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Specialty Finance & Asset Focus
Freeman & Co. LLC

Inside this Issue:

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Market Data as of 3/22/2013

DJIA	14,512
NASDAQ	3,245
S&P 500	1,556
FTSE 100	6,393
10-yr US T-Note	1.93%
USD per GBP	$1.52
USD per Euro	$1.30

Rebirth of the Mortgage Industry

After Significant Reform, the Mortgage Industry is Back, Presenting New Opportunities

- Robust transaction activity in the mortgage banking sector is likely to continue in 2013.
- There has been much activity among mortgage originators, as large banks have decreased their footprint in mortgage lending:
  - Certain large lenders, such as ResCap, sold originations platforms, while some specialty lenders without mortgage platforms — most notably Discover Financial — entered the space.
- Servicers have been especially active, in large part due to banks reconfiguring their mortgage businesses.
  - Serial acquirers Nationstar Mortgage Holdings/Newcastle Investment, Ocwen Financial, and Walter Investment Management have transformed the mortgage servicing industry.
- We have identified the following themes for 2013:
  - Convergence may occur between originators and servicers, with servicers acquiring or building out origination platforms to stem portfolio attrition.
  - The refinance boom was the key driver of originations in 2012. An increase in purchase originations is likely to partially offset an expected decline in refinances in 2013.
  - Gains-on-sale, while historically large, have declined and may continue to do so.
  - The economic value of servicing is high relative to current market values.
  - New structures for owning servicing will become even more attractive once banks have fully offloaded MSRs, thus increasing servicing valuations.
  - The industry has resolved many legacy legal issues, which should make it more attractive for M&A activity.
  - GSE regulatory issues remain, with an accelerated multi-year wind-down of Fannie and Freddie having been announced last year, as well as the recently announced insolvency of the FHA.
- We discuss the following niches in this report:
  - **Diversified Mortgage Companies** – Originators that retain servicing and may acquire servicing rights from pure-play originators.
  - **Mortgage Originators** – Lenders that do not retain servicing. Originators may look to acquire servicing capabilities, which can provide a steady income stream when originations decline.
  - **Mortgage Servicers** – Businesses that service mortgage loans but do not originate. Servicers have been acquiring mortgage originators to mitigate portfolio run-off and benefit from growth in purchase-money originations.
  - **Servicing Entities** – Businesses that provide tax-advantaged funding to finance MSRs from servicers, but don't own MSRs themselves. This niche came into existence in 2012 and continues to grow rapidly.

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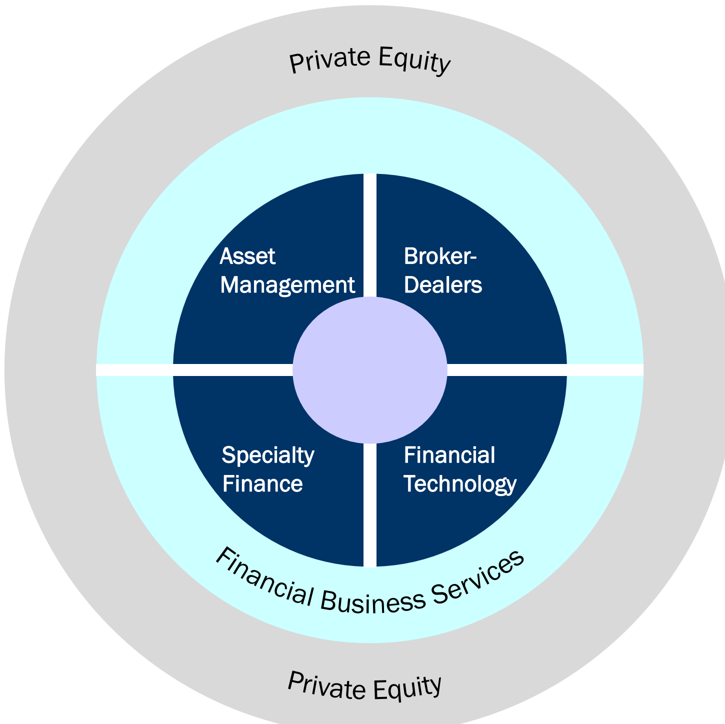

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Mortgage Origination

The outlook for M&A for mortgage originators is mixed. The industry is experiencing both tailwinds and headwinds.

