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TWO - Q1 2015 Two Harbors Investment Corp Earnings Call

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**Mark DeVries** *Barclays Capital - Analyst*

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**Ken Bruce** *BofA Merrill Lynch - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Two Harbors Investment Corp. first-quarter 2015 financial results conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference call, July Hugen, Director of Investor Relations. Ma'am, you may now begin.

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### July Hugen - *Two Harbors Investment Corporation - Director of IR*

Thank you, and good morning. Welcome to our first-quarter 2015 financial results conference call. With me this morning are Tom Siering, President and Chief Executive Officer; Brad Farrell, Chief Financial Officer; and Bill Roth, Chief Investment Officer.

After my introductory comments, Tom will provide a recap of our first-quarter 2015 results, Brad will highlight some key items from our financials, and Bill will review our portfolio performance and operational businesses. The press release and financial tables associated with today's conference call were filed yesterday with the SEC. If you do not have a copy you may find them on our website and the SEC's website. This call is being broadcast live over the Internet and may be accessed on our website in the Investor Relations section under the Events and Presentations link. We encourage you to reference the accompanying presentation to this call, which can also be found on our website.

Reconciliation of non-GAAP financial measures to GAAP can also be found in the presentation. We wish to remind you that remarks made by management during this conference call, and the supporting slide presentation, 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, target, expect, estimate, believe, assume, project, and should, or other similar 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 [www.sec.gov](http://www.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 Tom.

**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Thank you, July. Good morning, and thank you to everyone for joining the call today.

Beginning on slide 3, I will briefly review our financial results. Our book value, at March 31, was \$11.08 per share, representing a total quarterly return on book value of 2.2%, when combined with the first-quarter dividend of \$0.26 per share. During the quarter, we delivered comprehensive income of \$88.9 million, or \$0.24 per weighted-average share, and core and GAAP earnings of \$0.26 per weighted-average share, respectively. This performance exemplifies our long-term commitment to book value preservation and growth, especially with regard to diversification, asset selection, and risk management.

The highlight of the first quarter was the success of our conduit business, which is an important and developing franchise value for our stockholders over the long term. We closed two transactions totaling approximately \$575 million UPB and our pipeline remains robust. We continue to target long-term flow MSR partners, particularly where we can leverage our conduit relationships. Our goal is to work in tandem with our seller partners to develop a full suite of products that addresses voids within the market.

While relatively immaterial to our portfolio, we made an initial investment in commercial real estate during the first quarter. As previously mentioned, we intend to allocate \$500 million in equity capital to this initiative. And, we expect to deploy the remainder of this in the latter half of 2015 and into 2016. We have also been developing the infrastructure and team to support this strategy. We view commercial real estate as an attractive opportunity for our stockholders. My last comment on the portfolio is that our Agency and non-Agency assets continued to perform within our expansions during the quarter.

Please turn to slide 4. On the economic front, the March jobs report disappointed the market. And, the Fed continued to make dovish commentary about when and if they will raise rates. However, the market generally expects that a modest increase in rates is likely sometime in 2015. According to the CME group, there is roughly a 60% probability that the Fed will raise rates by at least 25 basis points by December, with an expected value of 35 basis points.

While over the past few years macroeconomic conditions in the US appear to be improving, the global backdrop has been less certain, leading to elevated interest rate volatility. This has been particularly true during the second quarter. National home prices increased 5.9% on a rolling 12-month basis in March, according to CoreLogic. We expect housing price appreciation to continue in 2015, albeit at a softer pace than the last few years.

Unemployment metrics have improved year over year, following the 5.5% in March 2015 from 6.6% in March 2014, despite recent disappointments. From a policy perspective, we continue to engage with parties in Washington on regulatory and policy-related topics that directly impact our business, including the private-label securities market, servicing standards, GSE risk sharing, and housing finance reform.

