75	Mr. McKerrow, Sr. was Chairman of the Board of Directors of the Company from its organization in 1982 until February 1994. Mr. McKerrow, Sr. retired from employment with the Company at the end of 2000, but continues as a director. Before joining the Company, Mr. McKerrow, Sr. was the Vice President and General Manager of the Dairy Pak Division of Champion International Corporation. Mr. McKerrow's son, George W. McKerrow, Jr., is a director of the Company.
Don L. Chapman 1992	61	Mr. Chapman was Chief Executive Officer of S&S Tug LLC, a manufacturer of aircraft towing equipment from December 1998 until March 2000. Mr. Chapman was President and Chief Executive Officer of Tug Manufacturing, the predecessor to S&S Tug LLC, for more than five years prior to its acquisition in December 1998. Mr. Chapman is also a director of AirTran Holdings, Inc. and serves on the compensation committee of that board. Mr. Chapman served as the Chief Executive Officer of Opti-World, Inc. from June 1983 until February 1995.
Lewis H. Jordan 1998	56	Mr. Jordan is the founder and principal officer of Wingspread Enterprises LLC, an investment and consulting firm since August 1997. Mr. Jordan currently serves and has served as a director of AirTran Holdings, Inc. since June 1993. Mr. Jordan was also President and Chief Operating Officer of ValuJet, Inc. from June 1993 until November 1997. Prior to 1993, Mr. Jordan held various executive officer positions in the airline industry.

**CLASS II - TERM EXPIRING ANNUAL MEETING 2003**

NAME AND YEAR FIRST ELECTED A DIRECTOR -----	AGE ---	POSITIONS WITH THE COMPANY, PRINCIPAL OCCUPATIONS DURING AT LEAST THE PAST FIVE YEARS, AND OTHER DIRECTORSHIPS -----
Philip J. Hickey, Jr. 1997	46	Mr. Hickey became the Company's Chairman of the Board of Directors and Chief Executive Officer in January 2001. From October 1997 until July 1998, Mr. Hickey served as the Company's President and Chief Operating Officer and a director. In July 1998, Mr. Hickey became the Company's Chief Executive Officer. From November 1992 until he joined the Company in October 1997, Mr. Hickey served as President and Chief Operating Officer of Innovative Restaurant Concepts, Inc.

("IRC") and Rio Bravo International, Inc., operators and franchisors of casual dining restaurants that were acquired by Applebee's International, Inc. in March 1995. From 1990 until 1992, Mr. Hickey was President and Chief Executive Officer of H&M Restaurants Inc., which was acquired by IRC in 1992.

George W. McKerrow, Jr. 50  
1982

Mr. McKerrow, Jr. served as Chairman of the Board of the Company from February 1994 until January 2001. Mr. McKerrow, Jr. previously served as President and a director of the Company from its organization in 1982 until February 1994, and also served as President of the Company from August 1997 to October 1997 and Chief Executive Officer from August 1997 to July 1998. Mr. McKerrow, Jr. founded the first LongHorn Steakhouse in Atlanta, Georgia in 1981. Mr. McKerrow, Jr. is the son of George W. McKerrow Sr., a director of the Company.

## MEETINGS OF THE BOARD OF DIRECTORS AND COMMITTEES

**Board of Directors.** The property, affairs and business of the Company are under the general management of its Board of Directors as provided by the laws of Georgia and the Bylaws of the Company. The Company has standing Audit, Compensation and Stock Option Committees of the Board of Directors and does not have a Nominating Committee.

**Audit Committee.** The members of the Audit Committee are Ronald W. San Martin, Lewis H. Jordan, and Carolyn H. Baldwin. The function of the Audit Committee is to provide oversight in the areas of financial reporting, corporate governance, and corporate control. In this capacity, a primary responsibility of the Audit Committee is to recommend to the Board of Directors for their approval the independent accountants to audit the financial statements of the Company, which includes an inspection of the books and accounts of the Company, and reviews with such accountants the scope of their audit and their report thereon, including any questions and recommendations that may arise relating to such audit and report or the Company's internal accounting procedures. The Audit Committee held four meetings during the 2000 fiscal year.

The Company's Board of Directors has determined that the members of the Audit Committee are independent as defined in the NASD listing standards.

The Company's Board of Directors has adopted and approved a written charter for the Audit Committee, a copy of which is attached hereto as Appendix B.

**Stock Option Committee.** The members of the Stock Option Committee are Lewis H. Jordan and John G. Pawly. The Stock Option Committee establishes targets and then recommends incentive awards under the incentive compensation plans of the Company for executive officers and other key personnel of the Company. The Stock Option Committee held one meeting during the 2000 fiscal year.

**Compensation Committee.** The members of the Compensation Committee are Don L. Chapman, John G. Pawly and Ronald W. San Martin. The function of the Compensation Committee is to review and approve the compensation of executive officers including salary, bonus and other annual compensation awards. The Compensation Committee reports to the Board of Directors. The Compensation Committee held one meeting during the 2000 fiscal year.

During the 2000 fiscal year, the Company's Board of Directors met five times. Each director, during the period he or she was a director, attended at least 75% of the aggregate number of meetings of the Board of Directors and the committees of the Board of Directors of which he or she was a member.

## EXECUTIVE OFFICERS OF THE COMPANY

Except for Messrs. Hickey and Lee discussed above, the following table sets forth the names of the executive officers of the Company, their ages, their position(s) with the Company, their principal occupations and employers for at least the last five years, and any other directorships held by them in certain other companies. For information concerning ownership of Common Stock, see Beneficial Owners of More Than Five Percent of the Company's Common Stock; Shares Held by Directors and Executive Officers below.

OCCUPATIONS DURING AT LEAST THE PAST

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NAME ---	AGE ---	FIVE YEARS, AND OTHER DIRECTORSHIPS -----
W. Douglas Benn	46	Mr. Benn became the Company's Executive Vice President, Finance, Chief Financial Officer and Secretary in March 1998. Before joining Company, Mr. Benn was an independent financial consultant providing consulting services primarily to companies in the restaurant industry including the Company, from February 1997 until March 1998. From April 1987 until February 1997, Mr. Benn was the Chief Financial Officer of Innovative Restaurant Concepts, Inc., an operator and franchisor of casual dining restaurants that was acquired by Applebee's International, Inc. in March 1995.
Joia M. Johnson	41	Ms. Johnson became the Company's Vice President and General Counsel in May 1999, became the Company's Secretary in July 1999 and was named Executive Vice President in May, 2000. Before joining the Company, Ms. Johnson served as Vice President, General Counsel and Secretary of H.J. Russell & Company, a real estate development, construction and property management firm, where she held that position from January 1989 to May 1999. For six years during her employment with H.J. Russell & Company, Ms. Johnson served as Corporate Counsel for Concessions International, Inc., an airport food and beverage concessionaire and affiliate of H.J. Russell & Company.
Thomas W. Gathers	45	Mr. Gathers became the Company's Executive Vice President of Human Resources in December 1998. For more than five years prior to joining the Company, he was Senior Vice President - Human Resources with Uno Restaurant Corporation.

### BENEFICIAL OWNERS OF MORE THAN FIVE PERCENT OF THE COMPANY'S COMMON

#### STOCK; SHARES HELD BY DIRECTORS AND EXECUTIVE OFFICERS

Based solely on information made available to the Company, the following table sets forth certain information with respect to the beneficial ownership of the Company's Common Stock as of March 20, 2001, by (i) each person who is known by the Company to beneficially own more than 5% of the outstanding shares of Common Stock of the Company, (ii) each director and nominee for director of the Company, (iii) the Named Executive Officers of the Company (as defined under "Executive Compensation" below), and (iv) all of the Company's executive officers and directors as a group.

NAME (1) -----	SHARES BENEFICIALLY OWNED -----	
	SHARES -----	PERCENT -----
Philip J. Hickey, Jr	660,526 (2)	3.1%
George W. McKerrow, Jr	299,877 (3)	1.4%
Ronald W. San Martin	323,975 (4)	1.5%
George W. McKerrow, Sr	307,500 (5)	1.5%
Eugene I. Lee, Jr	231,751 (6)	1.1%
Don L. Chapman	48,750 (7)	*
John G. Pawly	27,750 (8)	*
Lewis H. Jordan	20,625 (9)	*
Carolyn Baldwin	1,875 (10)	*
W. Douglas Benn	173,402 (11)	*
Thomas W. Gathers	26,602 (12)	*
Joia M. Johnson	11,265 (13)	*
Provident Investment Counsel, Inc	1,483,050 (14)	7.0%
All executive officers and directors as a group (twelve persons)	2,133,898 (15)	9.6%

BENEFICIAL OWNERS OF MORE THAN FIVE PERCENT OF THE COMPANY'S COMMON STOCK; SHARES HELD BY



\* Less than one percent.

1. The named shareholders have sole voting and investment power with respect to all shares shown as being beneficially owned by them, except as otherwise indicated. Shares underlying stock options that are exercisable within 60 days are deemed to be outstanding for the purpose of computing the outstanding shares owned by the particular person and by the group, but are not deemed outstanding for any other purpose.
2. Includes 18,000 shares held in an irrevocable trust for his daughter, 18,000 shares held in an irrevocable trust for his son, 3,150 shares owned jointly with his wife and 511,601 shares that are subject to stock options exercisable within 60 days.
3. Includes 4,150 shares held as custodian for one of his daughters, 1,500 shares owned by his wife and 167,999 shares that are subject to stock options exercisable within 60 days.
4. Includes 150,000 shares pledged to secure a loan to Mr. San Martin over which he has sole voting and shared investment power, and 63,750 shares that are subject to stock options exercisable within 60 days.
5. Consists of 307,500 shares held by the George W. McKerrow, Sr. Revocable Trust. Mr. McKerrow, Sr. is the sole trustee of such trust and has sole voting and investment power over all 307,500 shares held by the trust.
6. Includes 217,366 shares that are subject to stock options exercisable within 60 days.
7. Includes 20,250 shares that are subject to stock options exercisable within 60 days.
8. Includes 18,750 shares that are subject to stock options exercisable within 60 days.
9. Includes 9,375 shares that are subject to stock options exercisable within 60 days.
10. Includes 1,875 shares that are subject to stock options exercisable within 60 days.
11. Includes 1,500 shares held as custodian for his children and 156,127 shares that are subject to stock options exercisable within 60 days.
12. Includes 23,602 shares that are subject to stock options exercisable within 60 days.
13. Includes 11,265 shares that are subject to stock options exercisable within 60 days.
14. Based on a Schedule 13G dated January 10, 2001, filed by Provident Investment Counsel, Inc. The address of Provident Investment Counsel, Inc. is 300 North Lake Avenue, Pasadena, CA 91101-4022.
15. Includes 1,201,960 shares that are subject to stock options exercisable within 60 days.

## EXECUTIVE COMPENSATION

The following table presents certain summary information concerning compensation paid or accrued by the Company for services rendered in all capacities during the fiscal years ended December 27, 1998, December 26, 1999, and December 31, 2000 for (i) all individuals serving as the registrant's chief executive officer or acting in a similar capacity during the last completed fiscal year; and (ii) each of the four most highly compensated executive officers of the Company who earned in excess of \$100,000 during 2000 (collectively, the Named Executive Officers).

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION		LONG TERM COMPENSATION	
		SALARY	BONUS	SECURITIES UNDERLYING OPTIONS	ALL OTHER COMPENSATION
Philip J. Hickey, Jr. Chairman of the Board of Directors and Chief Executive Officer(1)	2000	\$339,904	\$339,766	308,003	\$5,115 (4)
	1999	272,115	272,115	--	--
	1998	251,923	183,076	--	--
Eugene I. Lee, Jr. President and Chief Operating Officer and Director(2)	2000	257,536	153,709	150,000	6,260 (4)
	1999	212,981	106,490	--	--
	1998	190,340	72,359	--	--
George W. McKerrow, Jr.	2000	205,132	80,000	75,000	3,458 (4)

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Director (3)	1999	200,000	80,000	--	--
	1998	229,533	82,733	150,000	5,000 (4)
W. Douglas Benn	2000	214,135	107,040	45,000	3,583 (4)
Executive Vice President, Finance	1999	189,615	95,165	--	--
and Chief Financial Officer (5)	1998	132,933	61,220	170,625	--
Thomas W. Gathers	2000	201,346	80,522	15,000	46,038 (4)
Executive Vice President of	1999	185,385	74,154	--	--
Human Resources (6)	1998	10,165		--	45,000

1. Mr. Hickey, Jr. was employed by the Company as President effective October 1997, became Chief Executive Officer effective July 1998 and Chairman of the Board of Directors effective January 1, 2001.
2. Mr. Lee, Jr. became the Company's Chief Operating Officer in January 1999 and President and Director effective January 1, 2001.
3. Mr. McKerrow, Jr. was Chief Executive Officer from July 1997 through July 1998 and Chairman of the Board of Directors from February 1994 through December 31, 2000.
4. Consists of discretionary and matching contributions to the Company's 401(k) and supplemental deferred compensation plans. The matching contributions are based on pre-tax elective contributions (included under salary and bonus) made to such plans. For Mr. Gathers, this amount also includes \$40,000 income from the forgiveness of a Company loan.
5. Mr. Benn was employed by the Company effective March 1998 and was Secretary through July 1999.
6. Mr. Gathers was employed by the Company effective December 1998.