Tailwinds	Headwinds
• Regulatory reform • Resolution of outstanding litigation • Improving housing market • Potential HARP expansion	• Lower gain-on-sale margins • Accelerated wind-down of the GSEs

Reduced regulatory uncertainty, as well as recently enacted regulatory reforms, will likely have a beneficial effect on M&A activity. With an established safe harbor for "qualifying mortgages", non-bank lenders and servicers may see less risk in this space and seek to acquire origination platforms. For the same reason, banks may change course and retain origination platforms. The resulting increase in demand and decrease in supply should push valuations of diversified mortgage companies and originators higher. Furthermore, higher levels of regulation will buttress the already high barrier to entry that licensing requirements impose. Consequently, acquisitions of originators will increasingly be the most feasible means by which to enter the market, thus further increasing valuations.

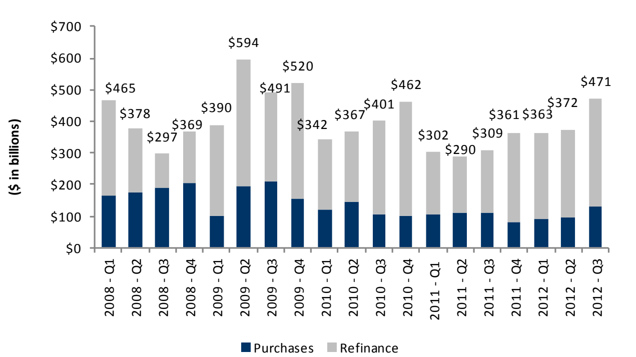
On a similar note, banks have been resolving litigation with Fannie and Freddie, with the most notable example being Bank of America, which paid Fannie Mae $3.6 billion and repurchased $6.8 billion in loans in January to resolve all current and future claims it misrepresented loans sold to Fannie. As other banks follow suit in resolving legacy issues, deal activity may increase as a result of lower litigation and put-back risk.

To date, approximately two million mortgagors have refinanced through HARP. President Obama has advocated for modifications to HARP that would expand the program to twelve million borrowers, from the estimated two million who currently qualify but have not yet refinanced. If the President's plan is not approved, refinance volume would likely decline.

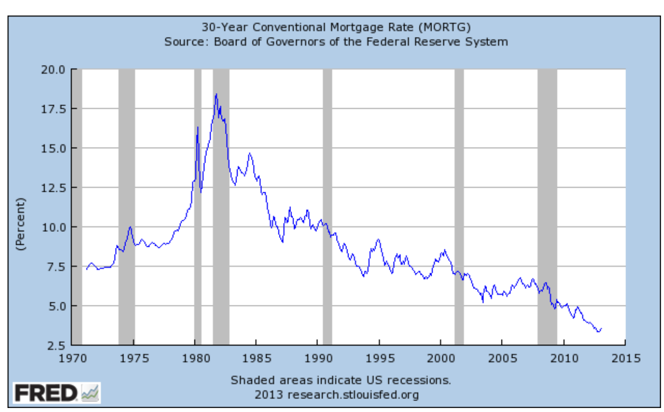
The Mortgage Bankers Association (MBA) expects a decline in refinances to $785 billion in 2013, from $1.2 trillion in 2012. This decline, resulting from higher interest rates, would be only partially offset by originations for home purchases, which the MBA expects to increase to $585 billion in 2013 from $500 billion in 2012.