We have not heard anything further from the FHFA, after submitting our response letter with respect to the proposed rulemaking regarding Federal Home Loan Bank membership. We understand that many letters were submitted, so the process could take some time. As most of you are aware, the FHLB admission window has reopened, and several mortgage REITs have recently been approved for membership. Importantly, we believe our interests align directly with the mission of the Home Loan Bank system, and our secured financings are consistent with their safety and soundness mantra.

For illustration, this financing enables us to provide stable and consistent pricing to the mortgage market, which is helpful to homeowners. We are members in good standing with the Home Loan Des Moines, as underscored by the recent increase in our facility to \$4 billion, up from \$2.5 billion.

With that, I will hand it to Brad to comment on our financial results.

**Brad Farrell** - *Two Harbors Investment Corporation - CFO*

Thank you, Tom, and good morning, everyone. Please turn to slide 5. Book value was \$11.08 per share at March 31, versus \$11.10 as of December 31. Comprehensive income was \$88.9 million, or \$0.24 per weighted share, in the first quarter. Comprehensive income was primarily driven by the net carry on our available-for-sale securities, held-for-sale loans, and retained interest on our securitizations. I would note that, during the quarter, we realized gains of \$117.5 million on the sale of primarily non-Agency RMBS. The Company declared dividends of \$95.3 million, or \$0.26 per share, in the first quarter.

Please turn to slide 6 for a summary of our financial results. Core earnings of \$0.26 per weighted share were in line with our expectations, and represented an annualized return on average equity of 9.2%. Core earnings increased quarter over quarter, and I would like to detail a few of the larger drivers of the variance. The most significant driver was lower swap expense, as a result of the repositioning of our overall hedges, which included a reduction in our swap notional in December.

While we modestly increased leverage on our Agency and non-Agency portfolios, resulting in higher interest income, our implied debt-to-equity ratio actually decreased, quarter over quarter, due to increased short TBA position. Offsetting these tailwinds was a slight uptick in our operating expense ratio to 1.6%. Looking forward, I would note that we increased our notional swap position, in March, to protect against higher rates, which will drive higher interest spread costs in future periods. We also continue to expect an increase in our other operating expense ratio, as we deploy capital into the commercial real estate strategy.

I would like to spend a brief moment on an accounting topic. Let's discuss the accounting treatment of our commercial real estate investments. For the majority of our assets, we use fair value accounting, as we believe this is the truest reflection of our portfolio performance and dividend power. That being said, we anticipate commercial real estate debt will deviate from this, as their bespoke structures do not lend themselves to fair value measurement. These investments will be accounted for at amortized cost and tested for impairment on a quarterly basis.

Please turn to slide 7 for an overview of our financing profile. I would like to highlight a couple of things on this page, which includes our typical financing disclosure. Our FHLB capacity was expanded to \$4 billion in late February, and we drew down \$125 million of the added capacity in the quarter. Subsequent to quarter end, we drew down another \$125 million, leaving \$1.25 billion of available capacity.

The FHLB facility is a valuable financing tool, that, among other things, affords our conduit business a stable and dynamic funding source at attractive rates and a variety of maturities, and provides us greater flexibility when responding to repo market shifts. While disruptions in the repo market have been reported in the media lately, due to the shortage of quality collateral in the market -- specifically, US treasuries and balance sheet constraints at the banks -- our repo continues to function normally, with no meaningful shifts in financing haircuts or rates. For more information on our repurchase agreements and FHLB financing, please see the Appendix, slide 22.

With that, I will turn the call over to Bill.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Thank you, Brad, and good morning, everyone. The markets in the first quarter were quite volatile. After a sharp rally in January, rates retraced dramatically before moving lower again in March. These lower first-quarter rates were due to a number of factors, including somewhat dovish commentary from the Fed on the timing and pace of future rate hikes.

That said, we believe we could be at an inflection point, with the potential for more volatility and higher rates, and are positioned accordingly. From a performance perspective, we essentially earned our carry this quarter, with the slight drop in book value due to a modest underperformance of -- in pay ups for specified pools. As we have discussed before, we continue to maintain a generally conservative risk profile and are focusing much of our time on our operational businesses, which I will talk about in more detail shortly.

