Granite Point Mortgage Trust Inc.

Third Quarter 2019 Financial Results

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CORPORATE PARTICIPANTS

Jack Taylor – *President and Chief Executive Officer*

Steve Alpart – *Chief Information Officer*

Marcin Urbaszek – *Chief Financial Officer*

Steve Plust – *Chief Operating Officer*

Chris Petta – *Investor Relations*

PRESENTATION

Operator

Good morning. My name is Jacob, and I will be your conference facilitator. At this time, I would like to welcome everyone to Granite Point Mortgage Trust's Third Quarter 2019 financial results conference call. All participants will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session.

I would like to now turn the conference over to Chris Petta with investor relations for Granite Point.

Chris Petta

Thank you, and good morning, everyone. Thank you for joining our call to discuss Granite Point's third-quarter 2019 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 summary of our business activities and a brief recap of market conditions. Steve Alpart will discuss our third-quarter originations, our portfolio and pipeline, and Marcin will highlight key items from our financials.

The press release and financial tables associated with today's call as well as our Form 10-Q were filed yesterday with the SEC. If you don't 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.

Jack Taylor

Thank you, Chris, and good morning everyone. We would like to welcome you all, and thank you for joining our third quarter 2019 earnings call.

Over the course of the year, we have been successfully executing on our investment strategy, while meaningfully growing our business. Our strong third quarter loan originations of over $630 million, again, illustrate the capabilities of our direct origination platform and our highly experienced team. Through the first 9 months of the year, we originated over $1.3 billion of new senior loans, an increase of about 47% over the same period last year. We expect our robust capital deployment to continue for the rest of the year, as evidenced by our forward pipeline of over $650 million of loans. Although our pace of originations has increased, we have maintained our emphasis on credit underwriting and loan structuring, while generating attractive risk-adjusted returns. Assuming all the loans in our pipeline close by year-end, we are on track to directly originate about $2 billion of new senior loan investments for the full year, which would be a record for our businesses and represents an increase of more than 25% over our originations volume in 2018.

Our strong third quarter originations, combined with the fundings of our existing loan commitments, resulted in record quarterly capital deployment of over $530 million. That, combined with manageable prepayments, generated another quarter of strong net portfolio growth of over $365 million, or about a 10% increase over the second quarter. The outstanding principal balance of our portfolio at quarter end was about $4 billion and $4.7 billion, including all our future funding commitments.

We are pleased with the ongoing strength of the credit quality of our portfolio. We remain focused on deploying our capital into strong credit stories backed by the high-quality properties and sponsors with business plans meeting our underwriting criteria, which in aggregate produces a well-secured and well-diversified portfolio. During the third quarter, one of our loans that had been previously risk rated 4 was repaid at par. This approximately $18 million loan on a multifamily property in New York was refinanced with another lender reaffirming our earlier views on the credit quality of this asset. We continue to actively monitor the one other loan that we have risk rated 4. Active credit monitoring of our investments is a key tenet of our overall asset management program and approach to risk mitigation.

We believe that, in general, the fundamentals of the commercial real estate market, along with the overall credit environment remain attractive. Even though the overall economic conditions have remained relatively stable with solid trends in the employment market, in a preemptive set of actions over the last few months the Fed has cut short-term interest rates significantly, which had a negative impact on our financial performance in the third quarter. This, along with some temporary shifts on our balance sheet, which Marcin will describe in more detail later, contributed to a decline in our earnings quarter over quarter. From the outset, we have been incorporating LIBOR floors from the vast majority of our loans as a partial offset to declining short-term rates. However, a significant portion of our portfolio is in older vintage investments with much lower LIBOR floors, which resulted in a disproportionate impact on our portfolio yield as short-term rates declined. As of September 30th, less than 10% of our portfolio had LIBOR floors that were in the money. However, our originations for the nine months of the year have a weighted average LIBOR floor of approximately 2.02%. As our portfolio seasons and the older vintage loans, those with lower LIBOR floors, continue to pay off, the sensitivity of our portfolio to further declines in short-term rates is expected to improve.

We have made substantial progress executing on our strategic goals and growing our company, while taking advantage of attractive investment opportunities available in the commercial real estate debt markets. We remain confident that our strategy will generate attractive risk-adjusted returns for our shareholders as we continue to grow and stabilize our business.

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

Steve Alpart

Thank you, Jack, and thank you all for joining our call this morning.