**OPTION GRANTS IN 2000**

The following table presents further information on grants of stock options during the fiscal year ended December 31, 2000 to the Named Executive Officers. Such grants are reflected in the Summary Compensation Table above.

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(1)	
	Number of Securities Underlying Options Granted (#)	% of Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	5% (\$)	10% (\$)
Philip J. Hickey, Jr.	277,500 (2)	29.07	12.792	12/27/09	980,739	5,657,435
	30,503 (2)	3.20	19.750	06/29/10	166,441	960,125
Eugene I. Lee, Jr.	150,000 (2)	15.71	12.792	12/27/09	530,129	3,058,073
George W. McKerrow, Jr.	75,000 (3)	7.86	12.792	12/27/09	265,065	1,529,037
W. Douglas Benn	45,000 (3)	4.71	12.792	12/27/09	159,039	917,422
Thomas W. Gathers	15,000 (3)	1.57	12.792	12/27/09	53,013	305,807

1. Amounts represent hypothetical gains that could be achieved for the respective options at the end of the option term, which is one day less than ten years for all options listed. The assumed 5% and 10% rates of stock

appreciation are mandated by the rules of the SEC and may not accurately reflect the appreciation of the price of the Common Stock from the grant date until the end of the option term. These assumptions are not intended to forecast future price appreciation of the Company's Common Stock.

2. This option will become exercisable over a five-year period, with 20% of the options vesting one year after the date of grant and the balance vesting in four equal annual installments.
3. This option will become exercisable over a three-year period, with 34% of the options vesting one year after the date of grant and the balance vesting in two equal annual installments.

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**AGGREGATED OPTION EXERCISES IN 2000  
AND YEAR-END OPTION VALUES**

The following table presents information with respect to options exercised by the Named Executive Officers during 2000 and the fiscal year end values of unexercised options to purchase the Company's Common Stock held by the Named Executive Officers as of December 31, 2000.

Name	Shares Acquired on Exercise (#)	Value Realized (\$)(1)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of In-the-Money Options at Fiscal Year-End
			Exercisable	Unexercisable	
Philip J. Hickey, Jr.	-	-	511,601	246,403	6,971,269
Eugene I. Lee, Jr.	73,635	1,254,685	217,366	129,000	2,693,398
George W. McKerrow, Jr.	-	-	167,999	49,501	2,496,095
W. Douglas Benn	29,500	485,880	118,927	66,900	1,655,967
Thomas W. Gathers	11,500	156,791	23,602	24,901	291,793

1. "Value Realized" represents the amount equal to the excess of the fair market value of the shares at the time of exercise over the exercise price.
2. Represents the fair market value as of December 29, 2000, the last trading day before the Company's fiscal year-end (\$22.3125), of the shares underlying the options less the exercise price of the options.

*Compensation of Directors.* During fiscal year 2000, directors of the Company who are not also employees received an annual retainer of \$4,000, director fees of \$1,000 per board meeting attended and \$500 per committee meeting attended during fiscal year 2000, plus reimbursement of travel and other expenses incurred in connection with the performance of their duties. Directors who are also employees of the Company are not paid any compensation for their services as directors. Beginning with fiscal year 2001, directors of the Company who are not also employees receive an annual retainer of \$8,000, director fees of \$1,500 per board meeting attended, and \$500 per committee meeting attended, plus reimbursement of travel and other expenses incurred in connection with the performance of their duties. In addition, non-employee Directors are also eligible to receive formula plan stock options under the Company's 1996 Stock Plan for Outside Directors ("Directors Plan"). In 2000, Messrs. San Martin, Chapman, Pawly and Jordan each received options to purchase 3,750 shares of Common Stock at an exercise price of \$11.92 per share and Ms. Baldwin received options to purchase 1,875 shares of common stock at an exercise price of \$18.00 per share under the Directors Plan.

*Employment Contracts.* Through the end of fiscal year 2000, the Company was party to an employment agreement with Mr. McKerrow, Jr. This agreement was terminated by the parties at the end of fiscal year 2000. The Company has entered into a consulting agreement with Mr. McKerrow, Jr. for a period of one year beginning January 1, 2001, for compensation at the rate of \$200,000 per year. In addition, Mr. McKerrow, Jr. agrees that for a period of one year following the termination of his consulting with the Company, without the consent of the Company he will not engage, in a general management capacity, in the operation of a steak restaurant within the Company's then current market areas.

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The Company and Mr. Hickey are parties to an employment agreement (the "Hickey Employment Agreement") dated September 30, 1997. The Hickey Employment Agreement had an initial term ending December 31, 2000 and renews annually thereafter unless terminated by either party. Mr. Hickey currently receives an annual salary of \$375,000 plus such additional amounts as may be approved by the Company's Board of Directors, and an annual bonus of up to 100% of his annual salary as determined and paid in accordance with a bonus program for the executive officers of the Company. The Hickey Employment Agreement provides certain death and disability benefits as well as certain additional payments in the event that the Company terminates Mr. Hickey's employment without cause or Mr. Hickey terminates his employment "for reason."

On October 16, 1997, the Company entered into an employment agreement (the "Lee Employment Agreement") with Mr. Eugene I. Lee, Jr. Under the Lee Employment Agreement, which is terminable at will by either the Company or Mr. Lee at any time, Mr. Lee currently receives an annual salary of \$275,000 plus such additional amounts as may be approved by the Company's Board of Directors, and an annual bonus as determined and paid in accordance with the bonus program for the executive officers of the Company as approved by the Company's Board of Directors from time to time. The Lee Employment Agreement also provides certain death and disability benefits as well as certain additional payments in the event that the Company terminates Mr. Lee's employment without cause.

On March 23, 1998, the Company entered into an employment agreement (the "Benn Employment Agreement") with Mr. W. Douglas Benn. Under the Benn Employment Agreement, which is terminable at will by either the Company or Mr. Benn at any time, Mr. Benn currently receives an annual salary of \$235,000 plus such additional amounts as may be approved by the Company's Board of Directors, and an annual bonus as determined and paid in accordance with the bonus program for the executive officers of the Company as approved by the Company's Board of Directors from time to time. During the term of the Benn Employment Agreement, Mr. Benn's maximum bonus potential under such bonus program shall not be less than 50% of Mr. Benn's base compensation for the fiscal year. The Benn Employment Agreement also provides certain death and disability benefits as well as certain additional payments in the event that the Company terminates Mr. Benn's employment without cause.

On November, 30 1998, the Company entered into an employment agreement (the "Gathers Employment Agreement") with Thomas W. Gathers. Under the Gathers Employment Agreement, which is terminable at will by either the Company or Mr. Gathers at any time, Mr. Gathers currently receives an annual salary of \$210,000 plus such additional amounts as may be approved by the Company's Board of Directors, and an annual bonus as determined and paid in accordance with the bonus program for the executive officers of the Company as approved by the Company's Board of Directors from time to time. During the term of the Gathers Employment Agreement, Mr. Gathers' maximum bonus potential under such bonus program shall not be less than 40% of Mr. Gathers' base compensation for the fiscal year. In addition, Mr. Gathers received a loan from the Company in the amount of \$40,000, payable on demand at any time following the termination of Mr. Gathers' employment by Mr. Gathers or by the Company for cause prior to November 30, 2000. If Mr. Gathers remained employed by the Company on November 30, 2000, the Company intended to forgive this loan as additional compensation to Mr. Gathers. In accordance with the agreement, this \$40,000 loan was forgiven in 2000. The Gathers Employment Agreement provides certain death and disability benefits as well as certain additional payments in the event that the Company terminates Mr. Gathers' employment without cause.

Each of the Hickey Employment Agreement, Lee Employment Agreement, Benn Employment Agreement, and Gathers Employment Agreement contains certain provisions relating to unauthorized disclosure of confidential information, recognition of proprietary rights and non-competition provisions which provide that without consent of the Company, the executive will not compete with the Company during his employment nor for a period of twelve (12) months following his termination.

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### SHAREHOLDER RETURN ANALYSIS

The following line-graph presentation compares cumulative shareholder returns of the Company with the Nasdaq Stock Market (U.S. Companies) and a Peer Index for the period beginning on December 31, 1995 (assuming the investment of \$100 in the Company's Common Stock, the Nasdaq Stock Market (U.S. Companies), and the Peer Index on December 31, 1995 and reinvestment of all dividends).

### COMPARISON OF CUMULATIVE TOTAL RETURNS RARE HOSPITALITY INTERNATIONAL, INC.

Total return calculations for the Nasdaq Stock Market (U.S. Companies) and the Peer Index were prepared by the Center for Research in Security Prices, The University of Chicago. The Peer Index is composed of 31 active companies, including the Company, offering a wide variety

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of restaurant services and franchising found primarily in the Standard Industrial Classification ("SIC") Code groups 5810 and 5812. Information with regard to SIC classifications in general can be found in the Standard Industrial Classification Manual published by the Executive Office of the President, Office of Management and Budget. Specific information regarding the companies comprising the Peer Index will be provided to any shareholder upon request to the Secretary of the Company.

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### COMPENSATION AND STOCK OPTION COMMITTEES' REPORT ON EXECUTIVE COMPENSATION

The compensation of the Company's executive officers, including those with employment agreements, is subject to annual review and approval by the Compensation Committee. Compensation of executives generally consists of base salary, cash bonuses, participation in various benefit plans on the same basis as other employees of the Company, and the award of stock options. In establishing compensation policies and levels, the Compensation Committee seeks to attract and retain an outstanding group of executives and to align the interests of those executives with the Company's overall business strategies and goals.

In January 2000, the Compensation Committee reviewed the compensation of the Company's executives and determined salaries in light of the level of responsibility of the executives, prior experience and achievements and the importance of each executive's contribution to the Company. The Compensation Committee's determinations of the level of compensation for the Named Executive Officers described in "Executive Compensation" above was also based upon a review of compensation levels at comparable companies in the Peer Index and the prior level of the executive's base compensation.

The Compensation Committee increased the annual base compensation of Philip J. Hickey, Jr. by 15.4% to \$375,000 on October 30, 2000, in recognition of his services during the previous 12 months.

The Company's executives are entitled to receive bonuses under a plan that bases bonuses on the Company's earnings or a combination of the Company's earnings and the performance of the concept in which the executive was employed. The bonus compensation of the Chief Executive Officer under this plan is entirely based on the Company's earnings. For 2000, cash bonuses were paid to each named Executive Officer under this plan.

The Stock Option Committee determines from time to time the key employees of the Company who are entitled to receive options or other stock-based incentive awards under the Company's 1997 Long-Term Incentive Plan, which was adopted in October 1997 and amended in May 2000, and from time to time grants to such key employees options under the Incentive Plan to provide greater incentive to such employees to increase the long-term value of the Company and its stock. The Stock Option Committee granted options in 2000 to each of the named Executive Officers. As of March 15, 2001, the named Executive Officers appearing in the Summary Compensation Table held stock or the right to acquire stock representing 5.4% of the Company's outstanding common stock, assuming all outstanding options exercisable within 60 days of March 15, 2001 held by such named Executive Officers are exercised.

Section 162(m) of the Internal Revenue Code (the "Code") adopted as part of the Revenue Reconciliation Act of 1993, generally limits to \$1 million the deduction that can be claimed by any publicly-held corporation for compensation paid to any "covered employee" in any taxable year beginning after December 31, 1993. The term "covered employee" for this purpose is defined generally as the Chief Executive Officer and the four other highest paid employees of the Company. Performance-based compensation is outside the scope of the \$1 million limitation and, hence, generally can be deducted by a publicly-held corporation without regard to amount, provided that, among other requirements, such compensation is approved by the shareholders. Because of the current levels of compensation of the Company's highest paid employees, the Compensation Committee has not yet developed a formal policy on this matter. Generally speaking, the Compensation Committee's executive compensation policies are performance-based, as described above.

#### COMPENSATION COMMITTEE:

Don L. Chapman

Ronald W. San Martin

John G. Pawly

#### STOCK OPTION COMMITTEE:

Lewis H. Jordan

John G. Pawly

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### REPORT OF THE AUDIT COMMITTEE

We have reviewed and discussed with management the Company's audited financial statements as of and for the year ended December 31, 2000.

We have discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, *Communication with Audit Committees*, as amended, by the Independence Standards Board of the American Institute of Certified Public

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Accountants.

We have received and reviewed the written disclosures and the letter from the independent auditors required by Independence Standard No. 1, Independence discussions with Audit Committees, as amended, by the Independence Standards Board, and have discussed with the auditors the auditors' independence.

Based on the reviews and discussions referred to above, we recommend to the Board of Directors that the financial statements referred to above be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

### **AUDIT COMMITTEE:**

Ronald W. San Martin, Chairman

Lewis H. Jordan

Carolyn H. Baldwin

### **AUDIT FEES**

During fiscal 2000, the Company paid KPMG LLP fees in the aggregate amount of \$492,000. Of this amount, \$200,000 were fees for the fiscal 2000 audit and the review of the forms 10-Q. KPMG did not render any services related to Financial Information Systems Design and Implementation.