Please turn to slide 8 for a portfolio update. As of March 31, the portfolio was \$16.3 billion in assets, including \$12.2 billion in the Rates strategy, representing 55% of capital, and \$4.1 billion, or 45% of capital, in the credit strategy. Additionally, we closed on a \$46-million commercial real estate loan for our first investment into the sector.

With respect to the Rates strategy, we added some specified pools, increasing our leverage slightly, while improving our convexity profile. In general, our basis risk exposure and leverage remain relatively low. In the credit strategy, we continued to sell certain legacy non-Agency bonds that we believe were fully valued. More importantly, we added assets that we created from two Agate Bay securitizations, including subordinate and IO bonds, as well as some AAAs. Finally, we added modestly to our GSE risk-sharing holdings.

As we have discussed before, capital allocation in our portfolio has been shifting towards our operational businesses, with over 20% dedicated to retained interest from securitizations, the loan pipeline, and MSR at quarter end. Capital to the conduit, at 11%, has increased greatly from virtually zero at December 31 of 2013 and 9% at year end.

Please turn to slide 9 for a review of our portfolio performance and yields. As you can see on the bottom right, our annualized net interest spread for the quarter was 3.07%, up 16 basis points quarter over quarter. This was due largely to lower swap expense, as Brad mentioned, as well as a 70-basis-point increase in MSR yield. As usual, I would note that future MSR yields will be driven by prepayment activity. For more details on our rates and credit strategies, please refer to the Appendix, slides 17 through 21.

With respect to risk management, our hedging profile has not changed dramatically from what was detailed on our fourth-quarter earnings call and on our Analyst and Investor Day in March. You may recall that we had eliminated several billion swaps in December, so our average swap position was lower during the first quarter. But we added swaps in March, taking our total notional payers up by \$1.1 billion from year end. We are positioned for the Fed to move interest rates higher on a measured basis, while maintaining optional protection, should a dramatic change in rates occur. See slides 23 and 24 in the Appendix, for more information on our hedges.

Please turn to slide 10, where I would like to spend some time talking about the conduit. We completed two securitizations during the quarter. These generated approximately \$45 million in subordinate and IO bonds for our portfolio, at ROEs in the low-double digits. While marketing Agate Bay 2015-1, interest rates fell and spreads on AAAs widened dramatically. While we did sell some AAAs from this deal, we retained the majority of them, as the expected ROE was attractive using FHLB financing.

As noted in the past, we have the flexibility to finance the AAA bonds with the FHLB if marketing conditions prove difficult, which was the case for this deal. On the other hand, Agate Bay 2015-2 came to market at a time when AAA spreads had tightened back to more normal levels and we sold all of the senior bonds. Importantly, as we bring more deals to market, we have seen broader investor interest, which is evidenced by the increasing number of investors purchasing bonds. We believe this results from becoming a consistent issuer and having developed some brand recognition. Our total net economic interest in securitization trusts, by market value, increased to \$770 million at March 31.

Subsequent to quarter end, we completed Agate Bay 2015-3, selling all of the AAA bonds and retaining the credit and IO bonds. Once again, we saw broad investor participation. Our prime jumbo pipeline, which includes loans and interest rate lock commitments, remains robust, and was approximately \$1.2 billion at March 31. The strength of our pipeline supports our goal to be a regular and consistent issuer. We are committed to growing our conduit business by expanding our high-quality network of sellers for both prime jumbo loans as well as a variety of products over time.

We remain on track to have 45 to 50 sellers in place by year end. We continue to work on an Expanded Credit program that would reach additional borrowers, particularly those ineligible for our standard prime jumbo program and those unable to get a mortgage, due to the tight credit standards that exist in the market today. We believe this expansion of credit can benefit the housing market, and while we continue to project slow volume growth in the near term, we believe this program could become meaningful to Two Harbors over time.