We continued our strong originations momentum in the third quarter and closed 15 new loans with total commitments of over $636 million, taking advantage of the plentiful attractive lending opportunities in our market. Our aggregate loan fundings of $535 million was the highest we have had since the inception of our business and consisted of about $475 million of initial fundings of new loans, about $58 million of future fundings from pre-existing loan commitments, and $2 million from the upsizing of two loans. The newly originated loans are secured by high-quality properties, mainly in the office and multifamily sectors, with a well-balanced geographical exposure. Our third quarter originations have attractive credit profiles with experienced sponsors, a weighted average stabilized LTV of 66% and a weighted average yield of LIBOR plus of 3.65%.

During the third quarter, we realized about $167 million of prepayments and principal amortization. However, we expect the volume of prepayments to exceed $300 million in the fourth quarter, driven primarily by the further seasoning of our portfolio as more of our sponsors have now had the time to successfully implement their business plans, leading them to either sell or refinance these properties. Since the end of the third quarter, we have already realized over $135 million of loan prepayments.

Driven by record loan fundings and relatively consistent prepayments, the principal balance of our investment portfolio grew to about $4 billion this quarter with a fully committed balance of about $4.7 billion. Our portfolio continues to exhibit strong credit characteristics and is well diversified across property types, markets and sponsors. The weighted average stabilized LTV across our portfolio is under 64%, and the weighted average yield at origination is LIBOR plus 4.40% with senior loans accounting for over 98% of our investments. Consistent with our strong focus on deep credit underwriting and our investment philosophy emphasizing diversification, our portfolio remains well insulated from exposure to binary risks and significant sponsor or tenant concentrations.

Turning to our forward pipeline, to date we have generated aggregate new loan commitments of over $650 million, which have over $500 million of initial fundings. So far, we have funded over $325 million of loans, which include funding of about $30 million from our prior commitments. We expect most of the remaining loans to close at some point during the fourth quarter, though some may delay into next year subject to customary closing conditions. Similar to our third-quarter originations, our pipeline is mainly concentrated in loans on multifamily and office properties located across a diverse array of markets and with strong credit characteristics. We currently estimate the loans in our forward pipeline to produce yields in the low to mid-threes over our LIBOR. Considering the higher expected level of Q4 prepayments and assuming that most of our pipeline loans close by year-end, we would anticipate a more modest portfolio growth in the fourth quarter compared to the third quarter, subject to timing of loan closings.

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

Marcin Urbaszek

Thank you, Steve, and good morning, everyone, thank you for joining our call.

Our strong originations in the third quarter continued our robust capital deployment this year and resulted in a healthy 10% net portfolio growth. Our financial results, however, were affected by lower short-term interest rates and movements on both sides of our balance sheet. Despite the strong portfolio growth, our interest income increased by only about 6%. It was impacted by the significant decline in one-month LIBOR during the third quarter as well as lower credit spreads on our newly originated loans relative to the spreads on the legacy loans that we have repaid. Over the course of the quarter, we increased our borrowings to provide us with the additional liquidity to fund our significant volume of originations in the third quarter and heading into the fourth quarter, some of which were delayed causing negative carry on our excess cash. As a result, we recognized higher interest expense, which contributed to the decline in our net interest income of about $0.01 per share versus the second quarter. Additionally, the prepayments of the CLO-financed loans created some additional drag on third quarter earnings as closings of new loans targeted for the deployment of those funds were also delayed. Since quarter end, we have largely reinvested the liquidity in our managed CLO.

The decline in net interest income and lack of prepayment fees, combined with slightly higher servicing expenses, driven by portfolio growth, largely accounted for the decrease in our core earnings from $19.4 million or $0.36 per share in the second quarter to $18.5 million or $0.34 per share in the third quarter. The recognition of additional shares outstanding issued through our ATM in the second quarter accounted for less than $0.01 of impact to our EPS results in the third quarter. Our book value at September 30th was $18.65 per common share.

Turning to our financing and leverage, the outstanding balance on our credit facilities increased to over $1.8 billion, driven by the growth of our portfolio and drawing down available borrowings to fund new loan originations. Additionally, at quarter end, we carried a much higher restricted cash balance as a result of the prepayments of loans financed through the CLOs that I referred to earlier. Our total borrowing capacity, inclusive of our options to upsize some of our facilities, was $2.5 billion, unchanged from the second quarter. During the third quarter, we partially exercised our option to upsize the JP Morgan facility from $350 million to $425 million. We can further grow the borrowing capacity on this facility up to $500 million. Since quarter end, we have also partially exercised our option to upsize the Wells Fargo facility from $200 million to $275 million, which can be further increased to $350 million. We ended the third quarter with our recourse leverage at 1.8 times, and including the nonrecourse, non-mark-to-market CLO debt, our total debt-to-equity ratio was 3.0 times. We would expect our total leverage to generally remain around this level in the near-term. As we continue to deploy our remaining capital and reinvest the liquidity, we expect to realize from loan repayments.

