Important disclosures can be found on pages 5 - 9 of this report.

September 6, 2016

Industry Update

2Q16 Earnings Recap: Updating Investment Ratings, Price Targets, and Estimate Changes; Highlighting Main Takeaways

Summary and Recommendation

With 2Q16 reporting now wrapped up for the REITs and special servicers, we are providing updated investment ratings, price targets, and estimate changes for our coverage. Additionally, we are highlighting our strongest picks and most noteworthy takeaways coming out of earnings season.

Key Points

- **We continue to point to STWD, our FBR Alpha Generator pick.** Following 2Q16 results, we continue to believe that Starwood is solidly in the "haves" category when it comes to the changing landscape of the CRE market given its large, diversified operating platform. As such, we expect the company will benefit as bank regulation, the CMBS wall of maturities, and risk retention disrupt the market. In 2Q16, the company originated and acquired $1.1B of loans at stronger yields and lower LTVs than the portfolio average. Core EPS came in at $0.50, covering the $0.48 quarterly dividend. Additionally, special servicing volumes ticked up in the quarter, and the company originated $288M of conduit loans, while some peers were pushed out of the market due to the challenging conditions. Since we added Starwood to the FBR Alpha Generator pick list on June 28, the stock has yielded a total return of ~18%, vs. S&P 500 up 9%, and we think there is plenty of return left to be captured. Our $24 price target suggests a 12% annualized total return on shares of STWD.
- **Sometimes simplicity is king; we like BXMT.** We believe that Blackstone is another commercial mREIT well positioned to capitalize on CRE market disruptions. What separates BXMT from its peers, in our view, is the simplicity and transparency of the business model, which we believe bodes well with investors in volatile times. As we highlighted recently in our note: "The CRE Debate Continues," BXMT is a straightforward, clean credit vehicle that we believe is able to leverage its broader Blackstone Group (BX – Not Rated) sponsorship to provide attractive risk-adjusted returns in any environment. With a dividend that we believe to be very secure yielding ~8.3% and enough liquidity that should support lending activity and discredit any concerns over an upcoming equity raise, we view BXMT as a compelling investment. Our $32 price target suggests an annualized total return of 15% at current levels.
- **Downgrading MFA and TWO.** Following 2Q16 earnings, we are downgrading shares of MFA and TWO to Market Perform from Outperform as shares are now trading at what we believe to be fair levels. Results for 2Q16 were strong for both companies: MFA reported core EPS of $0.20, covering the $0.20 quarterly dividend, and TWO reported core EPS of $0.22, which were just below the $0.23 quarterly dividend. Both companies are executing on their respective strategic initiatives, with MFA allocating more equity to credit investments and maintaining conservative leverage, while TWO continues to grow its commercial mortgage platform and shift capital to agency securities from non-agency securities; however, we believe that potential headwinds may exist and that valuation fairly reflects progress with shares of MFA and TWO trading at ~1.00x BV and ~0.90x BV, respectively. We continue to view both companies as high-quality institutions and all things being equal could become more constructive at more attractive valuations.
- **All eyes still on Colony NorthStar merger.** CLNY expects to file the final proxy statement sometime after September 5 and believes that the shareholder vote will be held sometime in late October or early November, with the deal closing in January 2017. CLNY reiterated its commitment to $1B of share repurchases or de-leveraging initiatives upon the merger closing, and it continues to foster a positive outlook for the capabilities of the new, combined company. We believe the implied value of Colony Northstar is materially weaker than what the company should be worth given all of the anticipated cost- and scale-related synergies, and as such, we view the "parts" as attractively valued with the "sum" being worth more.

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Price Target and EPS Estimate Updates