Please turn to slide 11. With respect to MSR, current market dynamics have changed over the last several months, and both flow and bulk MSR opportunities have become more attractive. Given this, it remains a top priority for us to add flow-sellers during the course of this year. We also

continue to evaluate bulk MSR deals as they become available. MSR remains an excellent asset for Two Harbors and we are focused on growing it as a core holding in our Rates strategy.

Another significant accomplishment was our initial investment in commercial real estate late in the quarter. Specifically, this is a \$46 million senior floating rate mezzanine loan on a diversified portfolio of hotel assets. We expect the ROE to be in our targeted range of low- to mid-double digits, using a small amount of leverage. More importantly, the personnel and infrastructure requirements necessary to fully ramp the program are close to being built out, and we are excited about the potential long-term opportunities commercial real estate offers our stockholders.

In closing, we are pleased with the continued growth of our operational businesses, as they have the potential to drive stockholder returns and the creation of franchise value over the long term.

I will now turn the call back to Marcus to assist us in taking any questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Doug Harter, Credit Suisse.

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### Sam Cho - Credit Suisse - Analyst

Hi, this is actually Sam Cho filling in for Doug Harter. I was wondering if you could expand on the attractiveness of the MSR opportunity and you see that persisting during the year?

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### Bill Roth - Two Harbors Investment Corporation - Chief Investment Officer

Yes, hello, good morning. This is Bill. Thanks for joining us today. Yes, so, on the MSR side a couple things are worth noting.

First of all, the potential supply this year appears to be higher. There's been some increased selling activity and comments about selling throughout the year. So the supply side looks fairly fulsome.

At the same time the competitive landscape that we see on the buy side has reduced somewhat. So, basically we've seen MSR cheapen out a little bit and making it more attractive. And, at the same time there's less competition for -- in certain situations.

So, when you put those two together, we think it's definitely a good time to focus on adding some flow sale partners, as well as taking a closer look at bulk deals when those come to market.

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### Sam Cho - Credit Suisse - Analyst

Got it. My second question was, I mean, the shares are trading below book, and I was wondering if you had any thoughts on, maybe, implementing a share repurchase plan during the year?



**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Sure, this is Tom. Obviously, with respect to share buyback, we view it as we would any investment opportunity. We view it versus other alternatives.

Obviously, we have bought back stock in the past. We did not during this quarter, but it's something that we constantly review.

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**Sam Cho** - *Credit Suisse - Analyst*

Got it. Thank you so much.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Thank you.

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**Operator**

Mark DeVries, Barclays.

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**Mark DeVries** - *Barclays Capital - Analyst*

Yes, thanks. Just a follow-up on the MSR opportunity. Bill, what kind of ROEs do you think you can get in the current environment, kind of, inclusive of the savings you get from reduced hedging costs?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, hello, Mark, good morning and thanks for joining us. Yes, so, MSR new -- prime new issue MSR, we see on its own, sort of, in the high single digits, which is out 100 to 200 basis points. And so, additionally on a hedge basis, it takes it into the low double digits.

But, in addition to that, instead of using swaps or other hedging activity that we would use, the MSR combination is a much lower basis risk position, so we view that as a higher quality ROE, as we've talked about before.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Yes, especially in the current interest rate environment where we have a lot of volatility. It's particularly beneficial in the overall risk mitigation strategy.

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**Mark DeVries** - *Barclays Capital - Analyst*

Okay, and I think you alluded to the fact that you are, kind of, bracing for greater volatility. Are you referring to, mainly, volatility in the rates market? Or, are you also concerned about the basis as we head towards what should be the eventual Fed tightening cycle and the additional withdraw of the reinvestment of principal by the Fed?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, sure. So, the thing is -- so first -- to answer the first part of your question, yes. The rate -- we think that as we get into this rec -- uncharted territory at least. And, the Fed hasn't raised rates in 10 years. We haven't seen that for a long time. And so, if you look back historically, typically you get increased rate volatility and you can get increased spread volatility.

So, it's our view and we've -- I've probably been a little -- we were -- probably been a little bit early on this last year by keeping a conservative position. But, we definitely think that you could see both dynamics take place, which is why we've kept our rate exposure and our basis exposure in a conservative position.