### **CERTAIN TRANSACTIONS**

On November 22, 1999, Eugene I. Lee, Jr., Executive Vice President and Chief Operating Officer, received loans from the Company aggregating \$130,000. These loans bear interest at 8% and are payable on demand at any time following the termination of Mr. Lee's employment by Mr. Lee or by the Company for cause. However, if Mr. Lee remains employed by the Company, the loans will be forgiven in certain installments resulting in a reduction in the principal amount of the loans to \$97,500 on November 15, 2001; \$65,000 on November 15, 2002; and \$0 on November 15, 2003. Any reduction in the principal amount of the loans and accrued interest thereon resulting from Mr. Lee's continued employment will be treated as additional compensation to Mr. Lee in the year of such reduction.

### **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

During 2000, Ms. Baldwin and Messrs. Chapman, Jordan, Pawly and San Martin served on the Compensation or Stock Option Committees. None of them were an officer or employee of the Company or any of its subsidiaries in 2000.

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## **PROPOSAL II**

### **PROPOSED AMENDMENT TO THE ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK**

On February 14, 2001, the Company's Board of Directors approved, subject to shareholder approval, an amendment to Article Four of the Company's Amended and Restated Articles of Incorporation (the "Articles of Incorporation") to increase the authorized number of shares of Common Stock, no par value, from 25,000,000 to 60,000,000. The full text of Article Four of the Articles of Incorporation reflecting this amendment is set forth as Appendix A to this proxy statement.

The Company is presently authorized to issue 25,000,000 shares of Common Stock, of which 21,237,694 were issued and outstanding at March 20, 2001, and 3,564,872 were reserved for issuance under certain stock option agreements and stock option plans. A balance of 197,434 authorized shares of Common Stock remained available for issuance without stockholder action. The 35,000,000 additional shares of Common Stock for which authorization is sought would have the same rights and privileges as the Common Stock presently outstanding. Holders of Common Stock have no preemptive rights to subscribe for any additional Common Stock of the Company.

The Board of Directors believes that it is beneficial to the Company to have additional authorized shares of Common Stock available for possible future stock dividends, splits or other issuances, employee benefit programs, acquisition transactions, and for other general corporate purposes. The proposed amendment could discourage attempts to acquire control of the Company. The issuance of Common Stock could be used to dilute the share ownership of a party seeking to obtain control of the Company or the Common Stock could be sold to persons who might support incumbent management. However, the Board believes that the availability of additional shares to assist in meeting corporate needs and

goals makes their authorization important without regard to any possible anti-takeover effects. The Company does not have any present plans or commitments with respect to the issuance of the additional shares of Common Stock for which authorization is sought. If the amendment is approved, the additional shares would be available for issuance without further action by the stockholders, unless such action is required by applicable law or the rules of the NASDAQ National Market System or any stock exchange or other quotation system on which the Company's securities may be listed or quoted in the future.

If the proposed amendment is approved by the shareholders, the amendment to the Articles of Incorporation will become effective upon the filing of Articles of Amendment thereto with the Secretary of the State of Georgia, which will occur as soon as practicable following the approval of the proposed amendment by the shareholders. Shareholders of the Company have no dissenters' rights with respect to the proposed amendment and will have no preemptive rights in connection with the issuance of any new shares of Common Stock.

**THE BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS VOTE FOR THIS PROPOSAL TO AMEND THE ARTICLES OF INCORPORATION. UNDER GEORGIA LAW, THE AFFIRMATIVE VOTE OF A MAJORITY OF THE OUTSTANDING COMMON STOCK IS REQUIRED FOR APPROVAL OF THIS PROPOSAL.**

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### PROPOSAL III

#### RATIFICATION OF SELECTION OF AUDITORS

The Company's Audit Committee has recommended and the Board of Directors has selected KPMG LLP to conduct the annual audit of the financial statements of the Company for the fiscal year ending December 30, 2001. The ratification by the shareholders of the selection of KPMG LLP as independent auditors is not required by law or by the Bylaws of the Company. The Board of Directors, consistent with the practice of most publicly held corporations, is nevertheless submitting this selection to the shareholders. If this selection is not ratified at the Meeting, the Board of Directors intends to reconsider its selection of independent auditors for the fiscal year ending December 30, 2001.

Representatives of KPMG LLP will be present at the Meeting with an opportunity to make statements, if they so desire, and to respond to appropriate questions with respect to that firm's audit of the Company's financial statements for the fiscal year ended December 31, 2000.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR RATIFICATION OF THE SELECTION OF KPMG LLP AS INDEPENDENT AUDITORS FOR THE FISCAL YEAR ENDING DECEMBER 30, 2001. RATIFICATION OF KPMG LLP REQUIRES THAT THE VOTES CAST IN FAVOR OF RATIFICATION EXCEED THE VOTES CAST AGAINST RATIFICATION AT THE MEETING AT WHICH A QUORUM IS PRESENT.**

#### SHAREHOLDER PROPOSALS

**ANY PROPOSAL WHICH A COMPANY SHAREHOLDER INTENDS TO PRESENT IN ACCORDANCE WITH RULE 14a-8 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED (THE EXCHANGE ACT) AT THE NEXT ANNUAL MEETING OF SHAREHOLDERS TO BE HELD IN 2002 MUST BE RECEIVED BY THE COMPANY ON OR BEFORE DECEMBER 13, 2001. NOTICE OF SHAREHOLDER PROPOSALS SUBMITTED OUTSIDE OF RULE 14a-8 OF THE EXCHANGE ACT WILL BE CONSIDERED UNTIMELY IF RECEIVED BY THE COMPANY AFTER FEBRUARY 26, 2002. ONLY PROPER PROPOSALS UNDER RULE 14A-8 OF THE EXCHANGE ACT, WHICH ARE TIMELY RECEIVED WILL BE INCLUDED IN THE PROXY STATEMENT AND PROXY.**

#### OTHER MATTERS

##### EXPENSES OF SOLICITATION

The cost of soliciting proxies in the accompanying form will be borne by the Company. In addition to the use of the mails, proxies may be solicited by directors, officers or other employees of the Company, personally, or by telephone. The Company does not expect to pay any compensation for the solicitation of proxies, but may reimburse brokers, custodians or other persons holding stock in their names or in the names of nominees for their expenses in sending proxy materials to principals and obtaining their instructions.

##### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely on a review of the copies of reports furnished to the Company, or written representations that no annual forms (Form 5) were required, the Company believes that, during the 2000 fiscal year, all filing requirements of its officers, directors and 10% shareholders for reporting to the Securities and Exchange Commission their ownership and changes in ownership of Common Stock (as required pursuant to Section 16(a) of the Securities Exchange Act of 1934) were complied with, except for the following: Mr. Lee reported one transaction on a Form 4 in the month subsequent to the month in which it should have been reported.

#### OTHER MATTERS



**MISCELLANEOUS**

Management does not know of any matters to be brought before the Meeting other than as described in this Proxy Statement. Should any other matters properly come before the Meeting of which the Company did not receive notice on or before February 21, 2001, the persons designated as proxies will vote in their sole discretion on such matters.

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**APPENDIX A**

**PROPOSED AMENDMENT TO ARTICLE FOUR OF THE COMPANY'S  
ARTICLES OF INCORPORATION**

**ARTICLE FOUR**

**Authorized Shares**

The corporation shall have authority to be exercised by the Board of Directors to issue not more than 60,000,000 shares of common stock, no par value, and not more than 10,000,000 shares of preferred stock, no par value. The shares of common stock shall have unlimited voting rights and shall be entitled to receive the net assets of the corporation upon dissolution. Subject to the provisions of these Amended and Restated Articles of Incorporation and to the provisions of the Georgia Business Corporation Code, the Board of Directors may determine (a) the preferences, limitations, and relative rights of any class of shares prior to the issuance of any shares of that class and (b) the preferences, limitations, and relative rights of one or more series within a class and may designate the number of shares within that series prior to the issuance of any shares of that series. A designation of the preferences, limitations and relative rights of the corporation's Series A Junior Participating Preferred Stock is attached as Exhibit A to these Amended and Restated Articles of Incorporation.

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**EXHIBIT A  
TO THE AMENDED AND RESTATED  
ARTICLES OF INCORPORATION  
OF RARE HOSPITALITY INTERNATIONAL, INC.**

**DESIGNATING THE PREFERENCES, LIMITATIONS AND RELATIVE  
RIGHTS OF SERIES A JUNIOR PARTICIPATING PREFERRED STOCK**

There is hereby designated, of the authorized but unissued shares of Preferred Stock of the corporation, a series thereof, and the number of shares, voting powers, designation, preferences, and relative, participating, optional, and other special rights, and the qualifications, limitations, and restrictions thereof, of the shares of such series (in addition to those set forth in the Amended and Restated Articles of Incorporation, which are applicable to the Preferred Stock of all series), shall be as follows:

1. Designation and Number of Shares. The designation of this series of Preferred Stock shall be Series A Junior Participating Preferred Stock (hereinafter called this Series ), to initially consist of 500,000 shares, which number may from time to time be increased or decreased (but not below the number then outstanding) by the Board of Directors by filing additional articles of amendment to the corporation's amended and restated articles of incorporation. The shares of this Series are sometimes hereinafter referred to as the Shares. Shares of this Series may be issued in fractional shares, which fractional shares shall entitle the holder, in proportion to such holder's fractional share, to all rights of a holder of a whole share of this Series.

2. Distributions.

(a) Distribution Rights. The holders of whole or fractional Shares shall be entitled to receive, when, as, and if declared by the Board of Directors, subject to restrictions imposed by the Georgia Business Corporation Code or the Amended and Restated Articles of Incorporation on distributions to shareholders, and subject to the rights of the holders of any shares of any series of Preferred Stock ranking prior and superior to this series with respect to dividends, (i) on each date that dividends or other distributions (other than dividends or distributions payable in Common Stock of the corporation) are payable on or in respect of Common Stock comprising part of the Reference Package (as defined below), in an amount per whole share of this Series equal to the aggregate amount of dividends or other distributions (other than dividends or distributions payable in Common Stock of the corporation) that would be payable on such date to a holder of the Reference Package and (ii) on the last day of March, June, September and December in each year, in an amount per whole share of this Series equal to the excess (if any) of \$1.00 over the aggregate dividends paid per whole share of this Series during the three-month period ending on such last day. Each such dividend shall be paid to the holders of record of shares of this Series on the date, not exceeding sixty days preceding such dividend or distribution payment date, fixed for that purpose

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by the Board of Directors in advance of payment of each particular dividend or distribution. Dividends on each full and each fractional share of this Series shall be cumulative from the date such full or fractional share is originally issued; provided that any such full or fractional share originally issued after a dividend record date and on or prior to the dividend payment date to which such record date relates shall not be entitled to receive the dividend payable on such dividend payment date or any amount in respect of the period from such original issuance to such dividend payment date. The term Reference Package shall initially mean 100 shares of Common Stock, no par value ( Common Stock ), of the corporation. In the event the corporation shall at any time (i) declare or pay a dividend on any Common Stock payable in Common Stock, (ii) subdivide any Common Stock or (iii) combine any Common Stock into a smaller number of shares, then and in each such case the Reference Package after such event shall be the Common Stock that a holder of the Reference Package immediately prior to such event would hold thereafter as a result thereof. Holders of shares of this Series shall not be entitled to any dividends, whether payable in cash, property or stock, in excess of full cumulative dividends, as herein provided on this Series.

So long as any shares of this Series are outstanding, no dividend (other than a dividend in Common Stock or in any other stock ranking junior to this Series as to dividends and upon liquidation) shall be declared or paid or set aside for payment or other distribution declared or made upon the Common Stock or upon any other stock ranking junior to this Series as to dividends or upon liquidation, nor shall any Common Stock nor any other stock of the corporation ranking junior to or on a parity with this Series as to dividends or upon liquidation be redeemed, purchased or otherwise acquired for any consideration (or any moneys to be paid to or made available for a sinking fund for the redemption of any shares of any such stock) by the corporation (except by conversion into or exchange for stock of the corporation ranking junior to this Series as to dividends and upon liquidation), unless, in each case, the full cumulative dividends (including the dividend to be due upon payment of such dividend, distribution, redemption, purchase or other acquisition) on all outstanding shares of this Series shall have been, or shall contemporaneously be, paid.

(b) Shares Purchased by Corporation. Shares of this Series purchased by the corporation shall be canceled and shall revert to authorized but unissued shares of Preferred Stock undesignated as to series, which shares may thereafter be provided for and designated by the Board of Directors pursuant to Article Four of the Amended and Restated Articles of Incorporation as part of a series of Preferred Stock to the same extent as if such shares had not previously been provided for and designated as part of a series of Preferred Stock; but such shares shall not be reissued as shares of this Series.

3. Rights of Redemption. The shares of this Series shall not be redeemable.

4. Rights on Liquidation, Dissolution, or Winding Up.

(a) In the event of any liquidation, dissolution or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of full and fractional shares of this Series shall be entitled, before any distribution or payment is made on any date to the holders of the Common Stock or any other stock of the corporation ranking junior to this Series upon liquidation, to be paid in full an amount per whole share of this Series equal to the greater of (A) \$1.00 or (B) the aggregate amount distributed or to be distributed prior to such date in connection with such liquidation, dissolution or winding up to a holder of the Reference Package (such greater amount being hereinafter referred to as the Liquidation Preference ), together with accrued dividends to such distribution or payment date, whether or not earned or declared. If such payment shall have been made in full to all holders of shares of this Series, the holders of shares of this Series as such shall have no right or claim to any of the remaining assets of the corporation.