Mortgage Originations by Quarter

($ in billions)



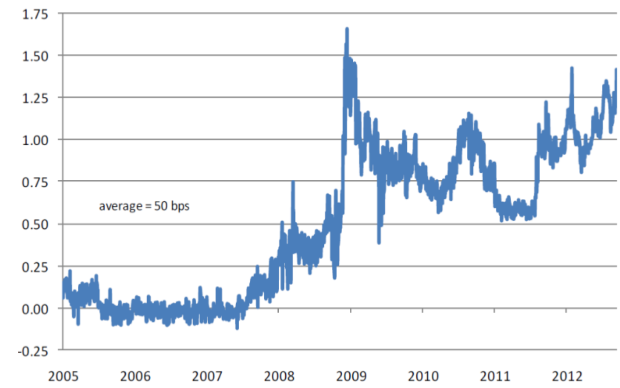
30 Year Conventional Mortgage Rates



Mortgage Origination (continued)

Expected decreases in gain-on-sale income may put pressure on valuations. Gain-on-sale margins began to slip in early 2013 after record-high margins of 4-5%, which were largely driven by industry-wide capacity constraints and the HARP 2.0 program. (HARP 2.0 effectively requires underwater borrowers to refinance with their existing servicer, thus giving the servicer considerable pricing power.) With a run-rate of 100,000 HARP refinances per month and an additional two million HARP-eligible mortgages, gain-on-sale margins are likely to remain near historical highs for most of 2013, though lower gain-on-sale margins for non-HARP refinances and purchases will likely cause gain on sale margins to decline.

Gain on Sale Margin Indicator[(1)]



Further, GSE-related issues may result in a reconfiguration of the mortgage industry. As Fannie and Freddie reduce their portfolio of loans owned, a significant source of liquidity in the mortgage market will disappear, given that their $2.6 trillion portfolio will decline to $250 billion by 2018. Over the intermediate to long term, originators may shift to non-agency product in response to the GSEs' exit from mortgage lending. Further, the FHA — which has taken over the higher risk portion of the market — is currently insolvent. The FHA's recent up-front insurance premium hike from 1.00% to 1.75% and annual premium hike of 0.10% to 0.35% may be inadequate given the delinquency rate of 9.6% in the its portfolio. To be restored to solvency, the FHA may raise insurance rates further, thus making FHA loans less competitive.

Mortgage Servicing

Servicing continues to be an attractive asset, and deal activity is likely to remain at elevated levels. In a rising interest rate environment, like the one expected in the long term, the value of servicing will increase as prepayments decrease. Servicing may be especially attractive for mortgage originators as a hedge to protect against rising interest rates.

Banks are expected to sell over $2 trillion of servicing in the next few years due to regulatory considerations and legacy issues among the major banks. As a result of excessive supply, driven primarily by bank sellers, servicing can be acquired at 2x annual servicing revenue, versus 4-5x historically. While depressing asset prices, the expectation of a large pipeline has resulted in high valuations for servicers. The strong pipeline is driving the valuation of servicers as "going concerns" and not just the present value of their servicing rights, which are liquidating assets ("melting icebergs").

Special servicing has been the most active area for deals. Special servicers concentrate on distressed portfolios, which carry a form of prepayment protection as borrowers cannot refinance delinquent loans. Furthermore, banks have encountered operational and regulatory obstacles to servicing distressed loans, estimated to be approximately $1 trillion.

Notably, servicers have been acquiring or creating their own origination platforms and expanding into ancillary services. For example, NationStar: (1) is actively refinancing loans in its servicing portfolio, (2) has entered into an arrangement with KB Homes by which it will be KB's preferred lender, and (3) has acquired Equifax's settlement services business.

Recent servicing acquisitions appear predicated on the assumption that the acquirer will be able to mine the portfolio for refis, generating gain-on-sale and MSR capitalization income. Currently under HARP, for an underwater loan, only the lender servicing the loan may refinance the loan without having to re-underwrite to the current value of the home. Therefore, underwater borrowers who wish to do HARP refinances must stay with the same servicer. Pending legislation will allow HARP-eligible borrowers to refinance with lenders other than the one servicing their mortgage without a full re-underwriting.

