Granite Point Mortgage Trust, Inc.

Second Quarter 2018 Financial Results Conference Call

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CORPORATE PARTICIPANTS

John Taylor - *President, Chief Executive Officer & Director*

Marcin Urbaszek – *Chief Financial Officer*

Stephen Alpart – *Chief Investment Officer*

Steven Plust – *Chief Operating Officer*

Chris Petta – *Investor Relations*

PRESENTATION

Operator
Good morning. My name is Brian and I will be your conference facilitator. At this time, I'd like to welcome everyone to the Granite Point Mortgage Trust's Second Quarter 2018 Financial Results Conference Call. All participants will be in a listen-only mode. After the speaker's remarks there will be a question and answer period. Please note this event is being recorded. I would now like to turn over the call to Chris Petta with Investor Relations for Granite Point. Please go ahead.

Chris Petta
Thank you, and good morning, everyone. Thank you for joining our call to discuss Granite Point's second quarter 2018 financial results. With me on the call this morning are Jack Taylor, our President and CEO; Marcin Urbaszek, our CFO; Steve Alpart, our CIO; and Steve Plust, our COO. After my introductory comments, Jack will provide a brief recap of market conditions and some business highlights. Steve Alpart will discuss our second quarter originations, portfolio and pipeline; and Marcin will highlight key items from our financials.

The press release and financial tables associated with today's call were filed yesterday with the SEC. If you do not have a copy, you may find them on our website or on the SEC's website at sec.gov.

In our earnings release and slides, which are now posted in the Investor Relations section of our website, we have provided a reconciliation of GAAP to non-GAAP financial measures. We urge you to review this information in conjunction with today's call. I would also like to mention that this call is being webcast and may be accessed on our website in the same location.

Before I turn the call over to Jack, I would like to remind you that remarks made by management during this conference call and the supporting slides may include forward-looking statements. Forward-looking statements reflect our views regarding future events and are typically associated with the use of words such as anticipate, expect, estimate and believe or other such words. We caution investors not to rely unduly on forward-looking statements. They imply risks and uncertainties, and actual results may differ materially from expectations. We urge you to carefully consider the risks described in our filings with the SEC, which may be obtained on the SEC's website at sec.gov. We do not undertake any obligation to update or correct any forward-looking statements if later events prove them to be inaccurate.

I will now turn the call over to Jack.

John Taylor
Thank you, Chris, and good morning, everyone. On behalf of our management team, we would like to welcome you all and thank you for joining us for our second quarter earnings call. We are excited to report our best originations and earnings quarter since becoming a public company a year ago. Our business is growing and our results keep improving as we continue to successfully execute our strategy. We made substantial progress in the first quarter building our investment pipeline. As a result, during the second quarter we originated almost $500 million of new senior floating rate loans. These strong originations helped us improve our earnings and dividend, and to grow our portfolio despite elevated prepayments.

Since quarter end, we have maintained our momentum, generating a pipeline of senior floating rate loan so far of over $440 million in total commitments. To date, we have closed and funded about $120 million of these loans. Our second quarter originations and pipeline demonstrates the direct origination capabilities of our platform and show that we continue to see many attractive lending opportunities on high quality properties. Also in May we closed our inaugural CLO which furthered our goal to diversify and expand our financing sources and structures. Our results continue to establish Granite Point as one of the leaders in our sector and help us to deliver attractive returns to our shareholders. Additionally, our recent inclusion in the S&P 600 Small Cap Index is another important milestone in our company's development and it should further expand our visibility within the investor community.

Moving to our second quarter performance, please turn to slide 4. Marcin will discuss our detailed financial results shortly, but I'd like to touch on some of the highlights. In the second quarter, we delivered core earnings of $0.38 per share, an increase of $0.03 share over the first quarter. We increased our common dividend for the second quarter by $0.02 to $0.40 per share, which we believe provides an attractive current yield to our shareholders. We expect our earnings and dividend to benefit as we continue deploying our capital and growing our investment portfolio over the second half of 2018.

At quarter end, our outstanding portfolio principal balance was $2.6 billion and $2.9 billion when we include our future funding commitments. Our portfolio is 100% performing with a weighted average stabilized LTV of 63%. Also as you can see, we have a diversified capital structure and an attractive mix of funding alternatives at our disposal, and we will continue to evaluate all options available to us going forward as we grow our business.