(b) In the event the assets of the corporation available for distribution to the holders of shares of this Series upon any liquidation, dissolution or winding up of the corporation, whether voluntary or involuntary, shall be insufficient to pay in full all amounts to which such holders are entitled pursuant to paragraph (a) above, no such distribution shall be made on account of any shares of any other class or series of Preferred Stock ranking on a parity with the shares of this Series upon such liquidation, dissolution or winding up unless proportionate distributive amounts shall be paid on account of the shares of this Series, ratably in proportion to the full distributable amounts for which holders of all such parity shares are respectively entitled upon such liquidation, dissolution or winding up.

(c) Upon the liquidation, dissolution or winding up of the corporation, the holders of shares of this Series then outstanding shall be entitled to be paid out of assets of the corporation available for distribution to its shareholders all amounts to which such holders are entitled pursuant to paragraph (a) above before any payment shall be made to the holders of Common Stock or any other stock of the corporation ranking junior upon liquidation to this Series.

(d) For purposes of this Section (4), the consolidation or merger of, or binding share exchange by, the corporation with any other corporation shall not be deemed to constitute a liquidation, dissolution or winding up of the corporation.

5. Merger, Consolidation, Share Exchange. In the event of any merger, consolidation, reclassification or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the shares of this Series shall at the same time be

similarly exchanged or changed in an amount per whole share equal to the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, that a holder of the Reference Package would be entitled to receive as a result of such transaction.

6. Voting Rights. In addition to any other vote or consent of shareholders required by law or by the Amended and Restated Articles of Incorporation, as amended, of the corporation, each whole share of this Series shall, on any matter, vote as a class with any other capital stock comprising part of the Reference Package and voting on such matter and shall have the number of votes thereon that a holder of the Reference Package would have.

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## APPENDIX B

### Charter of the Audit Committee of the Board of Directors

#### I. Audit Committee Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Audit Committee's primary duties and responsibilities are to:

- Monitor the integrity of the Company's financial reporting process and systems of internal controls regarding finance, accounting, and legal compliance.
- Monitor the independence and performance of the Company's independent auditors and internal auditing department.
- Provide an avenue of communication among the independent auditors, management, the internal auditing department, and the Board of Directors.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors as well as anyone in the organization. The Audit Committee has the ability to retain, at the Company's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

#### II. Audit Committee Composition and Meetings

Audit Committee members shall meet the requirements of the NASDAQ Exchange. The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be independent nonexecutive directors, free from any relationship that would interfere with the exercise of his or her independent judgment. All members of the Committee shall have a basic understanding of finance and accounting and be able to read and understand fundamental financial statements, and at least one member of the Committee shall have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

Audit Committee members shall be appointed by the Board. If an audit committee Chair is not designated or present, the members of the Committee may designate a Chair by majority vote of the Committee membership.

The Committee shall meet at least three times annually, or more frequently as circumstances dictate. The Audit Committee Chair shall prepare and/or approve an agenda in advance of each meeting. The Committee should meet privately in executive session at least annually with management, the director of the internal auditing department, the independent auditors, and as a committee to discuss any matters that the Committee or each of these groups believe should be discussed. In addition, the Committee, or at least its Chair, should communicate with management and the independent auditors quarterly to review the Company's financial statements and significant findings based upon the auditors' limited review procedures.

### III. Audit Committee Responsibilities and Duties

#### Review Procedures

1. Review and reassess the adequacy of this Charter at least annually. Submit the charter to the Board of Directors for approval and have the document published at least every three years in accordance with SEC regulations.
2. Review the Company's annual audited financial statements prior to filing or distribution. Review should include discussion with management and independent auditors of significant issues regarding accounting principles, practices, and judgments.
3. In consultation with the management, the independent auditors, and the internal auditors, consider the integrity of the Company's financial reporting processes and controls. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures. Review significant findings prepared by the independent auditors and the internal auditing department together with management's responses.
4. Review with financial management and/or the independent auditors the Company's quarterly financial results prior to the release of earnings and/or the Company's quarterly financial statements prior to filing or distribution. Discuss any significant changes to the Company's accounting principles and any items required to be communicated by the independent auditors in accordance with SAS 61. The Chair of the Committee may represent the entire Audit Committee for purposes of this review.

#### Independent Auditors

5. The independent auditors are ultimately accountable to the Audit Committee and the Board of Directors. The Audit Committee shall review the independence and performance of the auditors and annually recommend to the Board of Directors the appointment of the independent auditors or approve any discharge of auditors when circumstances warrant.
6. Approve the fees and other significant compensation to be paid to the independent auditors.
7. On an annual basis, the Committee should review and discuss with the independent auditors all significant relationships they have with the Company that could impair the auditors' independence.
8. Review the independent auditor's plan—discuss scope, staffing, locations, reliance upon management, and internal audit and general audit approach
9. Discuss the results of the audit with the independent auditors. Discuss certain matters required to be communicated to audit committees in accordance with AICPA SAS 61.
10. Consider the independent auditors' judgments about the quality and appropriateness of the Company's accounting principles as applied in its financial reporting.

#### Internal Audit Department

11. Review the budget, plan, changes in plan, activities, organizational structure, and qualifications of the internal audit department, as needed.

12. Review the appointment, performance, and replacement of the senior internal audit executive.
13. Review significant reports prepared by the internal audit department together with management's response and follow-up to these reports.

Legal Compliance

14. On at least an annual basis, review with the Company's counsel, any legal matters that could have a significant impact on the organizations, financial statements, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.

Other Audit Committee Responsibilities

15. Annually prepare a report to shareholders as required by the Securities and Exchange Commission. The report should be included in the Company's annual proxy statement.
16. Perform any other activities consistent with this Charter, the Company's by-laws, and governing law, as the Committee or the Board deems necessary or appropriate.
17. Maintain minutes of meetings and periodically report to the Board of Directors on significant results of the foregoing activities.

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**PROXY FOR RARE HOSPITALITY INTERNATIONAL, INC.  
ANNUAL MEETING OF SHAREHOLDERS  
ATLANTA, GEORGIA**

The undersigned shareholder of RARE Hospitality International, Inc. (the "Company"), hereby constitutes and appoints Philip J. Hickey, Jr. and Joia M. Johnson, or either one of them, each with full power of substitution, to vote the number of shares of Company common stock which the undersigned would be entitled to vote if personally present at the Annual Meeting of Shareholders to be held at the Crowne Plaza Ravinia, 4355 Ashford-Dunwoody Road, Atlanta, Georgia, on Monday, May 14, 2001, at 2:00 p.m. local time, or at any adjournments thereof (the "Meeting"), upon the proposals described in the Notice of Annual Meeting of Shareholders and Proxy Statement, both dated April 12, 2001, the receipt of which is acknowledged, in the manner specified below. The proxies, in their discretion, are further authorized to vote for the election of a person to the Board of Directors if any nominee named herein becomes unable to serve or for good cause will not serve and are further authorized to vote on matters properly brought before the Meeting or any adjournment thereof, of which the Board of Directors did not have notice on or before February 21, 2001. The Board of Directors recommends a vote FOR Proposals 1, 2 and 3.

1. **ELECTION OF DIRECTORS:** To elect Carolyn H. Baldwin to serve as a Class II director until the 2003 Annual Meeting of Shareholders of the Company and until her successor is elected and qualified, and to elect Ronald W. San Martin and Eugene I. Lee, Jr. to serve as Class III directors until the 2004 Annual Meeting of Shareholders of the Company and until their successors are elected and qualified:

FOR [ ] WITHHOLD AUTHORITY [ ]

To withhold authority for any individual nominee(s), write the name of the nominee(s) in the space provided:

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2. **MEND ARTICLES OF INCORPORATION:** To approve a proposal to amend Article Four of the Company's Articles of Incorporation to increase the authorized number of shares of Common Stock, no par value, from 25,000,000 to 60,000,000.

FOR [ ] AGAINST [ ] ABSTAIN [ ]

3. **RATIFICATION OF AUDITORS:** To ratify the selection of KPMG LLP to serve as the independent auditors of the Company for the fiscal year ending December 30, 2001:

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FOR [ ] AGAINST [ ] ABSTAIN [ ]

THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED BY THE UNDERSIGNED SHAREHOLDER. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED FOR PROPOSALS 1, 2 AND 3, AND WITH DISCRETIONARY AUTHORITY ON ALL OTHER MATTERS THAT MAY PROPERLY COME BEFORE THE MEETING OR ANY ADJOURNMENT THEREOF OF WHICH THE COMPANY DID NOT HAVE NOTICE ON OR BEFORE FEBRUARY 21, 2001.

Please sign exactly as your name appears on your stock certificate and date. Where shares are held jointly, each shareholder should sign. When signing as executor, administrator, trustee, or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

Signature of Shareholder

\_\_\_\_\_  
Signature of Other Shareholder (if held jointly)

Dated: \_\_\_\_\_, 2001

THIS PROXY IS SOLICITED ON BEHALF OF RARE HOSPITALITY INTERNATIONAL, INC. S BOARD OF DIRECTORS AND MAY BE REVOKED BY THE SHAREHOLDER PRIOR TO ITS EXERCISE.

1,999

July 10, 2014

July 28, 2014

July 31, 2014

0.180 1,759

June 11, 2014

June 25, 2014

June 30, 2014

0.180 1,712

May 8, 2014

May 27, 2014

May 30, 2014

0.180 1,641

April 8, 2014

April 25, 2014

April 30, 2014

0.180 1,636

March 11, 2014

March 26, 2014

March 31, 2014

0.180 1,550

February 11, 2014

February 25, 2014

February 28, 2014

0.180 974

January 9, 2014

January 27, 2014

January 31, 2014

0.180 925

Totals

\$2.160	\$22,643		
2013			
December 11, 2013			
December 26, 2013			
December 30, 2013			
		\$0.180	\$603
November 12, 2013			
November 25, 2013			
November 27, 2013			
		0.135	451
October 10, 2013			
October 25, 2013			
October 31, 2013			
		0.135	451
September 10, 2013			
September 25, 2013			
September 30, 2013			
		0.135	451
August 12, 2013			
August 26, 2013			
August 30, 2013			
		0.135	451
July 9, 2013			
July 25, 2013			
July 31, 2013			
		0.135	451
June 10, 2013			
June 25, 2013			
June 28, 2013			
		0.135	451
May 9, 2013			
May 28, 2013			
May 31, 2013			
		0.135	451
April 10, 2013			
April 25, 2013			
April 30, 2013			
		0.135	451
March 8, 2013			
March 25, 2013			
March 27, 2013			
		0.135	451
Totals			
\$1.395	\$4,662		

#### Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our

distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.



## Jumpstart Our Business Startups Act of 2012

We are an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). The JOBS Act permits emerging growth companies to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. We have elected to “opt out” of this provision and, as a result, we will be required to comply with new or revised accounting standards as required when they are adopted. The decision to opt out of the extended transition period under the JOBS Act is irrevocable.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk, prepayment risk, spread risk, liquidity risk, extension risk and counterparty credit risk.

### Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the RMBS that constitute our investment portfolio, which affects our net income and ability to realize gains from the sale of these assets and impacts our ability and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations. The principal instruments that we use are futures contracts and options to enter into interest rate swaps. These instruments are intended to serve as a hedge against future interest rate increases on our repurchase agreement borrowings. Hedging techniques are partly based on assumed levels of prepayments of our agency securities. If prepayments are slower or faster than assumed, the life of the agency securities will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns. Hedging techniques are also limited by the rules relating to REIT qualification. In order to preserve our REIT status, we may be forced to terminate a hedging transaction at a time when the transaction is most needed.

Our profitability and the value of our investment portfolio (including derivatives used for hedging purposes) may be adversely affected during any period as a result of changing interest rates including changes in the forward yield curve.

Our portfolio of PT RMBS is typically comprised of adjustable-rate RMBS, fixed-rate RMBS and hybrid adjustable-rate RMBS. We generally seek to acquire low duration assets that offer high levels of protection from mortgage prepayments provided they are reasonably priced by the market. Although the duration of an individual asset can change as a result of changes in interest rates, we strive to maintain a hedged PT RMBS portfolio with an effective duration of less than 2.0. The stated contractual final maturity of the mortgage loans underlying our portfolio of PT RMBS generally ranges up to 30 years. However, the effect of prepayments of the underlying mortgage loans tends to shorten the resulting cash flows from our investments substantially. Prepayments occur for various reasons,

including refinancing of underlying mortgages and loan payoffs in connection with home sales.

The duration of our IO and IIO portfolios will vary greatly depending on the structural features of the securities. While prepayment activity will always affect the cash flows associated with the securities, the interest only nature of IOs may cause their durations to become extremely negative when prepayments are high, and less negative when prepayments are low. Prepayments affect the durations of IIOs similarly, but the floating rate nature of the coupon of IIOs (which is inversely related to the level of one month LIBOR) cause their price movements - and model duration - to be affected by changes in both prepayments and one month LIBOR - both current and anticipated levels. As a result, the duration of IIO securities will also vary greatly.