Ratings, Price Target, and Estimate Changes

	Rating		8/31/2016	Price Target		FY16E EPS			FY17E EPS		
Company	Old	New	Share Price	Old	New	Old	New	FC Est.	Old	New	FC Est.
Residential Mortgage REITs											
AI	OP	OP	14.88	16.00	16.00	3.08	2.98	2.85	3.14	2.98	2.69
AJX	OP	OP	13.71	18.00	18.00	2.03	2.03	2.03	2.65	2.65	2.42
EFC	OP	OP	17.22	20.50	20.50	1.82	1.22	1.06	2.25	1.70	1.67
MFA	OP	MP	7.72	7.50	7.50	0.76	0.78	0.77	0.77	0.78	0.76
NLY	OP	OP	10.71	12.00	12.00	1.19	1.19	1.18	1.10	1.12	1.17
TWO	OP	MP	8.90	8.50	9.00	0.90	0.90	0.88	0.95	0.96	0.94
Commercial Mortgage REITs											
ACRE	OP	OP	12.57	13.00	13.00	1.31	1.20	1.14	1.18	1.14	1.16
BXMT	OP	OP	29.82	32.00	32.00	2.62	2.62	2.61	2.60	2.60	2.60
LADR	OP	OP	13.28	15.00	15.00	1.52	1.46	1.43	1.86	1.75	1.64
RAS	OP	OP	3.14	3.25	3.25	0.70	0.51	0.50	0.49	0.41	0.56
RSO	OP	OP	13.27	13.00	13.00	2.55	1.77	2.34	2.94	2.33	2.60
STWD	OP	OP	22.90	24.00	24.00	2.01	2.01	2.01	2.13	2.15	2.14
Commercial Equity REITs											
CLNY	OP	OP	18.47	22.00	22.00	1.73	1.93	1.38	1.93	1.95	1.61
NRF	MP	MP	13.34	12.75	12.75	2.40	2.25	2.25	2.30	2.20	2.10
NSAM	OP	OP	12.43	15.00	15.00	1.21	1.21	1.22	1.29	1.29	1.31
Farmland REITs											
AFCO	OP	OP	6.09	9.00	9.00	0.38	0.08	0.07	0.46	0.21	0.19
FPI	OP	OP	11.65	12.00	12.00	0.58	0.19	0.38	0.64	0.26	0.43
Specialty Servicers											
NSM	MP	MP	15.88	10.00	10.00	1.18	1.54	1.52	1.50	1.70	1.73

OP: Outperform; MP: Market Perform; UP: Underperform

Source: FBR Research and FactSet

Residential Mortgage REITs

- **Annaly Capital Management, Inc. (NLY – Outperform).** We maintain our price target and investment rating on shares of NLY. Additionally, we maintain our FY16 normalized core EPS estimate of $1.19 and modestly increase our FY17 normalized core EPS estimate to $1.12 from $1.10 to reflect higher leverage and growth in higher-yielding credit investments, partially offset by higher repo funding costs.

- **Arlington Asset Investment Corp. (AI – Outperform).** We are adjusting our FY16 core EPS estimate to $2.98 from $3.08 and our FY17 core EPS estimate to $2.98 from $3.14 following adjustments to our yield assumptions and higher repo funding costs. We maintain our price target and investment rating.

- **Ellington Financial LLC (EFC – Outperform).** We are adjusting our FY16 core EPS estimate to $1.22 from $1.82 following 2Q16 results that came in well short of our estimate. We also are adjusting our FY17 core EPS estimate to $1.70 from $2.25 to reflect lower earnings power. We maintain our price target and Outperform rating.

- **Great Ajax Corporation (AJX – Outperform).** We maintain our investment rating, price target, and EPS estimates for shares of AJX.

- **MFA Financial, Inc. (MFA – Market Perform).** We are lowering our investment rating to Market Perform from Outperform on shares of MFA as we view shares to be fairly valued, currently trading at ~1.0x 2Q16 book value. Additionally, we believe potential headwinds exist from higher repo costs, which may weigh on future earnings and/or jeopardize the security of the dividend. Reflecting 2Q16 results, we increase our FY16 EPS estimate to $0.78 from $0.76 and modestly increase our FY17 EPS estimate to $0.78 from $0.77.

- **Two Harbors Investment Corporation (TWO – Market Perform).** We are modestly increasing our price target on shares of TWO to $9.00 from $8.50 but lowering our investment rating to Market Perform from Outperform as we view shares to be fairly valued, currently trading at ~0.90x 2Q16 book value. Additionally, we believe potential headwinds exist from higher repo costs, which may weigh on future earnings and/or jeopardize the security of the dividend. We maintain our FY16 core EPS estimate of $0.90 and slightly increase our FY17 core EPS estimate to $0.96 from $0.95.