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 (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). At this time, we will pause momentarily to assemble our roster.

The first question comes from Jade Rahmani with KBW. Please go ahead.

Ryan

Good morning. This is actually Ryan on for Jade. Thanks for taking the questions. Marcin, I appreciate the commentary in your prepared remarks around the interest expense and the interest income.

I did not quite catch the main drivers of the reason why interest expense spiked so much in the quarter. Can you just try to clarify that for us a bit further, please? Thanks.

Marcin Urbaszek

Sure, and good morning. Thank you for joining us. So, the overall theme for the third quarter was the excess liquidity we carried, which put some pressure on net interest income and impacted our results. We were keeping extra liquidity on the balance sheet, and we were also preserving the funds available for reinvestment in our managed CLO for the large number of loans that we were closing, including some larger loans, the closings of which were unfortunately delayed, which resulted in a large interest expense without the offsetting interest income as the loans closed later. Most of that excess liquidity has been deployed, and if you think about it, given our smaller relative size, having $100 million to $150 million of extra liquidity for a couple of months, which is financed, obviously, through the borrowings, call it, 3.5% to 4%. That carries a little bit more significant impact to our results, and that is essentially what happened this quarter.

Jade Rahmani

Marcin, this is Jade. Are you expecting earnings to reach the dividend level in the fourth quarter?

And just broadly thinking about the dividend and the way it was established as a follow-on to the Two Harbors transaction. Based on where returns are today and given the outlook for interest rates, do you expect to reach the dividend level next year in terms of core earnings or should the dividend be adjusted to reflect current prospective levered returns?

Marcin Urbaszek

Good morning, Jade. Thank you for the question. So I will take the Q4 first, and then I will address the dividends after that. I would say, it is difficult to predict the exact number for the fourth quarter as, obviously you know, there are many factors influencing our earnings such as the timing of loan closings and prepayments.

We expect a higher level of prepays this quarter, as Steve mentioned in his prepared remarks, so that will be a driver along with the trends in the short-term rates. We still have some exposure to

LIBOR as we have largely a floating rate portfolio. Also, as Steve mentioned, we estimate the yields in our forward pipeline to be somewhere in the low-to-mid 300s over LIBOR. That, combined with the higher yields on the loans that are paying off will also have an impact. So taking all those factors into consideration and the fact that, as I just mentioned, the movements in our balance sheet to support a high volume of loans can have also some temporary effect on our EPS, it is hard to pinpoint a number for the fourth quarter.

Speaking of the dividends, also, there are a lot of factors that affect that. We are focused on longer-term supporting the dividend through stable run rate of core profitability. That will obviously depend on a variety of different things such as returns available in the market for our strategy. We do not expect to change the credit and risk profile of our investments in order to generate additional yield. Also, obviously, I alluded to earlier, for Q3, the excess liquidity we had, now we have funded over $300 million of loans in the second half of Q3 and over $325 million so far in the fourth quarter, as Steve mentioned.

We have invested most of that excess liquidity, so the interest income earned on these loans should definitely help offset the extra interest expense during the quarter. Third, our first CLO, which is a static deal, has been deleveraging, as loans have been paying off, making it a little bit less efficient. We expect this trend to continue as a meaningful portion of our expected prepayments are loans financed in that trust. We are looking at a variety of different options to address this issue, but it will take some time for us to implement.

Additionally, even though we ended the third quarter at 3.0 times debt-to-equity ratio, the average leverage for the quarter was about 2.7 times, somewhere around that level. To me, that illustrates that we were under levered for the quarter. We have some more room to lever up the portfolio on a more consistent basis up to that 3.0 times level, maybe a little bit higher once we are done with rationalizing our liabilities.

We are focused on investing our remaining capital and reinvesting the funds we will be getting from repayments and doing more work on our abilities to make the funding structure more efficient, and taking all those factors into consideration, once we bring our balance sheet toward a more stabilized level of leverage and assess the effect of all the other variables, we will have a discussion with our board regarding the longer-term, more sustainable level of our core profitability and reevaluate the level of the dividend against that and make any necessary adjustments in the future.

Jade Rahmani

Thanks for that. I think it is worth being realistic in considering that your current dividend implies a return of 9% on book value. Given the expense structure and G&A, that would require around 12%, 12.5% gross ROEs. Some have been commenting that achievable ROEs are more in the 11% to 11.5% range.