Prepayments on the loans underlying our RMBS can alter the timing of the cash flows from the underlying loans to us. As a result, we gauge the interest rate sensitivity of our assets by measuring their effective duration. While modified duration measures the price sensitivity of a bond to movements in interest rates, effective duration captures both the movement in interest rates and the fact that cash flows to a mortgage related security are altered when interest rates move. Accordingly, when the contract interest rate on a mortgage loan is substantially above prevailing interest rates in the market, the effective duration of securities collateralized by such loans can be quite low because of expected prepayments.

We face the risk that the market value of our PT RMBS assets will increase or decrease at different rates than that of our structured RMBS or liabilities, including our hedging instruments. Accordingly, we assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. We generally calculate duration using various third party models. However, empirical results and various third party models may produce different duration numbers for the same securities.

The following sensitivity analysis shows the estimated impact on the fair value of our interest rate-sensitive investments and hedge positions as of December 31, 2014 and 2013, assuming rates instantaneously fall 100 basis points (“bps”), fall 50bps, rise 50 bps and rise 100 bps, adjusted to reflect the impact of convexity, which is the measure of the sensitivity of our hedge positions and Agency RMBS’ effective duration to movements in interest rates.

All changes in value in the table below are measured as percentage changes from the investment portfolio value and net asset value at the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of December 31, 2014 and 2013. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and hedge positions, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections and could be larger or smaller than the estimates in the table below. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate increases and decreases on a static portfolio, we may from time to time sell any of our agency securities as a part of our overall management of our investment portfolio.

## Interest Rate Sensitivity(1)

Change in Interest Rate As of December 31, 2014	Portfolio Market		Book	
	Value(2)(3)		Value(3)(4)	
-100 Basis Points	(0.79	)%	(5.63	)%

-50 Basis Points	(0.13	)%	(0.89	)%
+50 Basis Points	(0.30	)%	(2.10	)%
+100 Basis Points	(0.94	)%	(6.64	)%
As of December 31, 2013				
-100 Basis Points	0.04	%	0.32	%
-50 Basis Points	0.28	%	2.17	%
+50 Basis Points	(0.80	)%	(6.28	)%
+100 Basis Points	(1.96	)%	(15.37	)%

- (1) Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties as well as by our Manager, and assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.
- (2) Includes the effect of derivatives and other securities used for hedging purposes.
- (3) Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.
- (4) Estimated dollar change in portfolio value expressed as a percent of stockholders' equity as of such date.

In addition to changes in interest rates, other factors impact the fair value of our interest rate-sensitive investments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above and such difference might be material and adverse to our stockholders.

#### Prepayment Risk

Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Various factors affect the rate at which mortgage prepayments occur, including changes in the level of and directional trends in housing prices, interest rates, general economic conditions, loan age and size, loan-to-value ratio, the location of the property and social and demographic conditions. Additionally, changes to GSE underwriting practices or other governmental programs could also significantly impact prepayment rates or expectations. Generally, prepayments on agency RMBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case. We may reinvest principal repayments at a yield that is lower or higher than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets.

#### Spread Risk

When the market spread widens between the yield on our agency RMBS and benchmark interest rates, our net book value could decline if the value of our agency securities fall by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk." The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve, market liquidity, or changes in required rates of return on different assets. Consequently, while we use futures contracts and interest rate swaps and swaptions to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

#### Liquidity Risk

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements. Our assets that are pledged to secure repurchase agreements are agency RMBS and cash. As of December 31, 2014, we had unrestricted cash and cash equivalents of \$93.1 million and unpledged securities of approximately \$31.9 million (not including securities pledged to us) available to meet margin calls on our repurchase agreements and derivative contracts and for other corporate purposes. However, should the value of our agency RMBS pledged as collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our repurchase and derivative agreements could increase, causing an adverse change in our liquidity position. Further, there is no assurance that we will always be able to renew (or roll) our repurchase agreements. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge, against repurchase agreements thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll the repurchase agreement. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

#### Extension Risk

The projected weighted-average life and the duration (or interest rate sensitivity) of our investments is based on our Manager's assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use futures contracts and interest rate swaptions to help manage our funding cost on our investments in the event that interest rates rise. These hedging instruments allow us to reduce our funding exposure on the notional amount of the instrument for a specified period of time.

However, if prepayment rates decrease in a rising interest rate environment, the average life or duration of our fixed-rate assets or the fixed-rate portion of the ARMs or other assets generally extends. This could have a negative impact on our results from operations, as our hedging instrument expirations are fixed and will, therefore, cover a smaller percentage of our funding exposure on our mortgage assets to the extent that their average lives increase due to slower prepayments. This situation may also cause the market value of our agency securities collateralized by fixed rate mortgages or hybrid ARMs to decline by more than otherwise would be the case while most of our hedging instruments would not receive any incremental offsetting gains. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses.

#### Counterparty Credit Risk

We are exposed to counterparty credit risk relating to potential losses that could be recognized in the event that the counterparties to our repurchase agreements and derivative contracts fail to perform their obligations under such agreements. The amount of assets we pledge as collateral in accordance with our agreements varies over time based on the market value and notional amount of such assets as well as the value of our derivative contracts. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our agreements and may have difficulty obtaining our assets pledged as collateral under such agreements. Our credit risk related to certain derivative transactions is largely mitigated through daily adjustments to collateral pledged based on changes in market value and we limit our counterparties to major financial institutions with acceptable credit ratings. However, there is no guarantee our efforts to manage counterparty credit risk will be successful and we could suffer significant losses if unsuccessful.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Statements of Cash Flows	74
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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
Orchid Island Capital, Inc.  
Vero Beach, Florida

We have audited the accompanying balance sheets of Orchid Island Capital, Inc. (the "Company") as of December 31, 2014 and 2013 and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

West Palm Beach, Florida  
February 24, 2015

/s/ BDO USA, LLP  
Certified Public Accountants



ORCHID ISLAND CAPITAL, INC.  
BALANCE SHEETS  
DECEMBER 31, 2014 and 2013  
(\$ in thousands, except per share data)

	2014	2013
<b>ASSETS:</b>		
Mortgage-backed securities, at fair value		
Pledged to counterparties	\$1,517,304	\$335,775
Unpledged	31,867	15,448
Total mortgage-backed securities	1,549,171	351,223
Cash and cash equivalents	93,137	8,169
Restricted cash	7,790	2,446
Accrued interest receivable	6,211	1,559
Derivative assets, at fair value	1,217	-
Other assets	282	179
<b>Total Assets</b>	<b>\$1,657,808</b>	<b>\$363,576</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Repurchase agreements	\$1,436,651	\$318,557
Accrued interest payable	628	91
Due to affiliates	330	82
Other liabilities	2,121	81
<b>Total Liabilities</b>	<b>1,439,730</b>	<b>318,811</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2014 and 2013	-	-
Common Stock, \$0.01 par value; 500,000,000 shares authorized, 16,699,656 and 3,341,665 shares issued and outstanding as of December 31, 2014 and 2013, respectively	167	33
Additional paid-in capital	217,419	46,116
Retained earnings (accumulated deficit)	492	(1,384)
<b>Total Stockholders' Equity</b>	<b>218,078</b>	<b>44,765</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$1,657,808</b>	<b>\$363,576</b>
See Notes to Financial Statements		

ORCHID ISLAND CAPITAL, INC.  
 STATEMENTS OF OPERATIONS  
 For the Years Ended December 31, 2014, 2013 and 2012  
 (\$ in thousands, except per share data)

	2014	2013	2012
Interest income	\$31,804	\$9,199	\$2,698
Interest expense	(3,031 )	(1,126 )	(277 )
Net interest income	28,773	8,073	2,421
Realized gains (losses) on mortgage-backed securities	2,791	(1,198 )	(308 )
Unrealized gains (losses) on mortgage-backed securities	11,368	(10,733 )	(806 )
(Losses) gains on derivative instruments	(13,925 )	4,828	(40 )
Net portfolio income	29,007	970	1,267
Expenses:			
Management fees	2,013	664	249
Accrued incentive compensation	500	-	-
Directors' fees and liability insurance	569	290	-
Audit, legal and other professional fees	588	420	178
Direct REIT operating expenses	182	164	177
Other administrative	636	130	129
Total expenses	4,488	1,668	733
Net income (loss)	\$24,519	\$(698 )	\$534
Basic and diluted net income (loss) per share	\$2.48	\$(0.23 )	\$0.54
Weighted Average Shares Outstanding	9,890,058	3,011,912	981,665
See Notes to Financial Statements			

ORCHID ISLAND CAPITAL, INC.  
 STATEMENTS OF STOCKHOLDERS' EQUITY  
 Years Ended December 31, 2014, 2013 and 2012  
 (\$ in thousands, except per share data)

	Common Stock	Additional Paid-in Capital	(Accumulated Deficit )/ Retained Earnings	Total
Balances, January 1, 2012	\$2	\$14,998	\$ (1,220 )	\$13,780
Net income	-	-	534	534
Issuance of common stock to repay amount due to Bimini Capital Management, Inc.	-	411	-	411
Balances, December 31, 2012	2	15,409	(686 )	14,725
Net loss	-	-	(698 )	(698 )
Cash dividends declared, \$1.395 per share	-	(4,662 )	-	(4,662 )
Issuance of common stock pursuant to public offering	23	35,377	-	35,400
Issuance of common stock pursuant to stock dividend	8	(8 )	-	-
Balances, December 31, 2013	33	46,116	(1,384 )	44,765
Net income	-	-	24,519	24,519
Cash dividends declared, \$2.160 per share	-	-	(22,643 )	(22,643 )
Issuance of common stock pursuant to public offerings	134	171,161	-	171,295
Issuance of common stock pursuant to equity compensation plan	-	77	-	77
Amortization of equity compensation	-	65	-	65
Balances, December 31, 2014	\$167	\$217,419	\$ 492	\$218,078

See Notes to Financial Statements

ORCHID ISLAND CAPITAL, INC.  
 STATEMENTS OF CASH FLOWS  
 For the Years Ended December 31, 2014, 2013 and 2012  
 (\$ in thousands)

	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$24,519	\$(698 )	\$534
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Stock based compensation	142	-	-
Realized and unrealized (gains) losses on mortgage-backed securities	(14,159 )	11,931	1,114
Realized and unrealized losses on interest rate swaptions	4,439	-	-
Changes in operating assets and liabilities:			
Accrued interest receivable	(4,652 )	(1,119 )	(66 )
Other assets	(105 )	(119 )	-
Accrued interest payable	536	37	43
Other liabilities	678	(60 )	126
Due to affiliates	248	127	128
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>11,646</b>	<b>10,099</b>	<b>1,879</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
From mortgage-backed securities investments:			
Purchases	(2,192,282)	(687,584 )	(199,078 )
Sales	928,009	408,982	129,068
Principal repayments	80,486	30,778	9,518
Increase in restricted cash	(5,344 )	(1,997 )	(358 )
Purchase of interest rate swaptions, net of margin cash received	(4,292 )	-	-
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(1,193,423)</b>	<b>(249,821 )</b>	<b>(60,850 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from repurchase agreements	7,663,332	3,319,670	581,462
Principal payments on repurchase agreements	(6,545,239)	(3,105,054)	(521,846 )
Cash dividends	(22,643 )	(4,662 )	-
Proceeds from issuance of common stock, net of issuance costs	171,295	35,400	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>1,266,745</b>	<b>245,354</b>	<b>59,616</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>84,968</b>	<b>5,632</b>	<b>645</b>
CASH AND CASH EQUIVALENTS, beginning of the year	8,169	2,537	1,892
CASH AND CASH EQUIVALENTS, end of the year	\$93,137	\$8,169	\$2,537
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Cash paid during the year for:			
Interest	\$2,495	\$1,089	\$235
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH FINANCING ACTIVITIES:</b>			
Issuance of common shares to			
Bimini Capital Management, Inc. pursuant to stock dividend	\$-	\$8	\$-

Issuance of common shares to repay amount due to Bimini Capital Management, Inc.	-	-	411
See Notes to Financial Statements			

ORCHID ISLAND CAPITAL, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Description

Orchid Island Capital, Inc., (“Orchid” or the “Company”), was incorporated in Maryland on August 17, 2010 for the purpose of creating and managing a leveraged investment portfolio consisting of residential mortgage-backed securities (“RMBS”). From incorporation to February 20, 2013 Orchid was a wholly owned subsidiary of Bimini Capital Management, Inc. (“Bimini”). Orchid began operations on November 24, 2010 (the date of commencement of operations). From incorporation through November 24, 2010, Orchid’s only activity was the issuance of common stock to Bimini.

On February 20, 2013, Orchid completed the initial public offering (“IPO”) of its common stock in which it sold approximately 2.4 million shares of its common stock and raised gross proceeds of \$35.4 million. Orchid is an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”).

Orchid completed a secondary offering of 1,800,000 common shares on January 23, 2014. The underwriters exercised their overallotment option in full for an additional 270,000 shares on January 29, 2014. The aggregate net proceeds to Orchid were approximately \$24.2 million which were invested in Agency RMBS securities on a leveraged basis.

Orchid completed a secondary offering of 3,200,000 common shares on March 24, 2014. The underwriters exercised their overallotment option in full for an additional 480,000 shares on April 11, 2014. The aggregate net proceeds to Orchid were approximately \$44.0 million which were invested in Agency RMBS securities on a leveraged basis.