Commercial Mortgage REITs

- **Ares Commercial Real Estate Corporation (ACRE – Outperform).** Following 2Q16 results, we are adjusting our FY16 EPS estimate to $1.20 from $1.31 and increasing our FY17 EPS estimate to $1.14 from $1.18. We believe that the company will be able to recycle the proceeds from the ACRE Capital sale into its principal lending business, which should boost earnings power to the $0.30 to $0.33 range once fully deployed. We maintain our investment rating and price target.
- **Blackstone Mortgage Trust, Inc. (BXMT – Outperform).** We maintain our investment rating, price target, and core EPS estimates for shares of BXMT.
- **Ladder Capital Corporation (LADR – Outperform).** We are lowering our FY16 core EPS estimate to $1.46 from $1.52 to account for a lack of securitizations in the quarter, as well as a more modest pace of capital deployment and share buybacks. Additionally, we adjust our FY17 core EPS estimate to $1.75 from $1.86. We maintain our investment rating and price target.
- **RAIT Financial Trust (RAS – Outperform).** We are lowering our FY16 CAD estimate to $0.51 from $0.70 following 2Q16 results and management's commentary on the call, which included an updated FY16 CAD guidance range of $0.48 to $0.55 and an uninspiring outlook for the conduit business in 2H16. Additionally, we adjust our FY17 CAD estimate to $0.41 from $0.49. We maintain our investment rating and price target.
- **Resource Capital Corporation (RSO – Outperform).** We are lowering our FY16 AFFO estimate to $1.77 from $2.55 following 2Q16 results that came in well below our estimate. While management reiterated its FY16 outlook, we believe that AFFO guidance will likely be taken down once C-III Partners completes the acquisition of RSO's manager, Resource America. As such, we are positioning our estimates well below the previously issued FY16 AFFO guidance of at least $2.65. Additionally, we adjust our FY17 AFFO estimate to $2.33 from $2.94. We maintain our investment rating and price target.
- **Starwood Property Trust, Inc. (STWD – Outperform).** We maintain our price target and investment rating on shares of STWD. Additionally, we maintain our FY16 core EPS estimate of $2.01 and modestly increase our FY17 core EPS estimate to $2.15 from $2.13.

Commercial Equity REITs

- **Colony Capital, Inc. (CLNY – Outperform).** We are adjusting our FY16 core FFO estimate to $1.93 from $1.73 following strong 2Q16 results that handily beat our estimate. Additionally, we modestly increase our FY17 core FFO estimate to $1.95 from $1.93. We maintain our investment rating and price target.
- **NorthStar Asset Management Corporation (NSAM – Outperform).** Following 2Q16 results, we maintain our FY16 and FY17 CAD estimates of $1.21 and $1.29, respectively. We also maintain our investment rating and price target.
- **NorthStar Realty Finance Corporation (NRF – Market Perform).** We are lowering our FY16 CAD estimate to $2.25 from $2.40 following 2Q16 results that missed our estimate. We also lower our FY17 CAD estimate to $2.20 from $2.30 to reflect modestly lower yield assumptions. Additionally, we maintain our investment rating and price target.

Farmland REITs

- **American Farmland Company (AFCO – Outperform).** We are adjusting our FY16 core FFO estimate to $0.08 from $0.38 following disappointing 1H16 results. Additionally, we are adjusting our FY17 core FFO estimate to $0.21 of $0.46. We maintain our price target and our investment rating.
- **Farmland Partners, Inc. (FPI – Outperform).** We are adjusting our FY16 core FFO estimate to $0.19 from $0.58 primarily to account for the exclusion of crop-year adjusted revenue from the calculation of AFFO. Our estimate reflects adjusted 1Q16 results, which did include the line item at the time of reporting. For this same reason, we are adjusting our FY17 core FFO estimate to $0.26 of $0.64. We maintain our price target and our investment rating.

Specialty Servicers

- **Nationstar Mortgage Holdings Inc. (NSM – Market Perform).** We are increasing our FY16 core EPS estimate to $1.54 from $1.18 following 2Q16 results that handily beat our estimate. We also are increasing our FY17 core EPS estimate to $1.70 from $1.50 to reflect continued strong growth in the origination platform, as well as the servicing and subservicing portfolios.

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Selling Uncovered Calls--Unlimited risk that investors may experience losses much greater than premium received.

Selling Uncovered Puts--Significant risk that investors will experience losses much greater than premium income received.

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Selling Call or Put Vertical Spreads (Calls--short call and long call with higher strike; Puts--short put and long put with a lower strike, same expiration month for both options.) Investors risk the loss of the difference between the strike prices, reduced by the premium received.

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HOLD [Market Perform]	32.93%	8.15%
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(1) As of midnight on the business day immediately prior to the date of this publication.

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