Granite Point Mortgage Trust Inc.

Q4 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jack Taylor – *President and Chief Executive Officer*

Steve Alpart – *Chief Investment Officer and Co-Head of Originations*

Peter Morral – *Chief Development Officer and Co-Head of Originations*

Steve Plust – *Chief Operating Officer*

Marcin Urbaszek – *Chief Financial Officer*

Chris Petta – *Investor Relations*

PRESENTATION

Operator
Good morning. My name is Matt, and I will be your conference facilitator. At this time, I would like to welcome everyone to Granite Point Mortgage Trust's fourth quarter and full year 2021 financial results conference call. All participants will be in a listen only mode. After the speakers' remarks, there will be a question-and-answer period. Please note, today's call is being recorded.

I would now like to 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 fourth quarter and full year 2021 financial results. With me on the call this morning are Jack Taylor, President and Chief Executive Officer; Marcin Urbaszek, our Chief Financial Officer; Steve Alpart, our Chief Investment Officer and Co-Head of Originations; Peter Morral, our Chief Development Officer and Co-Head of Originations; and Steve Plust, our Chief Operating Officer.

After my introductory comments, Jack will review our current business activities and provide a brief recap of market conditions. Steve Alpart will discuss our portfolio, and Marcin will highlight key items from our financial results.

The press release and financial tables associated with today's call were filed yesterday with the SEC and are available in the Investor Relations section of our website along with our Form 10-K, which was just filed this morning. I would like to remind you that remarks made by management during this call and the supporting slides may include forward looking statements, which are uncertain and outside of the company's control. Forward looking statements reflect our views regarding future events and are subject to uncertainties that could cause actual results to differ materially from expectations. Please see our filings with the SEC for a discussion of some of our risks that could affect results. We do not undertake any obligations to update any forward-looking statements.

We also refer to certain non-GAAP measures on this call. This information is not intended to be considered in isolation or as substitute for the financial information presented in accordance with GAAP. A reconciliation of these non-GAAP financial measures to the most comparable GAAP measures can be found in our earnings release and slides, which are now available on our website.

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 to our fourth quarter and full year 2021 earnings call.

Granite Point had a very successful 2021 across our business led by the strong performance of our well diversified, resilient, and growing investment portfolio, which continues to deliver solid earnings supporting our attractive dividend. We have been active in strengthening our balance sheet by adding over $1.5 billion of term match and non-mark-to-market financing, expanding our permanent capital base to over $1 billion by issuing perpetual preferred equity, and meaningfully reducing secured higher-cost corporate debt. These actions combined with our growing pipeline of attractive new loan investments will continue to position the company for a successful 2022.

While actively managing our portfolio and growing our pipeline of new loans, we have also further expanded our non-recourse and non-mark-to-market financings to over 75% of our total borrowings by issuing two commercial real estate CLOs during 2021, which financed over $1.4 billion of our loans on attractive terms. We expect to remain an opportunistic issuer in this market, as it is a compelling source of financing for our portfolio and an important component of our well-diversified funding mix.

In addition to further strengthening the profile of our liabilities, over the last few months, we also repaid $125 million of our higher-cost secured corporate debt and expanded our permanent equity base by issuing over $200 million of attractively priced preferred stock, inclusive of the recent $90 million add-on offering. This positive shift in our capital structure creates more flexibility by improving our interest coverage, while providing us with permanent and leverageable equity capital to support accretive growth of our investment portfolio. As an internally managed company, it also allows us to realize operating leverage benefits by lowering our expense ratio, which improves overall profitability as we grow our business.

Despite operating at a lower than historical leverage level, our run rate earnings comfortably covered our dividend in 2021. As short-term rates have remained low, our earnings have benefited from the LIBOR floors in our loans. But if as projected short-term interest rates increase over the course of 2022, depending on the pace and magnitude of those increases, our net interest income would in isolation be reduced. However, our company has substantial opportunities embedded in our balance sheet to further reduce debt cost, release incremental capital, and grow our portfolio. The refinancing and repayment to the remaining $100 million of higher-cost term-loan borrowings would reduce interest expense. Resolution of the two remaining non-accrual loans would release additional capital, which could be redeployed into earning assets. Also, some of our legacy funding vehicles has significantly delevered through loan repayments. Refinancing those facilities could also release capital, which could support further portfolio growth and lower our funding costs. We expect these initiatives to help return our liquidity and leverage to more normalized levels. Finally, as we originate new loans and grow our portfolio, our portfolio weighted average LIBOR floor should decline and increase the correlation of our earnings with rising interest rates.