(1): FNMA 30Y MBS Index v. Bankrate.com 30Y Mortgage Index (%)
Source: Compass Point

Mortgage Servicing (continued)

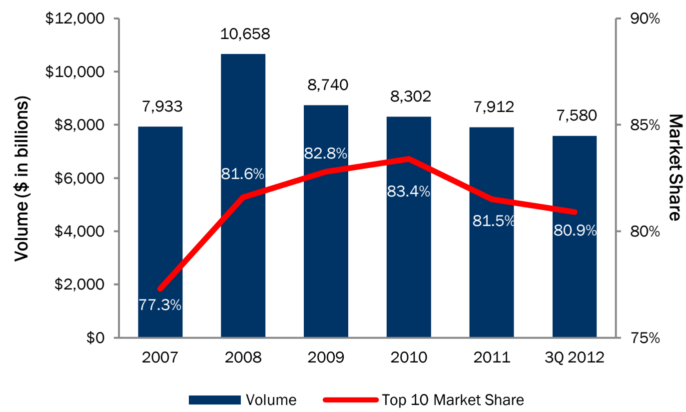
The impact of this pending legislation would likely be threefold. First, the legislation would make it more difficult to control prepays through refinances with the same servicer, thus decreasing servicer valuations. Second, servicers would have to decrease HARP refinance rates in the face of competition, thus decreasing gains-on-sale. Third, refinancing volume would increase in response to lower HARP refinance rates. (A study by Amherst Securities Group has indicated that this provision would decrease HARP loan coupon rates by 50bps.)

The rapid growth of large independent servicers has caught the attention of both ratings agencies and regulators, both of which have expressed concerns. The New York Superintendent of Financial services went so far as to block temporarily Ocwen's Homeward and Rescap deals. In the face of concerns over market concentration, originators and smaller servicers may be well-positioned to take market share from larger servicers.

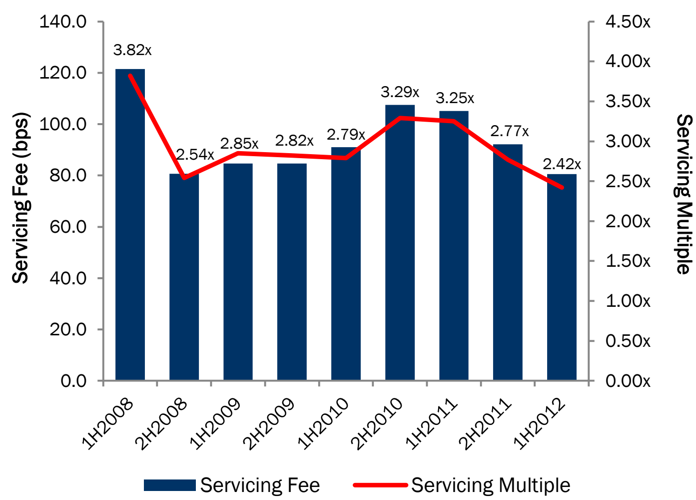
One of the most significant recent trends is that certain servicers have either established or have announced that they have plans to establish independent entities that purchase the rights to MSRs. Ocwen, for example, created Home Loan Servicing Solutions (HLSS) in 2012 to acquire rights to Ocwen's MSRs. HLSS receives the servicing fee, less a management and incentive fee paid to Ocwen. Nationstar and NewCastle have a similar relationship, with Nationstar acting as a servicer and co-investor with NewCastle in MSRs. More recently, in March 2013, Walter announced that it plans to create a similar entity.

Mortgage Servicing Volume (2007-2012)

($ in billions)



Historical Servicing Pricing[1]



Investor appetite for these entities has been robust, as evidenced by HLSS's success in executing its IPO and two follow-ons in under ten months. HLSS is currently trading at 13.1 times 2013 earnings with a 6.9% dividend yield. Servicing entities remain a highly attractive way of obtaining low-cost capital to grow mortgage origination and/or servicing businesses. Furthermore, diversified mortgage lenders creating servicing entities position themselves well for a lower gain-on-sale and higher interest rate environment. If gain-on-sale margins compress further and interest rates increase, the implicit cost in retaining servicing is likely to increase, making such entities even more attractive as financing vehicles.