The overall market lending standards generally remain rational in terms of leverage and loan structure. We continue to see strong credit quality in the loans we originate. Property evaluations overall continue to improve, but we believe they are supported by growth and cash flow and strong economic trends.

Competition for loan access remains very active and has continued to put pressure on loan spreads. However, in part due to our differentiated origination strategy and also owing to our industry reputation as a reliable and creative counterparty, we are able to source attractive investment opportunities for our portfolio as evidenced by our Q2 originations and strong forward pipeline. Improvements in our financing cost, whether through the execution of our CLO or better funding spreads on our credit facilities, have generally helped us maintain our returns within our target range.

We are confident that our broad network of deep industry relationships, our disciplined underwriting and our investment strategy including targeting originations across both the primary and secondary markets will enable us to continue to perform well and deliver attractive returns to our shareholders over time.

Now I will turn the call over to Steve Alpart to discuss our investment activity in more detail.

Stephen Alpart
Thank you, Jack, and good morning, everyone. We appreciate your time this morning. I'll spend a few minutes reviewing our second quarter originations and highlighting our progress so far in the third quarter and then I'll provide some key metrics on our portfolio. Let's turn to slide 5.

After successfully building a strong investment pipeline in the first quarter, we had record originations in the second quarter. We closed 15 new loans with total commitments of about $500 million representing the most loan closes we've had in a quarter since the inception of our company. Our total fundings in the second quarter were about $446 million, comprised of about $411 million of initial fundings for new loans, $2 million from upsizing 2 existing loans and about $32 million from our preexisting loan commitments. The loans we closed in the second quarter are secured by existing high quality income producing properties across our target markets and have a weighted average LTV of 62% and a weighted average yield of LIBOR plus 460.

Our new loans are well diversified across multiple property types with multifamily assets accounting for the largest portion at 37% of our second quarter originations. We continue to remain selective on retail and hotel. However, we are finding attractive opportunities which meet our credit underwriting standards and target returns in those sectors and about 29% of our second quarter originations were in the hotel sector, with the remainder largely concentrated in office properties.

Our mix of property types and markets will vary from quarter to quarter as will our volume of originations. However, over time we would expect our portfolio diversification across markets and property types to be pretty consistent unless we see significant shifts in the lending markets. We continue to see a healthy flow of attractive investment opportunities and we have maintained our strong momentum signing up new loans since quarter end as we build our pipeline. To date, in the third quarter, we have made total commitments of over $440 million of senior floating rate loans with initial fundings of over $285 million. Of this $285 million, we have already funded approximately $120 million and expect the remainder to close over the next few months, subject to typical closing conditions.

In our pipeline, we have a relatively large $100 plus million retail, mixed-use loan. This property is located in an attractive infill market in Southern California with a great sponsor and the loan has strong credit characteristics. Similar to hotel assets, we remain very selective on retail, but we are able to find attractive investments within this sector. You may recall that we had $100 plus million retail loan prepay in the second quarter as a result of the business plan being very well executed ahead of the anticipated timeline by a strong sponsor, so an excellent result. This new loan is a great example of our ability to find high credit quality retail assets with institutional quality sponsors who have a track record of successfully executing on their business plans. Overall, our retail exposure remains low and we feel very comfortable with the investments we have made.

As we discussed in our last earnings call, we had anticipated an elevated level of prepayments and we realized about $328 million in the second quarter. We expect we will continue to see prepayments during the remainder of the year as our portfolio seasons, though it is difficult to predict exactly when they will occur. As we stated previously, we believe that on a stabilized basis, our portfolio will likely pay off at an annual rate of approximately 25% as it becomes more seasoned. Despite a higher level of prepays in the second quarter, our originations allowed us to grow our portfolio as well as our earnings and dividends.

Moving on to slide 6, at June 30th our portfolio had a total outstanding principal balance of $2.6 billion, a weighted average stabilized LTV of approximately 63% and a weighted average asset yield of LIBOR plus 508. We have over $370 million of future funding commitments and we expect the majority of them to occur over the next couple of years.