We have already begun implementing some of these activities, the full benefit of which have not yet been reflected in our financial results. We are very pleased with the progress we have made and are excited to advance and execute on our opportunities over the course of 2022. One of the main factors driving our overall results is the strong credit performance of our portfolio throughout the pandemic, which reflects a credit culture of our highly talented and experienced team, as well as our ability to directly originate a significant volume of attractive senior loan investments. We remain focused on further repositioning our balance sheet by taking advantage of market opportunities to realize economies of scale and improve our profitability. Our company is well positioned to execute on our strategic priorities, which we believe should meaningfully accrue to the benefits of our stockholders over the course of 2022 and beyond.

I would now like to turn the call over to Steve Alpart to discuss our originations, forward pipeline, and portfolio.

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

During 2021, we funded over $820 million of loan balances, including over $268 million in the fourth quarter and are off to a strong start this year. We continue to see an ample volume of attractive investment opportunities with the current pipeline of approximately $285 million of commitments, which we expect to grow as we invest new capital and redeploy proceeds from loan repayments.

We had an active fourth quarter of originations, closing seven new loans totaling about $250 million in commitments and over $220 million of initial fundings. We also funded $40 million on existing commitments and $8 million in loan upsizings, bringing total fundings to over $268 million. We continue to source a significant volume of loans collateralized by properties with favorable fundamentals, with over 65% of our Q4 originations secured by multifamily assets and the balance split between industrial, well leased office, and mixed-use. The newly originated loans carry attractive risk-adjusted return characteristics, with a weighted average yield of LIBOR + 3.60% and a weighted average stabilized LTV of approximately 67%. The transitional property lending market remains very active, which allows us to be highly selective and pick the most attractive loans for our portfolio.

We realized about $145 million of loan repayments in the fourth quarter across various property types. The repayments were more than offset by our loan fundings, which resulted in net portfolio growth of roughly $125 million quarter-over-quarter to about $3.8 billion. Our 2021 repayments of over $950 million represent our typical expected pace of about 25% of our portfolio balance on an annual basis. We currently estimate full year 2022 repayment of about $1 billion, so the volume will vary across quarters as the timing of repayment is subject to market and typical loan closing conditions.

Our portfolio has an aggregate committed balance of $4.2 billion, spread across 105 loans with an average balance of about $36 million and about $400 million of future funding commitments. Our loans continue to deliver an attractive income stream and strong overall credit profile, generating a realized yield of about 5% with a weighted average stabilized LTV of 63%. Our fourth quarter weighted average portfolio risk-rating of 2.6 was unchanged compared to the prior quarter, illustrative of the generally stable credit conditions in our portfolio and progress in our borrower’s business plans. One office loan was downgraded to a risk rating of 4 during the quarter, as the property’s operating performance continues to be impacted by ongoing softness in the local leasing market.

As mentioned earlier, we currently have a pipeline of attractive investments with about $285 million of total commitments and $250 million of initial fundings. So far in the first quarter, we have funded over $80 million of loan principal, including approximately $22 million on prior commitments, and realized about $38 million of repayments. Over 60% of the loans in our current pipeline are secured by industrial and multifamily properties with the balance in well-leased office and other assets.

In summary, we continue to source an abundant flow of attractive investments that meet our credit and return criteria. As we execute on our strategy of optimizing our balance sheet, we plan to grow our portfolio over the course of the year.

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

Marcin Urbaszek
Thank you, Steve. Good morning, everyone, and thank you for joining us today.

Yesterday afternoon, we reported our fourth quarter GAAP net income of $6.7 million or $0.13 per share, as compared to $18.6 million or $0.34 per share in Q3. Our Q4 GAAP earnings include $5 million or $0.09 per share of CECL reserve release, and a charge on early extinguishment of debt of $8.9 million or $0.17 per share, which is related to the $75 million partial repayment of our term-loan, which was disclosed in our business update in December. Distributable earnings for the fourth quarter were $12.7 million or $0.24 per share versus $5.1 million or $0.09 per share in Q3. Our Q4 earnings don't include the full benefit of the partial term-loan repayment as it took place on December 9. Our fourth quarter book value decreased to $16.70 per share from $17.33 per share in Q3. The decrease was mainly driven by the previously disclosed settlement of the remaining warrants in October, which accounted for $0.46 per share. Our book value also includes an allowance for credit losses of about $0.79 per share.