Source: MortgageStats, Inside Mortgage Finance

Select Mortgage Acquisition Activity

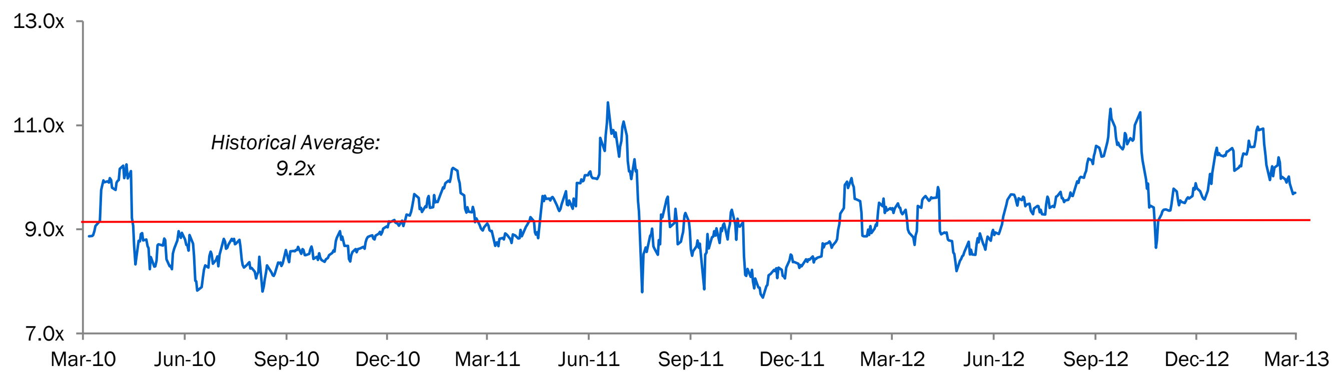
Buyer	Target/Seller	Type	Date	Announced Value ($mm)	Deal Pricing Ratios
Quicken Loans	Ally Financial	Mortgage Servicing Rights	3/21/13	$280.0	NA
Nationstar/ Newcastle	Bank of America	Mortgage Servicing Rights	1/7/2013	$1,345.0	Price/Mortgage Servicing: 0.63%
Walter Investment	Bank of America	Mortgage Servicing Rights	1/7/2013	$519.0	Price/Mortgage Servicing: 0.56%
Walter Investment	Security One	Company Acquisition	12/31/2012	$31.0	Price/Originations: 4.43%
Ocwen Financial/ Walter Investment	Residential Capital	MSRs and Servicing Platform	11/2/2012	$3,000.0	Price/Mortgage Servicing: 1.18%
JP Morgan Chase	MetLife	Mortgage Servicing Rights	11/2/2012	NA	NA
Ocwen Financial	Homeward Residential Holdings	Company Acquisition	10/3/2012	$766.0	Price/Mortgage Servicing: 0.97%
Stonegate Mortgage	NattyMac/ Guggenheim	Company Acquisition	9/5/2012	NA	NA
Walter Investment	Reverse Mortgage Solutions	Company Acquisition	8/31/2012	$119.8	Price/Earnings: 15.3x
Nationstar Mortgage	Aurora Bank	Mortgage Servicing Rights	6/28/2012	$1,928.0	Price/Mortgage Servicing: 3.08%
Discover Financial Services	Tree.com	Acquisition of Loan Origination Business	6/6/2012	$55.90	Price/Revenue: 0.49x Price/Book: 41%
Nationstar Mortgage	Bank of America	Mortgage Servicing Rights	5/31/2012	$10,400.0	NA
Nationstar Mortgage	Ally Financial	Mortgage Servicing Rights	5/13/2012	$1,005.0	Price/Mortgage Servicing: 0.27%
Ocwen Financial Corp.	Saxon Mortgage Services	Company Acquisition	4/2/2012	$1,451.3	Price/Mortgage Servicing: 5.77%