Senior loans comprise over 96% of our investments, which combined with the broader range of MSAs and generally smaller loan sizes reflect our overall investment strategy. By property type, our portfolio was weighted towards the office sector, which we continue to find attractive with the remainder spread across hotel, multifamily, industrial and retail assets.

Our portfolio is 100% performing and we continue to employ rigorous credit underwriting standards, which allows us to be selective and pick the best investments for our portfolio from a risk-adjusted return perspective.

As shown on slide 7, our portfolio is almost 98% floating rate, which positions us well for rising short-term rates. We estimate that if LIBOR were to increase by 100 basis points, our annual net interest income on existing portfolio would increase by approximately $0.18 per share.

Turning to slide 8, I'll briefly comment on a couple of recent deal examples that illustrate our strategy and the high quality assets we source through our large origination network. The first deal example is the $46 million senior floating rate loan collateralized by a 6-story, 50,000 square foot, mixed-use office and retail building that is well located in the prime Manhattan submarket of NoHo. This submarket has strong fundamentals including office and retail occupancy that both exceed 95%.

Our loan financed the acquisition of the property and provide future funding for capital improvements and leasing costs. The business plan involved the repositioning of office space to class-A quality and upgrading the retail areas. The business plan is well suited to the location and the property's high ceilings and large windows. Our sponsor, who is based in Manhattan with offices in Boston, LA and Hong Kong, is an institutional private equity firm with an in-house operating capability. They have a long track record executing similar value-add business plans, have executed over 200 real estate investments totaling approximately $16 billion in value, and are investing over $15.5 million of cash equity into this transaction. Our loan is moderately leveraged at approximately 51% and our loan base is significantly lower than comparable sales for stabilized properties.

The second deal example consists of two $18.5 million senior floating rate loans, $37 million in total, collateralized by 2 newly constructed multifamily properties totaling 102 units in Los Angeles; one in Hollywood the other in Koreatown. The properties offer fully furnished, luxury residential units and provide an enhanced suite of amenities. All loans refinance the existing debt on the properties and allow the sponsor to finalize their business plans, which is a lease up to stabilization. We like these types of apartment transactions because the business plans are straightforward and the properties are well located in strong submarkets.

The Los Angeles apartment market continues to be a strong performer with an overall 95% plus occupancy rate. Our sponsor is a well-regarded private real estate investment and development firm focused on opportunistic investments across several property types including multifamily, office, retail and hotel.

And finally, our loans are moderately leveraged with a weighted average LTV of approximately 67%.

So in summary, we continue to successfully execute on our strategy and we are excited to further build our business and deliver attractive returns to our shareholders.

I will now turn the call over to Marcin for a more detailed review of our quarterly financial results.

Marcin Urbaszek
Thank you Steve, and good morning everyone. Thank you for joining us. Over the next few minutes I will review our financial performance as well as our capitalization and liquidity. Turning to slide 9, our GAAP net income for the second quarter was $15.2 million or $0.35 per share. Our core earnings were $16.4 million or $0.38 per share. Our earnings include about $0.5 million or $0.01 per share of prepayment income. Taxable income for the second quarter was $20.6 million or $0.47 per share. The difference between our GAAP and taxable income was largely related to the GAAP to tax differences resulting from our formation transaction last year.

We declared a second quarter dividend of $0.40 per common share which we believe translates into an attractive current dividend yield. Our book value at June 30 was $19.02 per common share and was slightly affected by the common dividend in excess of GAAP earnings. As a reminder, since our IPO in June of last year, we have been amortizing additional taxable accretion which has caused our taxable income to be higher than our GAAP and core earnings. This has also caused our common dividend to exceed our core earnings since REIT dividends are largely driven by taxable income.

Through June 30, we have amortized about two-thirds of this GAAP to tax difference. We expect the majority of the remainder of this difference to be amortized over the next few quarters. As a result, we would expect our taxable income to be higher than our GAAP and core earnings in future periods, but at a declining scale. The timing of the recognition of this GAAP to tax difference is difficult to predict. However, we estimate it to be more of a short-term factor.

Turning to slide 10. As of June 30, we had approximately $1 billion outstanding on our repurchase agreements and a total borrowing capacity of $2.3 billion across 5 large institutional lenders. As we discussed previously, during the second quarter we added a $75 million revolving credit facility to help us manage our liquidity and we also closed an $826 million CLO providing us with diversification of funding sources and matched-term non-recourse and non-mark-to-market borrowings.