For full year 2021, we reported GAAP net income of $67.6 million or $1.24 per basic share, which includes about $20 million or $0.37 per share benefit from the release of our CECL reserves. Our 2021 earnings reflect the ongoing benefits from the LIBOR floors in our loans. Our short-term rates have remained low with our Q4 portfolio weighted average flow rate of 117 basis points, which meaningfully declined from about 156 basis points a year ago. The weighted average floor is expected to further decrease as we originate new loans and the legacy loans with higher floors continue to repay, which would improve our portfolio's correlation to rising short-term rates. Any impact on net interest income from higher rates will depend on a variety of factors, such as the timing and magnitude of rate increases and the pace and timing of loan repayments and new loan originations. However, reducing higher-cost borrowings, redeploying capital from non-accrual loans into earning assets, and releasing incremental growth capital through refinancing certain of our inefficient legacy funding facilities could help us manage the impact from rising short-term rates.

Turning to our CECL reserves, our Q4 allowance declined by about $5 million to $42.4 million. The benefit was largely driven by loan repayments and the continued improvement in the overall performance of our portfolio, which was partially offset by the establishment of reserves for newly originated loans. Our total allowance represents about 101 basis points of our total loan commitments. About $22 million of our allowance is allocated to our two remaining non-accrual loans.

We ended the quarter with about $190 million in cash and as of February 23rd we had $149 million in cash and about $62 million of unencumbered whole loans, which can be financed with our facilities subject to lender approval. Our total debt-to-equity ratio at December 31 declined to 2.7x from 3.0x in the prior quarter, driven by our attractively priced preferred equity offering and the partial repayment of the term-loan.

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

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press (*) then (1) on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed, and you would like to withdraw your question, please press (*) then (2). At this time, we will pause momentarily to assemble our roster.

Our first question will come from Doug Harter with Credit Suisse. Please go ahead.

Doug Harter
Thanks. Can you talk about how the recent backup and volatility in CLO spreads might impact your ability to refinance and re-lever some of the older CLOs that you talked about?

Jack Taylor
Hi, Doug, this is Jack Taylor. Thank you for your question and good to speak with you this morning. There's a definite backup in spreads in the public markets for the CLOs, and I think that's because of the extraordinary overall volume that has hit the CLO market over the past six months. And also because of general volatility in the world, but it's still a very viable market and will continue to be an issuer as ourselves who think of it as strategic financing as part of our portfolio mix and that has a one-off trade or an occasional trade, we'll be looking to that market. Having said all that, some liabilities are inefficient now both from across the funds and extent of leverage perspective, and this includes one of our public CLOs in particular. We wouldn't announce in advance the pay-off, or timing of, or repayment of the CLO, but it is an obvious source of capital release and improving cost of funds. And to really answer your question, we have multiple ways of addressing the refinancing away from the public markets. So, if the public markets are not as amenable, we're not dependent upon that.

Doug Harter
Great. And then you started to make good progress, starting to pay down the higher-cost senior secured. Can you talk about the outlook for retiring the last $100 million?

Marcin Urbaszek
Hi good morning, Doug. Thanks for the question, it’s Marcin. Look, we want to repay the rest of it, I think, it's something we are focused on. Obviously, it is a potential source of additional earnings power. What we're trying to accomplish is balancing out cash and liquidity for repayment of debt, as well as originating new loans, growing the portfolio and driving our earnings that way and improving our correlation to rising rates. So, it's a balancing act between the two, but we do intend to fully repay it.

If you think about, kind of overall balance sheets, the preferred cash is fungible, right? So, if you look at the preferred capital over $200 million, that's sort of almost speaks for the entire term loan. We repaid $125 million of that. So, from a cost and earnings perspective, it's almost a wash in terms of how much interest expense we removed and how many preferred dividends we added to our structure. So, now we're originating new loans with the rest of the capital, which obviously is going to provide upside since that's earnings to the bottom line, but we are committed to refinancing the rest of it, hopefully in the near-term, but definitely over the course of 2022.

Doug Harter
Thank you.

Operator
Our next question will come from Steve DeLaney with JMP Securities. Please go ahead.