On June 17, 2014, Orchid entered into an equity distribution agreement (the “June 2014 Equity Distribution Agreement”) with two sales agents pursuant to which the Company could offer and sell, from time to time, up to an aggregate amount of \$35,000,000 of shares of the Company’s common stock in transactions that were deemed to be “at the market” offerings and privately negotiated transactions. The Company issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees, prior to its termination.

On September 3, 2014, Orchid entered into a second equity distribution agreement (the “September 2014 Equity Distribution Agreement”) with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$75,000,000 of shares of the Company’s common stock in transactions that are deemed to be “at the market” offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. Through December 31, 2014, the Company issued a total of 5,073,731 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$68.9 million, net of commissions and fees. After December 31, 2014, the Company issued an additional 13,915 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$0.2 million, net of commissions and fees.

### Basis of Presentation and Use of Estimates

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates. The significant estimates affecting the accompanying financial statements are the fair values of RMBS, Eurodollar futures contracts and interest rate swaptions.

### Statement of Comprehensive Income (Loss)

In accordance with the Financial Accounting Standards Board’s Accounting Standards Codification (“FASB ASC”) Topic 220, Comprehensive Income, a statement of comprehensive income has not been included as the Company has no items of other comprehensive income. Comprehensive income (loss) is the same as net income (loss) for the periods presented.

### Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents include cash on deposit with financial institutions and highly liquid investments with original maturities of three months or less. At December 31, 2014 restricted cash consisted of \$5,174,000 of cash held by a broker as margin on Eurodollar futures contracts and \$2,616,000 of cash held on deposit as collateral with repurchase agreement counterparties. At December 31, 2013 restricted cash consisted of approximately \$2,446,000 of cash held by a broker as margin on Eurodollar futures contracts.

The Company maintains cash balances at four banks, and, at times, balances may exceed federally insured limits. The Company has not experienced any losses related to these balances. The Federal Deposit Insurance Corporation insures eligible accounts up to \$250,000 per depositor at each financial institution. At December 31, 2014, the Company’s cash deposits exceeded federally insured limits by approximately \$93.1 million. Restricted cash balances are uninsured, but are held in separate customer accounts that are segregated from the general funds of the counterparty. The Company uses only large, well-known bank and derivative counterparties and believes that it is not exposed to any significant credit risk on cash and cash equivalents or restricted cash balances.

### Mortgage-Backed Securities

The Company invests primarily in mortgage pass-through (“PT”) certificates, collateralized mortgage obligations, and interest only (“IO”) securities and inverse interest only (“IIO”) securities representing interest in or obligations backed by pools of residential mortgage-backed loans (collectively, “RMBS”). These investments meet the requirements to be classified as available for sale under ASC 320-10-25, Debt and Equity Securities (which requires the securities to be carried at fair value on the balance sheet with changes in fair value charged to other comprehensive income, a component of stockholders’ equity). However, the Company has elected to account for its investment in RMBS under the fair value option. Electing the fair value option requires the Company to record changes in fair value in the statement of operations, which, in management’s view, more appropriately reflects the results of our operations for a particular reporting period and is consistent with the underlying economics and how the portfolio is managed.

The Company records RMBS transactions on the trade date. Security purchases that have not settled as of the balance sheet date are included in the RMBS balance with an offsetting liability recorded, whereas securities sold that have not

settled as of the balance sheet date are removed from the RMBS balance with an offsetting receivable recorded.



The fair value of the Company's investments in RMBS is governed by FASB ASC 820, Fair Value Measurement. The definition of fair value in FASB ASC 820 focuses on the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset or transfer the liability either occurs in the principal market for the asset or liability, or in the absence of a principal market, occurs in the most advantageous market for the asset or liability. Estimated fair values for RMBS are based on independent pricing sources and/or third-party broker quotes, when available.

Income on PT RMBS securities is based on the stated interest rate of the security. Premiums or discounts present at the date of purchase are not amortized. For IO securities, the income is accrued based on the carrying value and the effective yield. The difference between income accrued and the interest received on the security is characterized as a return of investment and serves to reduce the asset's carrying value. At each reporting date, the effective yield is adjusted prospectively from the reporting period based on the new estimate of prepayments and the contractual terms of the security. For IIO securities, effective yield and income recognition calculations also take into account the index value applicable to the security. Changes in fair value of RMBS during each reporting period are recorded in earnings and reported as unrealized gains or losses on mortgage-backed securities in the accompanying statements of operations.

#### Derivative Financial Instruments

The Company uses derivative instruments to manage interest rate risk, facilitate asset/liability strategies and manage other exposures, and it may continue to do so in the future. The principal instruments that the Company has used to date are T-Note and Eurodollar futures contracts and options to enter in interest rate swaps ("interest rate swaptions"), but may enter into other transactions in the future. The Company has elected to not treat any of its derivative financial instruments as hedges. FASB ASC Topic 815, Derivatives and Hedging, requires that all derivative instruments be carried at fair value. Changes in fair value are recorded in earnings for each period.

Holding derivatives creates exposure to credit risk related to the potential for failure on the part of counterparties to honor their commitments. In addition, the Company may be required to post collateral based on any declines in the market value of the derivatives. In the event of default by a counterparty, the Company may have difficulty recovering its collateral and may not receive payments provided for under the terms of the agreement. To mitigate this risk, the Company uses only well-established commercial banks as counterparties.

#### Financial Instruments

FASB ASC 825, Financial Instruments, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value, either in the body of the financial statements or in the accompanying notes. RMBS, Eurodollar futures contracts and interest rate swaptions are accounted for at fair value in the balance sheets. The methods and assumptions used to estimate fair value for these instruments are presented in Note 11 of the financial statements.

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, other assets, due to affiliates, repurchase agreements, accrued interest payable and other liabilities generally approximates their carrying values as of December 31, 2014 and 2013 due to the short-term nature of these financial instruments.

#### Repurchase Agreements

The Company finances the acquisition of the majority of its PT RMBS through the use of repurchase agreements under master repurchase agreements. Pursuant to ASC Topic 860, Transfers and Servicing, the Company accounts for repurchase transactions as collateralized financing transactions, which are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

## Manager Compensation

The Company is externally managed by Bimini Advisors, LLC, a Maryland limited liability company and wholly-owned subsidiary of Bimini (“the Manager” or “Bimini Advisors”). The Company’s management agreement with the Manager provides for the payment to the Manager of a management fee and reimbursement of certain operating expenses, which are accrued and expensed during the period for which they are earned or incurred. Refer to Note 12 for the terms of the management agreement.

## Earnings Per Share

The Company follows the provisions of FASB ASC 260, Earnings Per Share. Basic earnings per share (“EPS”) is calculated as net income or loss attributable to common stockholders divided by the weighted average number of shares of common stock outstanding or subscribed during the period. Diluted EPS is calculated using the treasury stock or two-class method, as applicable, for common stock equivalents, if any. However, the common stock equivalents are not included in computing diluted EPS if the result is anti-dilutive.

## Income Taxes

Bimini has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”). Until the closing of its IPO on February 20, 2013, Orchid was a “qualified REIT subsidiary” of Bimini under the Code. Beginning with its short tax period commencing on February 20, 2013 and ended December 31, 2013, Orchid has qualified and elected to be taxed as a REIT, and filed a REIT tax return separate from Bimini. REITs are generally not subject to federal income tax on their REIT taxable income provided that they distribute to their stockholders at least 90% of their REIT taxable income on an annual basis. In addition, a REIT must meet other provisions of the Code to retain its tax status.

Orchid measures, recognizes and presents its uncertain tax positions in accordance with FASB ASC 740, Income Taxes. Under that guidance, Orchid assesses the likelihood, based on their technical merit, that tax positions will be sustained upon examination based on the facts, circumstances and information available at the end of each period. All of Orchid’s tax positions are categorized as highly certain. There is no accrual for any tax, interest or penalties related to Orchid’s tax position assessment. The measurement of uncertain tax positions is adjusted when new information is available, or when an event occurs that requires a change.

## Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentations.

## Recent Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2014-12, Compensation-Stock Compensation: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that performance targets that affect vesting and that could be achieved after the requisite service period be treated as performance conditions. The effective date of ASU 2014-12 is for interim and annual reporting periods beginning after December 15, 2015. The ASU is not expected to materially impact the Company’s financial statements.



In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. ASU 2014-11 amends the accounting guidance for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings, and requires additional disclosure about certain transactions by the transferor. ASU 2014-11 is effective for certain transactions that qualify for sales treatment for the first interim or annual period beginning after December 15, 2014. The new disclosure requirements for repurchase agreements, securities lending transactions and repurchase-to-maturity transactions that qualify for secured borrowing treatment is effective for annual periods beginning after December 15, 2014 and for interim periods beginning after March 15, 2015. We currently record our repurchase arrangements as secured borrowings and do not anticipate that ASU 2014-11 will have a material impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This new standard requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the unrecognized tax benefits. The ASU became effective beginning January 1, 2014 on either a prospective or retrospective basis. The guidance represents a change in financial statement presentation only and the adoption of this ASU did not have a material impact on the Company's financial results.

## NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's RMBS portfolio as of December 31, 2014 and 2013:

(in thousands)

	December 31, 2014	December 31, 2013
Pass-Through RMBS Certificates:		
Hybrid Adjustable-rate Mortgages	\$70,400	\$76,118
Adjustable-rate Mortgages	3,794	5,334
Fixed-rate Mortgages	1,412,593	245,523
Total Pass-Through Certificates	1,486,787	326,975
Structured RMBS Certificates:		
Interest-Only Securities	46,611	19,206
Inverse Interest-Only Securities	15,773	5,042
Total Structured RMBS Certificates	62,384	24,248
Total	\$1,549,171	\$351,223

The following table summarizes the Company's RMBS portfolio as of December 31, 2014 and 2013, according to the contractual maturities of the securities in the portfolio. Actual maturities of RMBS investments are generally shorter than stated contractual maturities and are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal.

(in thousands)

	December 31, 2014	December 31, 2013
Greater than five years and less than ten years	\$967	\$1,521

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Greater than or equal to ten years	1,548,204	349,702
Total	\$1,549,171	\$351,223

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## NOTE 3. REPURCHASE AGREEMENTS

As of December 31, 2014, the Company had outstanding repurchase obligations of approximately \$1,436.7 million with a net weighted average borrowing rate of 0.36%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$1,522.9 million, and cash pledged to the counterparties of approximately \$2.6 million. As of December 31, 2014 counterparties have posted securities to the Company totaling approximately \$1.7 million. As of December 31, 2013, the Company had outstanding repurchase obligations of approximately \$318.6 million with a net weighted average borrowing rate of 0.39%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$337.0 million.

As of December 31, 2014 and 2013, the Company's repurchase agreements had remaining maturities as summarized below:

(\$ in thousands)

	OVERNIGHT (1 DAY OR LESS)	BETWEEN 2 AND 30 DAYS	BETWEEN 31 AND 90 DAYS	GREATER THAN 90 DAYS	TOTAL
December 31, 2014					
Fair market value of securities pledged, including accrued interest receivable	\$ -	\$984,823	\$534,238	\$3,844	\$1,522,905
Repurchase agreement liabilities associated with these securities	\$ -	\$929,831	\$502,947	\$3,873	\$1,436,651
Net weighted average borrowing rate	-	0.36	% 0.37	% 0.38	% 0.36
December 31, 2013					
Fair market value of securities pledged, including accrued interest receivable	\$ -	\$326,348	\$10,650	\$-	\$336,998
Repurchase agreement liabilities associated with these securities	\$ -	\$308,402	\$10,155	\$-	\$318,557
Net weighted average borrowing rate	-	0.39	% 0.37	% -	0.39

If, during the term of a repurchase agreement, a lender files for bankruptcy, the Company might experience difficulty recovering its pledged assets, which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged to such lender, including the accrued interest receivable and cash posted by the Company as collateral. At December 31, 2014, the Company had a maximum amount at risk (the difference between the amount loaned to the Company, including interest payable, and the fair value of securities and cash pledged (if any), including accrued interest on such securities) of approximately \$86.6 million. The Company did not have an amount at risk with any individual counterparty greater than 10% of the Company's equity at December 31, 2014. Summary information regarding the Company's amounts at risk with individual counterparties greater than 10% of the Company's equity at December 31, 2013 is as follows:

(in thousands)

Repurchase Agreement Counterparties	Amount at Risk	% of Stockholders' Equity at Risk	Weighted Average Maturity (in Days)
December 31, 2013			
Citigroup Global Markets, Inc.	\$5,487	12.3%	11

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## NOTE 4. DERIVATIVE FINANCIAL INSTRUMENTS

In connection with its interest rate risk management strategy, the Company economically hedges a portion of the cost of its repurchase agreement funding by entering into derivatives, such as Eurodollar and T-Note futures contracts and interest rate swaptions. The Company has not elected hedging treatment under GAAP, and as such all gains or losses (realized and unrealized) on these instruments are reflected in earnings for all periods presented.

As of December 31, 2013, such instruments were comprised entirely of Eurodollar futures contracts. During the year ended December 31, 2014, the Company entered into, and settled before the end of the year, a T-Note futures contract. Eurodollar and T-Note futures are cash settled futures contracts on an interest rate, with gains or losses credited or charged to the Company's account on a daily basis and reflected in earnings as they occur. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. This margin represents the collateral the Company has posted for its open positions and is recorded on the balance sheets as part of restricted cash. The Company is exposed to the changes in value of the futures by the amount of margin held by the broker.