Mortgage Company Trading Metrics and Stock Performance

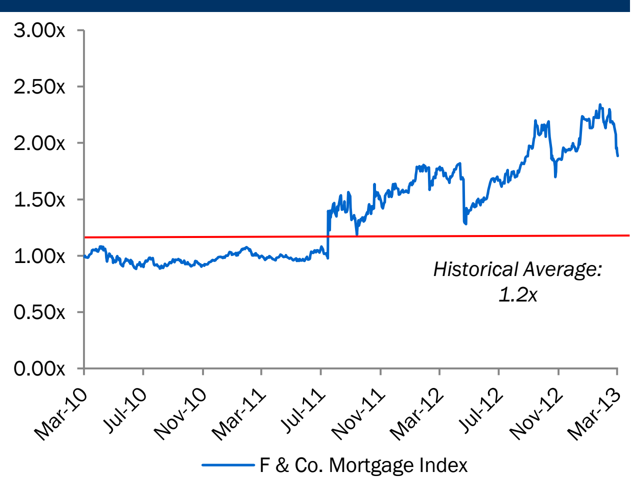
As of 3/22/13	Ticker	Share Price	Market Cap ($mm)	Dividend Yield (%)	Price/ Book	Price / Pre-Tax Earnings LTM	Price / Pre-Tax Earnings 2013E	Price / Pre-Tax Earnings 2014E	Price / Net Income LTM	Price / Net Income 2013E	Price / Net Income 2014E
Mortgage Companies											
Ocwen Financial Corporation	OCN	$ 34.99	$ 4,745.97	-	2.95x	18.4x	6.6x	5.9x	26.2x	7.6x	6.7x
Nationstar Mortgage Holdings Inc.	NSM	32.86	2,972.16	-	3.92	10.7	5.6	3.8	14.5	8.6	5.4
Newcastle Investment Corp.	NCT	10.51	2,659.30	8.4 %	1.79	6.1	7.9	6.2	6.1	NM	NM
Redwood Trust, Inc.	RWT	22.03	1,799.78	5.1	1.58	13.5	11.3	8.7	13.7	12.3	11.0
PennyMac Mortgage Investment Trust	PMT	25.30	1,490.34	9.0	1.24	8.0	5.5	5.4	10.8	7.5	7.8
Home Loan Servicing Solutions, Ltd.	HLSS	22.62	1,286.07	6.9	1.44	NM	13.1	13.0	NM	13.1	13.0
PHH Corporation	PHH	22.22	1,267.62	0.0	0.83	14.6	3.6	3.7	13.6	7.7	7.1
Walter Investment Management Corp.	WAC	32.49	1,198.47	-	1.33	NM	6.2	4.8	NM	9.9	7.8
Impac Mortgage Holdings, Inc.	IMH	9.70	84.01	-	NM	5.9	NA	NA	6.4	NA	NA
			Mean	**3.3 %**	**1.88x**	**11.0x**	**7.5x**	**6.4x**	**13.0x**	**9.6x**	**8.4x**
			Median	**0.0**	**1.51**	**10.7**	**6.4**	**5.6**	**13.6**	**9.2**	**7.8**

Mortgage companies are currently trading at multi-year highs. They have significantly outperformed the broader market, but trade at lower forward multiples, suggesting that investors still remain cautious on the sector.

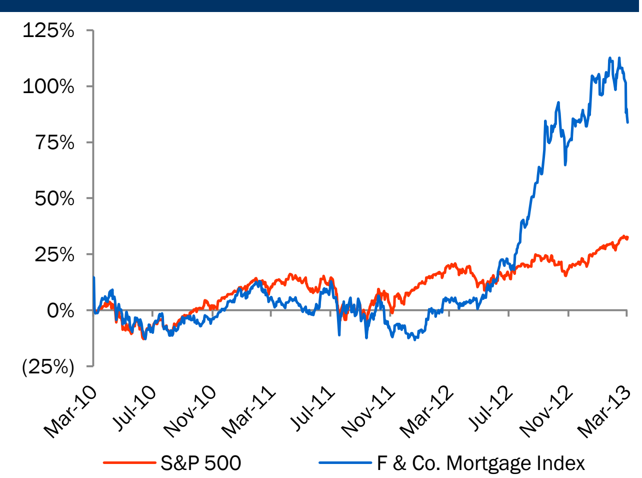
Mortgage Company Historical Price / NTM Earnings Multiple[(1)]



Mortgage Companies – Price/Book Ratio[(1)]



Mortgage Companies – Total Return[(1)]



(1) F&Co. Mortgage Index includes: Home Loan Servicing Solutions, Impac Mortgage, Nationstar Mortgage, Newcastle Investment, Ocwen Financial Corporation, PennyMac Mortgage Investment Trust, PHH Corp., Walter Investment Management, and Redwood Trust

Source: MortgageStats, Inside Mortgage Finance, SNL, Capital IQ

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