One thing I have asked you guys about in the past, given your track record and history in the CMBS market, is ancillary businesses, which typically conduit-type businesses generate high ROEs. Just wondering if you have any updated thoughts on that.

Jack Taylor

Hi, Jade. This is Jack. Good to speak with you. Well, I think as we have discussed in the past, we are always evaluating and open to evaluating various business opportunities that will drive extra returns, and our team really has strong capabilities to execute on a variety of investment strategies, as we have done so over many different formats over our long careers, but since going public two years ago, we have been solely focused on deploying our capital and growing the balance sheet and bringing our business to more run rate performance. We are not currently actively looking to expand the business, but we would not rule out doing so, and we would not rule out potential partnerships and/or JVs that could help us do that if that makes sense as well from both a strategic and a risk perspective. So, the answer is, nothing imminent, but not excluded.

I just want to add something to what Marcin was saying about the improving our financing for the company, and he referred to CLO market. As we have said in the past, also, we view the CLO market as very complementary and attractive way to finance our business in conjunction with the other types of borrowings we do, and we have positioned our company to be a repeat issuer in the CLO market, and we have executed two CLOs to date. As you know, both of which were really well received and supported by a broad array of institutional investors, many of them repeat investors in the second deal, and as our origination pace has picked up and we have grown our portfolio significantly this year, we have ample asset capacity to take advantage of the CLO market. We have been paying close attention to the developments in the CLO market, including what I will call the noticeably more advantageous executions available to issuers. We have been considering another securitization that would be beneficial to our balance sheet and in a way help us catch up with the new developments in the CLO market that some of our peers have been able to take advantage of, and so depending on overall market conditions, we may elect to access the CLO market over the next several months.

Jade Rahmani

Thanks very much.

Jack Taylor

Thank you.

Operator

The next question comes from Rick Shane with JP Morgan. Please go ahead.

Rick Shane

Hey, guys. Thanks for taking my questions this morning. Marcin, you talked about the average leverage during the quarter. What was the average cash balance?

Marcin Urbaszek

Hi Rick, I think if you look at the cash on the balance sheet and some of the funds that we had in our managed CLOs, I would say, was definitely north of $100 million. Our covenant requires at least $40 million. We try to keep a cushion above that, somewhere between that and $100 million. So we definitely had excess liquidity of $100 million to $150 million over the course of the quarter.

Also, what happened was, if you recall last quarter, we mentioned one of our larger loans, the Northeast office loan, that repaid actually was in the managed trust. It repaid at the end of the second quarter. We had another great large office loan slated for that to replace it, unfortunately, that loan got delayed, it was partially why we had some negative carry on that.

Rick Shane

Got it, and okay, that is helpful context, this ties into the question that Jade just asked. If we look at the dividend, the implied of the required ROE at book value today to achieve that is about 9%. That is, frankly, above where ROE has been at any point in the history of the company. You are in an environment where, at a bare minimum, base rates are working against you. In order to achieve that dividend, you either need to grow book value, widen spread, lower funding cost or substantially increase leverage. What is the best tool there? And to the point, is the dividend sustainable?

Marcin Urbaszek

Thanks, Rick, as I said earlier, there are a lot of different factors that affect it, but from the equity offering in the first quarter, I would assume we probably would have earned the dividend in Q1 of 2019. Obviously, that was diluted by our equity raise, which was strategic for us for many reasons.

Since then, a lot of things happened. I think as Jack mentioned, we have some additional earnings power potentially coming from another CLO. We have the first CLO that is becoming more and more inefficient. Releasing some of that excess capital that is stuck in that trust will definitely provide us with more efficiency. Looking at the market today it will definitely provide us with some additional earnings power. We are realistic about the market conditions and about the structure of our business. We are continuously discussing this with our Board, and once we have had the time to rationalize our liabilities, our assets, we have proven that we can produce a lot of very high-quality and well-returning assets. Once we are done addressing the liability side of the balance sheet, we will again reassess our core profitability of the business and take any actions as necessary as we discuss it with our board.

Rick Shane

Great. Thank you so much.

Operator

Again, if you have a question, please press star (*) then one (1).

The next question comes from Arren Cyganovich with Citi. Please go ahead.

Arren Cyganovich

Thanks. You have mentioned that prepayments are likely to be elevated in the fourth quarter, around $300 million. Do you think this is getting to more of what you would see as kind of a sustainable level of prepayments as your portfolio is starting to season here? And do you expect any significant prepayment income relative to those prepayments in the fourth quarter?

Steve Plust

Arren, this is Steve Plust. Thanks for the question. We said repeatedly on these calls that we think a sustainable level of prepays when the portfolio matures, will be something like a 25% rate annually, and the $300 million certainly is approaching that.