During the year ended December 31, 2014, the Company was a party to interest rate swaption agreements. At December 31, 2014, the Company had outstanding swaption agreements which grant the Company the right but not the obligation to enter into underlying pay fixed interest rate swap ("payer swaption"). The Company may also enter into swaption agreements that provide the Company the option to enter into receive fixed interest rate swap ("receiver swaption").

## Derivative Assets (Liability), at Fair Value

The table below summarizes fair value information about our derivative assets and liability as of December 31, 2014 and 2013.

(in thousands)

Derivative Instruments and Related Accounts	Balance Sheet Location	2014	2013
<b>Assets</b>			
Eurodollar futures - Margin posted to counterparty	Restricted cash	\$5,174	\$2,446
Payer swaptions	Derivative assets, at fair value	1,217	-
		\$6,391	\$2,446
<b>Liability</b>			
Payer swaptions - Margin posted by counterparty	Other liabilities	\$(1,364)	\$-

The table below presents information related to the Company's Eurodollar futures positions at December 31, 2014 and 2013.

(\$ in thousands)

Expiration Year	Weighted Average LIBOR Rate	2014			2013		
		Contract Notional Amount	Open Equity(1)	Weighted Average LIBOR Rate	Contract Notional Amount	Open Equity(1)	
2014	-	\$-	\$-	0.40 %	\$262,500	\$(189)	
2015	0.63 %	650,000	(1,039)	0.80 %	275,000	(146)	

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2016	1.54	%	800,000	139	1.90	%	250,000	1,367
2017	2.23	%	800,000	(1,041 )	3.03	%	250,000	2,291
2018	2.54	%	800,000	(2,361 )	3.77	%	250,000	1,575
Total / Weighted Average	1.73	%	\$760,000	\$(4,302 )	2.02	%	\$257,353	\$4,898

(1) Open equity represents the cumulative gains (losses) recorded on open futures positions from inception.

The table below presents information related to the Company's interest rate swaption positions at December 31, 2014.

(\$ in thousands)

Expiration	Option			Underlying Swap			Weighted Average Term (Years)
	Cost	Fair Value	Weighted Average Months to Expiration	Notional Amount	Fixed Pay Rate	Receive Rate (LIBOR)	
≤ 1 year	\$5,350	\$1,217	6	\$375,000	2.79%	3 Month	7.3

#### Gain (Loss) From Derivative Instruments, Net

The table below presents the effect of the Company's derivative financial instruments on the statements of operations for the years ended December 31, 2014, 2013 and 2012.

(in thousands)

	2014	2013	2012
Eurodollar futures contracts (short positions)	\$ (9,558)	\$ 4,828	(40)
T-Note futures contract (short position)	72	-	-
Payer swaptions	(4,439)	-	-
	\$ (13,925)	\$ 4,828	(40)

#### Credit Risk-Related Contingent Features

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We minimize this risk by limiting our counterparties for instruments which are not centrally cleared on a registered exchange to major financial institutions with acceptable credit ratings and monitoring positions with individual counterparties. In addition, we may be required to pledge assets as collateral for our derivatives, whose amounts vary over time based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our derivative agreements, and may have difficulty obtaining our assets pledged as collateral for our derivatives. The cash and cash equivalents pledged as collateral for our derivative instruments are included in restricted cash on our balance sheets.

#### NOTE 5. OFFSETTING ASSETS AND LIABILITIES

The Company's derivatives and repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its assets and liabilities subject to these arrangements on a gross basis.

The following table presents information regarding those assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of December 31, 2014 and 2013.

(in thousands)

	Offsetting of Assets			Gross Amount Not Offset in the Balance Sheet		
	Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Net Amount of Assets Presented in the Balance Sheet	Instruments Received as Collateral	Cash Received as Collateral	Net Amount
<b>December 31, 2014</b>						
Derivative assets - Payer swaptions	\$1,217	\$-	\$1,217	\$-	\$(1,217)	\$-
<b>December 31, 2013</b>						
Derivative asset	\$-	\$-	\$-	\$-	\$-	\$-

(in thousands)

	Offsetting of Liabilities			Gross Amount Not Offset in the Balance Sheet		
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Instruments Posted as Collateral	Cash Posted as Collateral	Net Amount
<b>December 31, 2014</b>						
Repurchase Agreements	\$1,436,651	\$-	\$1,436,651	\$(1,434,035)	\$(2,616)	\$-
<b>December 31, 2013</b>						
Repurchase Agreements	\$318,557	\$-	\$318,557	\$(318,557)	\$-	\$-

The amounts disclosed for collateral received by or posted to the same counterparty up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the actual collateral received by or posted to the same counterparty typically exceeds the amounts presented. See Notes 3 and 4 for a discussion of collateral posted or received against or for repurchase obligations and derivative instruments.

#### NOTE 6. CAPITAL STOCK

At December 31, 2012, the Company had the authority to issue 1,000,000 shares of \$0.01 par value common stock. In connection with the Company's IPO in February 2013, the Company's charter was amended to increase the authorized

capital stock to 600,000,000 shares, of which (i) 500,000,000 shares are designated as common stock and (ii) 100,000,000 shares are designated as preferred stock, each with a par value of \$0.01 per share. Holders of shares of the common stock generally have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any securities of the Company. Subject to the provisions of our charter regarding restrictions on ownership and transfer of our stock, all holders of shares of the common stock will have equal liquidation and other rights.

Our charter authorizes our Board of Directors, without stockholder approval, to reclassify any unissued shares of our common stock into other classes or series of stock and to establish the number of shares in each class or series and to set the preferences, conversion or other rights, voting powers (including voting rights exclusive to such class or series), restrictions (including, without limitation, restrictions on transferability), limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each such class or series.

Our charter authorizes our Board of Directors, without stockholder approval, to classify any unissued shares of preferred stock and to reclassify any previously classified but unissued shares of any class or series of preferred stock. Prior to issuance of shares of each class or series, our Board of Directors is required by Maryland law and our charter to set the preferences, conversion or other rights, voting powers (including voting rights exclusive to such class or series), restrictions (including, without limitation, restrictions on transferability), limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each such class or series. Thus, our Board of Directors could authorize the issuance of shares of preferred stock that have priority over our common stock with respect to dividends or rights upon liquidation or with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control of the Company that might involve a premium price for holders of our common stock or otherwise be in their best interests. No shares of preferred stock have been issued, therefore none are outstanding.

#### Restrictions on Ownership and Transfer

In order to qualify as a REIT under the Code for each taxable year beginning after December 31, 2013, our shares of stock must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months or during a proportionate part of a shorter taxable year. Also, for our taxable years beginning after December 31, 2013, no more than 50% of the value of our outstanding shares of capital stock may be owned, directly or constructively, by five or fewer individuals (as defined in the Code to include certain entities) during the second half of any calendar year.

Because the Company's Board of Directors believes it is at present essential for us to qualify as a REIT, our charter provides that, subject to certain exceptions, no person or entity may beneficially or constructively own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock, or the ownership limit, except that Bimini may own up to 35.0% of our common stock so long as Bimini continues to qualify as a REIT.

The Company's charter also prohibits any person from (i) beneficially or constructively owning or transferring shares of the Company's capital stock if such ownership or transfer would result in the Company being "closely held" under Section 856(h) of the Code (without regard to whether the ownership interest is held during the last half of a taxable year) or otherwise cause the Company to fail to qualify as a REIT and (ii) transferring shares of the Company's capital stock if such transfer would result in the Company's capital stock being beneficially owned by fewer than 100 persons (determined under the principles of Section 856(a)(5) of the Code). Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of shares of the Company's stock that will or may violate any of the foregoing restrictions on transfer and ownership, or who is the intended transferee of shares of the Company's stock which are transferred to the trust (as described below), will be required to give written notice immediately to the Company or in the case of a proposed or attempted transaction, to give at least 15 days' prior written notice, and provide the Company with such other information as the Company may request in order to determine the effect, if any, of such transfer on the Company's status as a REIT. The foregoing restrictions on transfer and ownership will not apply if the Company's Board of Directors determines that it is no longer in the Company's best interests to attempt to qualify, or to continue to qualify, as a REIT, or that compliance with the restrictions on transfer and ownership is no longer required for the Company to qualify as a REIT.

The Company's Board of Directors, in its sole discretion, may exempt (prospectively or retroactively) a person from certain of the limits described above and may establish or increase an exempted holder limit for such person. The person seeking an exemption must provide to the Board of Directors any such representations, covenants and undertakings as the Board of Directors may deem appropriate in order to conclude that granting the exemption and/or establishing or increasing an excepted holder limit, as the case may be, will not cause the Company to fail to qualify as a REIT. The Company's Board of Directors may also require a ruling from the IRS or an opinion of counsel in order

to determine that granting the exemption will not cause the Company to lose its qualification as a REIT. In connection with granting a waiver of the ownership limit or creating an excepted holder limit or at any other time, the Company's Board of Directors may from time to time increase or decrease the ownership limit, subject to certain restrictions.

## Common Stock Issuances

During 2014 and 2013, the Company completed the following public offerings of its common stock.

(\$ in thousands, except per share amounts)

Type of Offering	Period	Price Received Per Share(1)	Shares	Net Proceeds(2)
2014				
Secondary Offering	First Quarter	\$ 12.50	2,070,000	\$ 24,174
Secondary Offering(3)	First Quarter	12.55	3,680,000	43,989
At-the-Market Offering Program(4)	Second Quarter	13.14	537,499	6,914
At-the-Market Offering Program(4)	Third Quarter	13.99	3,389,441	46,372
At-the-Market Offering Program(4)	Fourth Quarter	13.87	3,675,207	49,846
			13,352,147	\$ 171,295

(\$ in thousands, except per share amounts)

Type of Offering	Period	Price Received Per Share(1)	Shares	Net Proceeds(2)
2013				
Initial Public Offering	First Quarter	\$ 15.00	2,360,000	\$ 35,400 (5)
			2,360,000	\$ 35,400

(1) Price received per share is gross of underwriters' discount, if applicable, and other offering costs.

(2) Net proceeds are net of the underwriters' discount, if applicable, and other offering costs.

(3) Includes net proceeds received of \$5.7 million for the 480,000 shares issued to the underwriters in April 2014 pursuant to the exercise of their overallotment option related to the March 2014 offering.

(4) The Company has entered into two Equity Distribution Agreements, one of which was replaced with the current agreement, to publicly offer and sell shares of the Company's common stock in at-the-market and privately negotiated transactions from time to time. As of December 31, 2014, shares with a value of \$4.5 million remain available for issuance under the September Equity Distribution Agreement.

(5) Bimini Advisors has paid, or has reimbursed the Company for all offering expenses in connection with the Company's IPO. The Company has no obligation or intent to reimburse Bimini Advisors, either directly or indirectly, for the offering costs; therefore they are not included in the Company's financial statements.

## Stock Dividend

On February 14, 2013, Orchid's Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed pursuant to this dividend were issued to Bimini on February 20, 2013, immediately prior to the Company's IPO.



## Cash Dividends

The table below presents the cash dividends declared on the Company's common stock since its IPO.

(in thousands, except per share data)

Declaration Date	Record Date	Payment Date	Per Share Amount	Total
<b>2015</b>				
February 10, 2015(1)	February 25, 2015	February 27, 2015	\$0.180	\$3,017
January 13, 2015(1)	January 26, 2015	January 30, 2015	0.180	3,017
Totals			\$0.360	\$6,034
<b>2014</b>				
December 9, 2014	December 26, 2014	December 30, 2014	\$0.180	\$3,004
November 12, 2014	November 25, 2014	November 28, 2014	0.180	2,737
October 9, 2014	October 28, 2014	October 31, 2014	0.180	2,358
September 9, 2014	September 25, 2014	September 30, 2014	0.180	2,348
August 12, 2014	August 26, 2014	August 29, 2014	0.180	1,999
July 10, 2014	July 28, 2014	July 31, 2014	0.180	1,759
June 11, 2014	June 25, 2014	June 30, 2014	0.180	1,712
May 8, 2014	May 27, 2014	May 30, 2014	0.180	1,641
April 8, 2014	April 25, 2014	April 30, 2014	0.180	1,636
March 11, 2014	March 26, 2014	March 31, 2014	0.180	1,550
February 11, 2014	February 25, 2014	February 28, 2014	0.180	974
January 9, 2014	January 27, 2014	January 31, 2014	0.180	925
Totals			\$2.160	\$22,643
<b>2013</b>				
December 11, 2013	December 26, 2013	December 30, 2013	\$0.180	\$603
November 12, 2013	November 25, 2013	November 27, 2013	0.135	451
October 10, 2013	October 25, 2013	October 31, 2013	0.135	451
September 10, 2013	September 25, 2013	September 30, 2013	0.135	451
August 12, 2013	August 26, 2013	August 30, 2013	0.135	451
July 9, 2013	July 25, 2013	July 31, 2013	0.135	451
June 10, 2013	June 25, 2013	June 28, 2013	0.135	451
May 9, 2013	May 28, 2013	May 31, 2013	0.135	451
April 10, 2013	April 25, 2013	April 30, 2013	0.135	451
March 8, 2013	March 25, 2013	March 27, 2013	0.135	451
Totals			\$1.395	\$4,662

(1) The effect of the dividends declared during 2015 is not reflected in the Company's financial statements as of December 31, 2014.