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**Mark DeVries** - *Barclays Capital - Analyst*

Do you think that spread volatility could get exacerbated by the tapering that goes on as well?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, I mean, look, mortgages, if you look at them on a spread or an OAS basis over a long period of time, like many other asset classes, they're at the tighter end. So, it's certainly possible. It, kind of, depends on whether the -- what the Fed does in their reinvestment, or how much delta hedging you need to see.

Now, given that, the Fed is not in delta hedging, that obviously reduces the need for re-hedging. But, last time we saw, during the taper tantrum a few years ago, there was a lot of spread volatility. So, I mean, certainly could happen again.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Yes, Mark, I mean, without a doubt, right? There's correlation between interest rate volatility and it's -- and spread volatility, historically. And, that's why, if you look at our overall risk profile, our spread duration is very low. Our leverage is very low. We're very fully hedged on interest rates. And so, we think we're well positioned for a variety of Fed scenarios.

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**Mark DeVries** - *Barclays Capital - Analyst*

Okay. Great. Thank you

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Thank you, Mark.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Thank you.

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**Operator**

Trevor Cranston, JMP Securities.





**Trevor Cranston** - *JMP Securities - Analyst*

Hello, thanks. I guess, first question, now that you guys have done several securitizations off your own shelf, can you, maybe, just give us some color and talk about any changes you've seen and trends in the execution on your deals? In terms of subordination and, kind of, how that's improved over time as you've become a more regular issuer?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, hello, good morning, Trevor.

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**Trevor Cranston** - *JMP Securities - Analyst*

Morning.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Thanks for joining us. Yes, well, I would say there's a couple parts to that. And so, there's probably a few different points to address.

So, the first thing is, we've done -- in the last couple years we did three Agate Bay deals last year. We had one in the prior year. And, we've done three so far this year in just the first four months.

So, I think there's a couple -- so, first, I think we're seeing some good -- we've developed somewhat of a brand. Our investor base has expanded greatly. We've obviously been out telling the story and meeting with folks and that helps as people gain better understanding of what we're doing.

Additionally, as you're a buyer of securities, you want to feel like there's some liquidity. And so, to the extent that you're a regular issue, people feel that there's better liquidity.

So, we have seen our spreads very consistent with where the better names in the AAA space trade. And so, from that standpoint, we feel like our execution on the AAAs has -- is as good as is in the market.

In terms of credit enhancement. A few years ago, credit enhancement on some of these deals was, like, 8% or so. And, we started to see that come down. Not only across the sector, but on our most recent deal, Agate Bay 2015-3, our credit enhancement to AAA was 5.35%.

The earlier deals in the year were 6.65% and 6.05%. So, clearly the trend is good and I think that reflects the quality of the collateral that we're putting out there and the recognition of that. And so, despite the lower credit enhancement, we still have had very broad investor participation and interest.

So, we're very pleased that the CE has come down. Obviously, there's a limit to that, but at least it feels like it's much more in the range that's appropriate, as opposed to what it was a few years ago.

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**Trevor Cranston** - *JMP Securities - Analyst*

Got it. That's helpful color. And then, on slide 9, I noticed that there was a new bucket there in the Rates category for Ginnie Mae buyouts. I assume that's pretty small, but can you, maybe, talk a little bit about what the strategy is there?



**Brad Farrell** - *Two Harbors Investment Corporation - CFO*

Yes, thank you for the question. So, over the -- as we own Ginnie Mae MSR pools, and own that economic responsibility, we have an obligation to buy out loans when they are in the process or about to be modified. So typically, the process: you buy the loans from the pool. They undergo some form of modification, and then, based on their performance, can be re-delivered to new Ginnie Mae pools.

So, it's largely an operational process that we undergo as owners of the MSR. And, those loans come on our balance sheet. We work with them. And then, the ultimate goal is to have them be re-performing and be re-delivered to pools.