The CLO was accounted for as a financing and has been consolidated on our financial statements. We continue to have ready access to financing and have realized better cost of funds on our new originations, which would help us offset some of the spread compression on our loan investments. We ended the second quarter with a debt-to-equity leverage ratio of 2.2 times including the non-recourse CLO debt. We believe we will get to our target leverage of 2.5 times to 3 times by the end of the year as we deploy our available capital.

Accounting for our pipeline, we currently have liquidity to originate over $400 million of new loans without including any additional potential prepayments which we may realize over the remainder of the year.

Thank you again for joining us today and now, I will ask the operator to open the call to questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up the handset before pressing the keys. To withdraw the question, please press star then two. Once again, if you'd like to ask a question today, please press star then one.

And our first question today comes from Jade Rahmani with KBW.

Jade Rahmani
Thanks very much for taking the questions. I wanted to see if you viewed the spreads that you generated in the quarter as sustainable. It seems like you're still able to generate slightly higher spreads than some of your competitors who are more focused on the large loan space.

John Taylor
Jade, this is Jack, and thank you for your question. It's good to hear from you. We do see a continuing spread compression in the market. We've seen healthy levels of competition. Happily that's been on the spreads and price side and not on the credit. I would say that our view is the spreads will overall in the market continue to tighten for the duration of this year, but we do think it's going to start tapering off. We think that it's going to be coming down. We've seen about a 25 basis point tightening quarter-over-quarter for comparable credits, and we think that this is going to continue a little bit. But our ability to generate attractive deals, I think, will be sustained and we'll have to move with the market, I think we're going to be able to maintain our double digit ROI.

Stephen Alpart
Hi Jade, it's Steve. I just want to add to what Jack just said in terms of the actual composition of Q2 versus Q3. We are estimating the yields on Q3 originations will be somewhere in the mid to high 3s over LIBOR. That's partially a function of what Jack just said as far as market spreads. It's also a function of

asset mix as well. So Jack just talked about spreads overall, which obviously depend on the specific deal. Our Q2 originations, I just want to point out, we had one loan that was opportunistic in nature. We knew the property, we're able to get outside returns and that one deal probably increased our weighted average second quarter origination yield by about 40 basis points.

Also our Q2 pipeline, we had a higher hotel concentration than we expect to have in Q3. We want to just emphasize that while spreads have been compressing and that is specific to the mix of Q2 versus Q3. As we've talked about in the past, the spread compression is largely being offset by higher LIBOR and better financing cost on the new loans.

Jade Rahmani
Okay, thanks. That's helpful. How many originators do you have overall?

John Taylor
This is Jack. We have a core team of about ten people that do both origination and underwriting in a team concept and I would say six of those are more primarily identified as originators.

Jade Rahmani
What do you think if capital was unlimited, the origination capacity in annual volume terms would be? And let's say you broadened the spectrum to include CMBS loans, potentially mezzanine loans and other products, what's the overall origination capacity of the current team?

John Taylor
The current team has a run rate of about $1.5 billion per year and I do believe that could be enhanced and grown, especially if we added different types of products, but our organic growth is at around $1.5 billion and growing. I would say some of that is and would be dependent upon asset size as well, not just fixed rate versus floating. As we grow the portfolio, we will be adding some larger loans. You've seen some $100 million plus loans, that same team could grow just by sizing up on 25% of the portfolio, getting larger size, we could grow more than the $1.5 billion annual run rate.

Jade Rahmani
And just a follow up to that, what's the company's interest in adding additional cylinders, additional business lines, to take more full advantage of the origination team and potentially generate fee revenue if you were able to manage funds for, say, life insurance companies?

John Taylor
Honestly that's more of a 2019 perspective than a 2018 perspective and we are looking at things like that. We do have a number of parties, counterparties, that have actually on a reverse inquiry approached us and asked us to do so for them. And we're looking at that, but we're not moving on it in the near term.

Jade Rahmani
Thanks very much, appreciate that and I think that would confer some franchise value and platform value that perhaps is not recognized in the current valuation.