## NOTE 7. STOCK INCENTIVE PLAN

In October 2012, the Company's Board of Directors adopted and Bimini, then the Company's sole stockholder, approved, the Orchid Island Capital, Inc. 2012 Equity Incentive Plan (the "Incentive Plan") to recruit and retain employees, directors and other service providers, including employees of the Manager and other affiliates. The Incentive Plan provides for the award of stock options, stock appreciation rights, stock award, performance units, other equity-based awards (and dividend equivalents with respect to awards of performance units and other equity-based awards) and incentive awards. The Incentive Plan is administered by the Compensation Committee of the Company's Board of Directors except that the Company's full Board of Directors will administer awards made to directors who are not employees of the Company or its affiliates. The Incentive Plan provides for awards of up to an aggregate of 10% of the issued and outstanding shares of our common stock (on a fully diluted basis) at the time of the awards, subject to a maximum aggregate 4,000,000 shares of the Company's common stock that may be issued under the Incentive Plan.

A summary of incentive share activity during the year ended December 31, 2014 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Life
Restricted common stock, at January 1, 2014	-	\$-	-
Restricted common stock granted during the year	29,844	12.41	-
Vested during the year	(5,844 )	13.16	-
Restricted common stock, at December 31, 2014	24,000	\$12.23	2.3 Years

On April 25, 2014, our Compensation Committee granted each of our non-employee directors 6,000 shares of restricted common stock subject to a three year vesting schedule whereby 2,000 shares of the award vest on the first, second and third anniversaries of the award date. Directors have all the rights of a stockholder with respect to the awards, including the right to receive dividends and vote the shares. The awards are subject to forfeiture should the director no longer be a member of the Board of Directors of the Company prior to the respective vesting dates.

During the year ended December 31, 2014, the Company recognized approximately \$142,000 of share based compensation expense, including expense relating to the non-employee director restricted share grants and the value of common shares received by non-employee directors for board service, which is included under the caption directors fees and liability insurance in the Company's statement of operations.

As of December 31, 2014, there was approximately \$228,000 of unrecognized compensation expense related to unvested restricted share awards. The intrinsic value of the unvested restricted shares as of December 31, 2014 was \$313,000.

On January 21, 2015, our Compensation Committee granted equity awards and agreed to pay cash bonuses of \$250,000 to employees of the Manager. The equity awards were made pursuant to the terms and conditions of the Incentive Plan and consist of 11,292 shares of immediately vested Common Stock and 7,507 Performance Units. For purposes of the equity grants, the Common Stock was valued at \$13.32 per share, which was the closing market price of the Common Stock on January 21, 2015. The Performance Units are earned at the rate of 10% per quarter commencing with the quarter ending March 31, 2016 and concluding with the quarter ending June 30, 2018. The Grantee must continue to serve as an executive officer of the Company as of the end of each such quarter, and the

performance objectives (as defined) must have been achieved, in order to receive the number of Performance Units that may be earned on that date. When earned, each Performance Unit shall be settled by the issuance of one share of the Company's Common Stock, at which time the Performance Unit shall be cancelled. The Performance Units contain dividend equivalent rights which entitle the Participants to receive distributions declared by the Company on Common Stock.

NOTE 8. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at December 31, 2014.

NOTE 9. INCOME TAXES

The Company will generally not be subject to federal income tax on its REIT taxable income to the extent that it distributes its REIT taxable income to its stockholders and satisfies the ongoing REIT requirements, including meeting certain asset, income and stock ownership tests. A REIT must generally distribute at least 90% of its REIT taxable income to its stockholders, of which 85% generally must be distributed within the taxable year, in order to avoid the imposition of an excise tax. The remaining balance may be distributed up to the end of the following taxable year, provided the REIT elects to treat such amount as a prior year distribution and meets certain other requirements.

REIT taxable income (loss) is computed in accordance with the Code, which is different than the Company's financial statement net income (loss) computed in accordance with GAAP. All of the Company's estimated REIT taxable income or loss prior to the completion of the Company's IPO is included in the consolidated tax return of Bimini.

In general, dividends declared by the Company will be considered ordinary income to stockholders for income tax purposes. From time to time, a portion of the Company's dividends may be characterized as capital gains or return of capital. For the tax periods ended December 31, 2014 and 2013 all income distributed in the form of dividends declared is considered characterized as ordinary income.

The Company has elected to treat approximately \$0.4 million of the January 2015 dividend and approximately \$0.1 million of the January 2014 dividend as having been paid with respect to 2014 and 2013, respectively in order to reduce REIT taxable income to zero for each of those years. Accordingly, no income tax provision was recorded for 2014 and 2013.

As of December 31, 2014, Orchid had approximately \$3.7 million of capital loss carryforwards that can be utilized to offset future capital gains.

NOTE 10. EARNINGS PER SHARE (EPS)

The Company had dividend eligible shares of restricted common stock that were outstanding during the year ended December 31, 2014. The basic and diluted per share computations include these unvested shares of restricted common stock if there is income available to Common Stock, as they have dividend participation rights. The shares of restricted common stock have no contractual obligation to share in losses. Because there is no such obligation, the shares of restricted common stock are not included in the basic and diluted EPS computations when no income is available to Common Stock even though they are considered participating securities.

The table below reconciles the numerator and denominator of EPS for the years ended December 31, 2014, 2013 and 2012.

(in thousands, except per-share information)

	2014	2013	2012
<b>Basic and diluted EPS per common share:</b>			
Numerator for basic and diluted EPS per common share:			
Net income (loss) - Basic and diluted	\$24,519	\$(698 )	\$534
Weighted average common shares:			
Common shares outstanding at the balance sheet date	16,700	3,342	154
Common shares to be distributed as a stock dividend	-	-	828
Unvested dividend-eligible stock incentive plan shares outstanding at the balance sheet date	24	-	-
Effect of weighting	(6,834 )	(330 )	-
Weighted average shares-basic and diluted	9,890	3,012	982
<b>Income (loss) per common share:</b>			
Basic and diluted	\$2.48	\$(0.23 )	\$0.54

On February 14, 2013, Orchid's Board of Directors declared a stock dividend whereby 5.37 shares of common stock were issued for each share of common stock outstanding. The 827,555 shares distributed as the dividend were issued to Bimini on February 20, 2013, immediately prior to Orchid's IPO. For the years ended December 31, 2013 and 2012, the 827,555 shares distributed as a stock dividend were treated as if outstanding for the entire period, as Bimini was the sole stockholder during the entire period prior to Orchid's IPO.

#### NOTE 11. FAIR VALUE

Authoritative accounting literature establishes a framework for using fair value to measure assets and liabilities and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of non-performance. Required disclosures include stratification of balance sheet amounts measured at fair value based on inputs the Company uses to derive fair value measurements. These stratifications are:

- Level 1 valuations, where the valuation is based on quoted market prices for identical assets or liabilities traded in active markets (which include exchanges and over-the-counter markets with sufficient volume),
- Level 2 valuations, where the valuation is based on quoted market prices for similar instruments traded in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market, and
- Level 3 valuations, where the valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect the Company's own estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include option pricing models, discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

The Company's RMBS and interest rate swaptions are valued using Level 2 valuations, and such valuations currently are determined by the Company based on independent pricing sources and/or third party broker quotes, when available. Because the price estimates may vary, the Company must make certain judgments and assumptions about the appropriate price to use to calculate the fair values. Alternatively, the Company could opt to have the value of all of our positions in RMBS and interest rate swaptions determined by either an independent third-party or do so internally.

RMBS, interest rate swaptions and Eurodollar futures contracts were recorded at fair value on a recurring basis during the years ended December 31, 2014, 2013 and 2012. When determining fair value measurements, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset. When possible, the Company looks to active and observable markets to price identical assets. When identical assets are not traded in active markets, the Company looks to market observable data for similar assets.

The following table presents financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2014 and 2013:

(in thousands)

	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2014</b>				
Mortgage-backed securities	\$ 1,549,171	\$-	\$1,549,171	\$ -
Eurodollar futures contracts	5,174	5,174	-	-
Payer swaptions	1,217	-	1,217	-
<b>December 31, 2013</b>				
Mortgage-backed securities	\$ 351,223	\$-	\$351,223	\$ -
Eurodollar futures contracts	2,446	2,446	-	-

During the years ended December 31, 2014, 2013 and 2012, there were no transfers of financial assets or liabilities between levels 1, 2 or 3.

## NOTE 12. RELATED PARTY TRANSACTIONS

### Management Agreement

The Company entered into a management agreement with Bimini, which provided for an initial term through December 31, 2011 with automatic one-year extension options. The agreement was extended under the option to December 31, 2013, but was terminated at the completion of the Company's IPO on February 20, 2013. At the completion of the IPO, the Company entered into a management agreement with the Manager, which provides for an initial term through February 20, 2016 with automatic one-year extensions and is subject to certain termination rights. Under the terms of the management agreement, the Manager will be responsible for administering the business activities and day-to-day operations of the Company. The Manager receives a monthly management fee in the amount of:

- One-twelfth of 1.5% of the first \$250 million of the Company's equity, as defined in the management agreement,
- One-twelfth of 1.25% of the Company's equity that is greater than \$250 million and less than or equal to \$500 million, and
  - One-twelfth of 1.00% of the Company's equity that is greater than \$500 million.

The Company is obligated to reimburse the Manager for any direct expenses incurred on its behalf. In addition, the Manager began allocating to the Company its pro rata portion of certain overhead costs set forth in the management agreement commencing with the calendar quarter beginning July 1, 2014. Should the Company terminate the

management agreement without cause, it shall pay to Bimini Advisors a termination fee equal to three times the average annual management fee, as defined in the management agreement, before or on the last day of the initial term or automatic renewal term.

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The Company was obligated to reimburse Bimini for its costs incurred under the original management agreement. In addition, the Company was required to pay Bimini a monthly fee of \$7,200, which represents an allocation of overhead expenses for items that included, but were not limited to, occupancy costs, insurance and administrative expenses. These expenses were allocated based on the ratio of the Company's assets and Bimini's consolidated assets.

Total expenses recorded during the years ended December 31, 2014, 2013 and 2012 for the management fee and costs incurred was approximately \$2,404,000, \$679,000 and \$335,000, respectively. At December 31, 2014 and 2013, the net amount due to affiliates was approximately \$330,000 and \$82,000, respectively.

#### Payment of Certain Offering Expenses

The Manager has paid, or has reimbursed Orchid, for all offering expenses in connection with the Company's IPO. During the years ended December 31, 2013 and 2012 these expenses were approximately \$3.0 million and \$0.2 million, respectively. In addition, during the year ended December 31, 2012, Bimini Advisors paid certain expenses totaling approximately \$0.8 million on behalf of the Company associated with a failed merger attempt. The Company has no obligation or intent to reimburse Bimini Advisors, either directly or indirectly, for the offering costs or attempted merger costs, therefore they are not included in the Company's financial statements.

#### Board Memberships

John B. Van Heuvelen, one of our independent director nominees, owns shares of common stock of Bimini. Robert Cauley, our Chief Executive Officer and Chairman of our Board of Directors, also serves as Chief Executive Officer and Chairman of the Board of Directors of Bimini and owns shares of common stock of Bimini. Hunter Haas, our Chief Financial Officer, Chief Investment Officer, Secretary and a member of our Board of Directors, also serves as the Chief Financial Officer, Chief Investment Officer and Treasurer of Bimini and owns shares of common stock of Bimini.

#### Consulting Agreement

In September 2010, the Company entered into a consulting agreement with W Coleman Bitting, who became one of the Company's independent directors in February 2013. The terms of the consulting agreement provided that Mr. Bitting would advise the Company with respect to financing alternatives, business strategies and related matters as requested during the term of the agreement. In exchange for his services, the consulting agreement provided that the Company pay Mr. Bitting an hourly fee of \$150 and reimburse him for all out-of-pocket expenses reasonably incurred in the performance of his services. During years ended December 31, 2013 and 2012, the Company paid Mr. Bitting approximately \$3,800 and \$30,400, respectively, under this agreement. Mr. Bitting's consulting agreement was terminated upon completion of the Company's IPO. The total compensation Mr. Bitting received under the consulting agreement was approximately \$115,000.

## NOTE 13. QUARTERLY RESULTS (UNAUDITED)

The following is a presentation of the quarterly results of operations for the years ended December 31, 2014 and 2013.

(in thousands, except per share information)

	Quarter Ended			
	March 31, 2014	June 30, 2014	September 30, 2014	December 31, 2014
Interest income	\$3,783	\$6,589	\$9,286	\$12,146
Interest expense	(411 )	(676 )	(818 )	(1,126 )
Net interest income	3,372	5,913	8,468	11,020
Gains (losses)	758	5,837	(307 )	(6,054 )
Net portfolio income	4,130	11,750	8,161	4,966
Expenses:				
Management fees	303	430	543	737
Other expenses	232	685	850	708
Total expenses	535	1,115	1,393	1,445
Net income	\$3,595	10,635	\$6,768	\$3,521
Basic and diluted net income per share	\$0.71	1.17	\$0.63	\$0.24
Weighted Average Shares Outstanding	5,094	9,078	10,710	14,565
Dividends declared per share	\$0.54	\$0.54	\$0.54	\$0.54