The amounts are really small. But, they've grown enough that we wanted to make sure that they were distinct against credit sensitive loans, or, quote, re-performing loans, which was a strategy we, obviously, were doing in the past couple years. And so, that's why the separate break out and that's why they're included in the Rate strategy.

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**Trevor Cranston** - *JMP Securities - Analyst*

Okay. Got it. Thanks, guys.

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**Operator**

Eric Beardsley, Goldman Sachs.

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**Eric Beardsley** - *Goldman Sachs - Analyst*

Hi, thank you and good morning. Just a quick question on your non-prime plans. I guess, when will we expect to see something out there in the market?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Hello, good morning, Eric. Let me just clarify your question. When you say, in the market, are you talking about a securitization? Or, are you --?

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**Eric Beardsley** - *Goldman Sachs - Analyst*

I guess, just in terms of a product and when you think you might have some loans on your book?

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Well, we've already been taking, as we said in the past, we've been taking it some higher LTV loans. Now, that is relatively light volume, given the nature of the borrower. And, our hope would be that we would start to see something on the lower credit quality sometime later this year. But, it's too hard to predict exact timing on that.

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**Eric Beardsley** - *Goldman Sachs - Analyst*

Got it. And, just on the commercial real estate. You'd mentioned that you put modest leverage on the mezz loan that you did. Just curious, in terms of, I guess, where you have the financing costs today? And, what the optimal leverage on that might be?

**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, sure on the commercial real estate. So basically, you use one turn of leverage on that. And, the financing -- if the financing was, sort of, sub-200 over LIBOR. Without getting too granular on that.

But, we think that's appropriate for a conservative mezzanine loan. And so, as I mentioned on the call -- in my comments. We see that as sort of a low- to mid-double digits ROE. We have floating rate asset; floating rate financing.

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**Eric Beardsley** - *Goldman Sachs - Analyst*

Got it. And then just lastly, I don't know if you could just remind us where you see your spread duration today? You'd mentioned that you were keeping a lower prof -- from certainly, a lower profile with the MSR book.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, I think as you -- I think some folks publish an actuals -- duration number when -- with regard to rates, we're pretty fully hedged. If you look at our sensitivities to rate changes, they're extremely low. I mean, they've always been low, but today they're really extremely low.

And then, on spread duration, not much has changed from -- on the asset side from our Analyst/Investor Day in March where we talked about having mostly high coupons, which are short duration, HECMs, which are sport -- short duration, et cetera.

So, if you look in the appendix at our holdings, you'll see that between the low leverage, and effectively, the shorter average life bonds, spreads widened. Obviously, that's going to impact the valuations, but not as much as if you had the more current coupons.

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**Eric Beardsley** - *Goldman Sachs - Analyst*

Got it. Great. Thank you.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Thank you.

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**Operator**

Ken Bruce, Bank of America.

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**Ken Bruce** - *BofA Merrill Lynch - Analyst*

Great. Thank you. Good morning, gentlemen. The allocation of capital into the rates in credit strategies has been relatively consistent over the last several quarters. I'm just wondering if you see that changing as volatility and rates increases here, going forward? Or, how we should be thinking about that overall capital allocation going forward?

It's obviously 55%, and the Rates strategy's still high by itself. And, given the leverage there, it has a pretty big balance sheet impact. So, do you see that changing at all?



**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Yes, hello Ken, thanks for joining us. This is Bill. I'd say, first, a couple things. First of all, within the Rates strategy. Keep in mind, that MSR, say, most of 2013 and into early part of last year, was zero, and that's now about 10%. So, of the 55%, the Agency pools, et cetera, have actually gone down quite a bit from up in the high-50% into the mid-40%.

So, additionally, as I mentioned on the conduit, assets created by the conduit, have gone from zero to 11%. So, those are our retained interests as well as loans in pipeline.

So, if you think about, I mentioned that, between MSR and assets we create in a conduit have gone from effectively zero to 20%. Or, actually over 20%, into the low-20%. And, we think that trend's going to continue.