John Taylor
Thank you. We agree with you.

Operator
Next question comes from Rick Shane of J.P. Morgan. Please go ahead.

Richard Shane
Hi guys, thanks for taking my question. Marcin talked about available funding capacity of about $400 million. I am curious given where you are both in terms of capital deployment and in terms of G&A expense. Would that largely be pure operating leverage, because you wouldn't see an increase in management fees or operating fees? Are you at the point where there is operating leverage developing in the business model?

Marcin Urbaszek
Hi Rick, thanks for joining us. Thanks for your question. Yes, the $400 million that I referenced, just to make clear to everyone, it's essentially our liquidity for new originations from here on out accounting for our current pipeline, which Steve referred to earlier. So that's essentially just levering off our existing capital base and investing the cash that we have available to us.

So from an earnings perspective, we look at it as just essentially levering off the expense base and levering off the capital structure and the capital of the company. So that should be pure profit to the bottom line once we invest the available liquidity that we have currently.

Richard Shane
Great, thank you guys.

Operator
Again, if you'd like to ask a question today, please press star then one. And our next question will be Ben Zucker with BTIG. Please go ahead.

Benjamin Zucker
Good morning guys and thanks for taking my questions. Maybe this is for Steve, but has there been any shift in the loans that you guys are now targeting? I ask that because I calculate fundings as a percent of total commitments of 83% in 2Q and that metric looks to be something like 65% on your subsequent 3Q originations. So could you talk about the loans in your 3Q pipeline a little bit and are you seeing better risk adjusted returns and these may be slightly more transitional assets now? Just curious for your thoughts.

Stephen Alpart
Thanks, Ben, its Steve. I would say overall the target assets will not change that much, that could change over time. But if you look at the Q2 pipeline versus the Q3 pipeline, the types of loans and types of assets are similar. I mentioned earlier that we had a higher concentration of hotels in the second quarter versus the third quarter, but as far as the nature of how transitional the assets are, I would say it's directionally pretty similar quarter-over-quarter.

Benjamin Zucker
Okay, that's helpful. And while I have you, I heard your comments on repayments. Once the portfolio is stabilized, you expect 25% to repay each year. But it didn't sound like you were saying GPMT is at that point yet. So I know you guys quite hate getting this question because of how difficult it is to pin down, but how should we think about repayments in the second half of the year? It feels like 2Q was definitely heavy, maybe 1Q was a little light, but any way you could help frame this would just be very helpful given that you guys are still ramping the portfolio.

Steven Plust
Hi Ben, it's Steve Plust, I'll handle that one. It's hard to predict from quarter-to-quarter because things happen quickly. Right now, we're looking like Q3 will be a very light quarter for prepays, something significantly less than $100 million and beyond that, we really can't say right now, can't predict, but we

do think that the portfolio will be close to if not stabilized, turning the year into early 2019.

Benjamin Zucker
That's great to hear on full stabilization, thanks. And then lastly, just a bit of housekeeping from Marcin. How much of that GAAP to tax discount accretion is still remaining?

Marcin Urbaszek
Hi Ben. We have amortized about two-thirds of it through the end of the second quarter. The rest of it, as I said earlier, should be amortized over the next few quarters. But we feel like it's going to be more of a short-term phenomenon than long-term phenomenon. So, again, it'll depend a lot on prepays that we receive. As loans prepay, we accelerate this recognition and that happened in the second quarter when we had a lot of prepayments and you saw a pretty significant growth in the taxable income number. So the next two to four quarters, but on a declining scale then it should not be such a significant impact to our results.

Benjamin Zucker
That's helpful. I guess as you grow your denominator for earnings, the swing effect that accretion causes is much more muted. Appreciate your comments guys. Thanks for taking the questions.

CONCLUSION

Operator
Once again, if you'd like to ask a question today, please press star then one.

At this time, there doesn't appear to be any more questions in the queue. So I'd like to conclude today's question and answer session, and turn the conference back over to Jack Taylor for any closing remarks.

John Taylor
Thank you very much, Brian. We very much appreciate everybody being on the call today and we appreciate your support for the company. We look forward to speaking with you again very soon. Thank you.

Operator
The conference has now concluded. We want to thank you for attending today's presentation. You may now disconnect.