Obviously, quarter to quarter, these are lumpy assets. Quarter to quarter, the numbers are going to move around, and they are not going to be smooth and consistent, and with respect to prepayment fees, I will pass it on to Marcin.

Marcin Urbaszek

Thanks, Steve. Arren, as of right now, it is depending on which loans prepay when. There are a mix of loans that are older vintage, which are obviously out of the call protection and yield maintenance period and some newer ones, which may have that period expire over the course of the fourth quarter. It is really hard to estimate. We have obviously had prepayment income between $0 and also a million dollars quarterly. Again, depending on the time of the loans, it is really hard to say right now whether we are going to have any or not.

Arren Cyganovich

OK. And I guess with your stock now trading kind of at or slightly below book value and it does not sound like you are going to increase your leverage too much, do you think you have enough of a recycling of the portfolio that can consistently provide enough capital to fund what you have in the pipeline into next year?

Jack Taylor

Yes, we do. This is Jack. Thank you for your question, and I will say, we do have enough to cover our origination pipeline that is in hand, and we have about $200 million plus of additional growth origination capacity in excess of that, and as we noted, expect meaningfully higher prepayments in this fourth quarter, but also beyond that we should generate additional liquidity to originate new loans beyond that. So that is not for growth. That is to reinvest the capital.

We are well covered in our ability to take care of our pipeline. We have the capacity to generate, as we have just shown, about $2 billion a year out of our platform, and depending on how stable the market conditions are and what our prepayment rates will be, will depend on whether or not we are actually going to grow the portfolio, we are always very careful to make sure we have the capacity to cover what we are doing.

Arren Cyganovich

Thank you.

Operator

The next question comes from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani

Thanks. I am sorry if I missed this earlier, but the risk 4 rated loans, I think there are two last quarter and now one, could you just provide color on that?

Steve Alpart

Hey Jade. It is Steve Alpart. Thanks for the question. Thanks for joining. We are continuing to monitor that asset for Q3. We maintained the risk rating of 4, at 9/30 loan was current on its debt payment, and we do not expect to create any reserves for that loan other than what might be required under CECL. We mentioned in the past we still are believing that we are well secured on the asset. It is 100% performing, basically really no change since last quarter.

Jade Rahmani

Last quarter, were there two risk 4 rated loans? And now there is one. Well, I guess, what happened to the other loan?

Steve Alpart

Sure. As Jack mentioned earlier, during Q3, we had a multifamily asset in New York, and that loan repaid at par.

Jade Rahmani

Was that subject to rent control?

Steve Alpart

That asset had a few units in it that were subject to rent control, but as our general approach, it was a de minimis part of the business plan, and we typically do not underwrite to those types of assets, meaning rent control. If it had not paid off, we were not concerned about that one being impacted by the new laws.

Jade Rahmani

Thanks for that. I wanted to ask a broader question, again, drawing upon your experience in the industry. Everyone talked about how benign the credit cycle has been, but that is because most commercial real estate loans have 10-year maturities, and we are not yet at the doorstep of those anniversaries. Even though there has been a lot of refinancings, about 50% of defaults in the commercial real estate business are due to maturity loan default.

Just looking away from GPMT's portfolio, but for the industry overall, are you expecting a pickup in loan defaults next year, as we come upon the anniversary of the 2010 originations?

Steve Plust

Hey, Jade. Good morning, this is Steve Plust. It is really hard to say because from our experience, unless you got a macro cycle going against you, most defaults are really episodic and what I would say, call it, idiosyncratic and specific to a particular business plan or a particular market. For sure, I would imagine there were some snafus made in originations 10 years ago, but I do not see global macro, local or global macro conditions getting in the way of refinancings right now.

Jade Rahmani

And in terms of your own internal asset management process, what is the level of frequency of dialogue with borrowers?

Steve Plust

It is pretty high given the nature of the assets. We are doing a lot of future fundings. There is business plans that require our participation as a result, where, I would not call it constant, but very frequent dialogue with sponsors about the state of what is going on, reviewing leasing activity reports, reviewing CapEx plans, and annual budget review. We are in fairly continuous dialogue with our sponsors on these business plans.

Jade Rahmani

Thanks very much.

Steve Plust

My pleasure.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Jack Taylor for any closing remarks.

CONCLUSION

Jack Taylor

Well, thank you, operator, I would like to thank everyone for joining us today and for taking the time and for your support of our business and we look forward to speaking with you all again soon. Thank you.

Operator

The conference has now been concluded. Thank you for attending today's presentation. You may now disconnect.