So as we do more securitizations, you're going to see that increase on the credit side. And, as we add more MSR, you're going to see that increase as a percentage of the rate strategy.

And then finally, we -- commercial real estate, we've committed \$500 million of equity capital, which is about 12.5%. And, that's currently -- it's not zero, but it's pretty darn close to zero. Because, we just have one loan and that's going to, obviously, go up a lot.

So, I think if you look forward, say, in the next year or two, you're going to see the securitization interests go up. You're going to see MSR go up. You're going to see commercial real estate go up. And, you're going to see Agency pools and legacy credit bonds go down.

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**Ken Bruce** - *BofA Merrill Lynch - Analyst*

You were -- good, that's actually very helpful. Is there -- is it, maybe, have you given any consideration to, maybe, refining the way that you, basically, present that information? I mean, when you look at Two Harbors, it gets lumped in with a lot of different types of mortgage REITs. And, yours is quite different and unique in a lot of different ways.

And frankly, should comp against those that are trading in much higher multiples. And, it seems to, kind of, get thrown into the basket with the more Agency-oriented ones. And, anything that would help to, maybe, separate you from the pack might actually be helpful from that perspective. I guess, as a comment.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Yes, this is Tom. Thanks for the question. It's a very good one. Well, obviously we always want to do anything that is beneficial to our shareholders. So, if you have thoughts on presentation, we'd be delighted to talk about those. But, we do appreciate your comments. And, our business is quite different from other business models within the mortgage REIT space, but, we're always eager for input from our valued analysts.

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**Ken Bruce** - *BofA Merrill Lynch - Analyst*

And then, maybe, my last question is, just, you've had a lot of success in the operational businesses. And, we've talked in the past about, that's a very different indefinite. You can't move in and out of it as quickly. You've got dedicated property, plant, equipment, resources, and the like, that are part of that.

Do you really envision this, really, turning into almost an operational company? Or, do you always feel like it's going to have a heavy emphasis on the investment aspects and operational -- it's just manufacturing for the end investments you're looking to retain?



**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Yes, it's a great question. Obviously, we have a few gating factors, right? The whole pool test is a gating factor for us. Which historically, has needed to be fulfilled within the Agency space.

But, I would say this, that we want to be able to do a number of things within the mortgage space. And, our messaging today is very consistent with our messaging in the past.

Which are, that our new initiatives of securitization MSR and commercial real estate are the most attractive use for dollars today. And obviously, that's where we're dedicating money and resources and thought. And so, as we've said that in the past, we want to operate within whatever space we feel delivers the highest quality ROE to our shareholders.

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**Brad Farrell** - *Two Harbors Investment Corporation - CFO*

I would offer one thing, specifically as you address the operational and, kind of, the size of the infrastructure. We don't touch the borrower. So, we do not -- we obviously use sub-servicers and we use, obviously, originators, facing the borrower for origination.

So, really, where we've grown our operational capability is really in oversight and credit quality and control. So, we're -- our -- if you think about our overhead, our quote, middle-office operations, is really to, kind of, add value to the investment. To understand the investments and to help generate that ROE that we project.

So, it's a different form of operational. But, it adds value in how we're approaching the capital piece of the investment.

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**Ken Bruce** - *BofA Merrill Lynch - Analyst*

Great. Well, thank you for your comments and congrats on a very successful quarter.

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**Bill Roth** - *Two Harbors Investment Corporation - Chief Investment Officer*

Thank you.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Thanks very much, Ken.

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**Operator**

This concludes our question-and-answer session. I would now like to turn the conference over to Mr. Siering for closing comments.

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**Tom Siering** - *Two Harbors Investment Corporation - President & CEO*

Thank you, Marcus, and thank you for joining our earnings call today. We will be attending the KBW mortgage finance conference on June 2 in New York, and would welcome the opportunity to speak with you at this event.

Have a wonderful day. Thank you.



**Operator**

Ladies and gentlemen, thank you for attending today's conference. This does conclude today's program. You may now disconnect. Have a wonderful day.

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