Steve DeLaney
Good morning, everyone and congratulations on the progress made in reducing the higher-cost debt, and also settling the related warrants because that really cleans up your book value. That was a point of confusion for investors, I believe, in terms of what book value really was.

Jack Taylor
Thank you.

Steve DeLaney
You're welcome.

Picking up on where Doug was, I think that is the question of the day, sort of, and I appreciate he asking it. I was just scratching some numbers out and we actually have, I think there's a stated rate on the facility of like 8%, but I guess with fees and OID, it seems there is somewhere the effective cost is more like 11%. So, Marcin am I correct that it's somewhere in the neighborhood of 11%, the way you look at it on an all-in basis?

Marcin Urbaszek
Yes. Good morning, Steve and thank you for joining us. It's 10% - 11%. So, my point to Doug’s question, you know $125 million of principal balance that's sort of $12 - $13 million of interest expense, right? If we added roughly $14 million of preferred dividends, but we didn’t deploy all the money, we have another $70 - $75 million of preferred capital to put to work. Net-net, it's accretive transaction and it gives us way more balance sheet flexibility. The preferred equity is essentially across capital for us, if you think about it from the balance sheet.

Steve DeLaney
That's the way I was thinking about it. It seems to me you could probably have close to a 4%, if you just looked at the whole thing, whether it's $100 or the $225 million, it looks like you can roll your funding costs down by about 4%, and that would, you know, depends whether we look at the whole thing or just the remaining, but it seems like it could be several cents a quarter anyway in terms of the savings. And your answer to him, I think what you're saying is, it's a process and it probably will be incremental. You've already given us another $50 million here already. So, it's

not like we should be expecting this just to go away in the next quarter or so. Its's kind of the way I took your response.

Marcin Urbaszek
Yes, it is a process, and you know, if you were looking at this from an overall balance sheet and earnings perspective, right? Do we have the cash to just write a check and pay the whole thing off? Yes. However, if you think about the earnings and a run rate earnings perspective of the company, kind of where we are in the rate environment, right, removing a chunk of this helps us with earnings, remove the drag from the preferred, and at the same time it allows us to increase the correlation of the portfolio to rising rates by originating new loans rather than just paying off the debt, right? So, we are looking at it from both perspectives and we think we will repay the rest of it, like I said, over the course of the year, but adding additional loans to the balance sheet today is also beneficial today and going forward.

Steve DeLaney
Great. Thanks for the comments.

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

Our next question will come from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thank you very much. Just wanted to find out, the surge in originations we've seen from non-bank lenders, what in your view has driven that? Do you feel it's a sustainable trend? And do you expect that to continue this year?

Steve Alpart
Hey Jade, it's Steve, good morning. Hope you are well. Yes, look, we all have seen that the non-bank lenders are playing an important role in our markets, filling a big need in our market. Whether you're talking about mortgage REITs, or debt funds, or other specialty players. I mean, from what we see, we and our peers can move quickly, we can execute with a high degree of certainty, deliver very professional institutional experience for borrowers. We view this sector as important for the CRE lending universe, and it has grown rapidly and we expect it to continue to grow.

Jade Rahmani
Thanks very much. In terms of credit outlook and credit quality, can you talk to both, what you're seeing, in terms of portfolio trends? Anything on the horizon, positive or negative, that we should be cognizant of? And just overall in the market in terms of credit quality and loans that's being originated, what are your views on that?

Jack Taylor
Sure. I'll start with our portfolio. So, I guess the best thing to look at is our risk rankings, which were stable in Q4, compared to Q3, not much credit migration. We're comfortable with our risk rankings and feel very good about the overall credit of our portfolio. As you guys know, we look

at all of our loans every quarter, we evaluate each loan, we feel good about the overall credit profile in the portfolio.

As far as the second part of your question, I guess, credit quality in the market, we like what we see. We have a robust pipeline, we like the fundamentals and the sectors that we're targeting, the credit quality of the individual loans was strong, leverage levels are in check, the structure and covenant that we liked on these loans we're able to achieve. We're not originating billions per quarter, so we can be very selective. So, overall, I think we notwithstanding some of the current market volatility, we like the profile of the credits that we're seeing coming down the pipe.

Jade Rahmani
Thanks very much.

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
Thank you. And I would like to thank all of you for joining us today for our 2021 and Q4 call, and we look forward to speaking with you again in the future. We wish you health during this continuing time, and a respect for the volatility that's ongoing in the markets. Thank you, again.

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