



Starwood Property Trust Inc. (STWD)

Updated May 9th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$16.76	5 Year CAGR Estimate:	10.5%	Market Cap:	\$5.40 B
Fair Value Price:	\$18.00	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	06/29/23 ¹
% Fair Value:	93%	5 Year Valuation Multiple Estimate:	1.4%	Dividend Payment Date:	07/14/23
Dividend Yield:	11.5%	5 Year Price Target	\$18.00	Years of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Starwood Property Trust, Inc. is a real estate investment trust that operates in the commercial mortgage space. Starwood originates, acquires, finances, and manages commercial mortgage loans and other debt and equity investments. It has multiple operating segments which include Real Estate Lending, Real Estate Property, and Real Estate Investing and Servicing. Real Estate Lending investments include commercial first and subordinated mortgages, mezzanine loans, preferred equity, and residential mortgage loans. The Real Estate Property segment consists of acquiring equity interests in commercial real estate properties. The Real Estate Investing and Servicing segment mostly invests in unrated, investment grade, and non-investment grade commercial real estate assets. Starwood had its IPO in 2009, and currently has a market capitalization of \$5.40 billion.

On May 4th, 2023, Starwood reported its Q1 results for the period ending March 31st, 2023. For the quarter, revenues came in at \$490.4 million, a 7.8% increase sequentially. Distributable earnings-per-share came in at \$0.49, down by a cent quarter-over-quarter.

Management remains confident that the company's best-in-class balance sheet remains one of Starwood's key competitive advantages in the current market environment. In addition to \$4.2 billion of unencumbered collateral and \$3.4 billion of owned property, Starwood also has \$25.6 billion of financing capacity diversified across 25 lenders and over 40 facilities, of which \$8.3 billion is undrawn.

Starwood's book value per share fell by \$0.33 to \$21.37 compared to the previous quarter. For FY2023, our updated estimates point toward distributable EPS of about \$2.00.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
DEPS	\$1.82	\$2.24	\$1.91	\$1.50	\$2.23	\$2.19	\$2.20	\$1.98	\$2.63	\$2.28	\$2.00	\$2.00
DPS	\$1.82	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92	\$1.92
Shares²	166.4	214.9	233.4	238.5	259.6	265.3	279.3	282.0	285.9	305.5	319.7	380.0

Note: Starwood's "Distributable" earnings metric is similar to Funds from Operations (FFO), adding back in items like depreciation and amortization. The mortgage REIT business model performs well when short-term interest rates are declining. Mortgage REITs like Starwood make money by borrowing at short-term rates and investing in long-term securities. Starwood then earns a spread between the two, which is its profit margin. This explains its strong earnings growth since its IPO through 2014.

Starwood's earnings-per-share peaked last year and could remain below this level due to compressing interest spreads. Furthermore, the trust's dividend growth has stalled. However, performance during the challenging 2020 remained robust amid Starwood's portfolio of high-quality assets, which, unlike its peers, didn't force the trust to cut its dividend. With the trust acquiring multiple assets at quite attractive prices as of recently, we believe that its financial performance

¹ Estimated Date

² In millions

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will remain solid in the medium term. Still, we expect both Starwood's EPS and DPS to remain stagnant moving forward, as incremental profits from capital deployed is usually offset by an equal increase in the company's share count.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	11.5	10.5	11.8	13.8	9.9	9.0	10.9	8.0	9.3	9.4	8.4	9.0
Avg. Yld.	8.7%	8.2%	8.5%	9.3%	8.7%	9.7%	8.0%	11.6%	7.8%	8.9%	11.5%	10.7%

Since Starwood's IPO, the stock has traded with an average price-to-earnings ratio in the low-double digits. The trust's portfolio proved itself worthy during the pandemic, and investors are likely to appreciate the stock's massive yield. While a discount to a YieldCo is deserved in the current environment, given the higher cost of equity, we believe that the market likely undervalued Starwood at a P/E of 8.4. We retain our fair P/E at 9.0, which we feel better characterizes the company's investment case. The yield is currently hovering at a substantial 11.5% and reflects the main source of expected future returns. Shares are trading at a notable discount to NAV as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

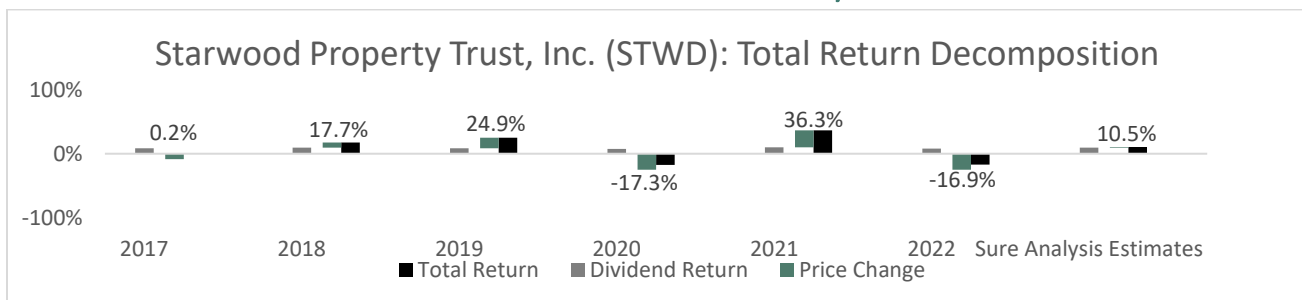
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	100%	86%	101%	128%	86%	88%	87%	97%	73%	84%	96%	96%

Starwood does not have many competitive advantages in our view. Starwood's primary benefit is its management's talent and its ability to make successful investments, both of which can be finicky. In addition, Starwood is not a recession-resistant trust. A tightening credit cycle, flattening yield curve, or downturn in the commercial real estate industry would all have a significant negative impact. The mortgage REIT business model calls for very high leverage. This makes stocks in the industry inherently risky. During the years after the Great Recession, the low-interest-rate environment allowed Starwood to increase its debt and earn substantial returns for its shareholders. Considering that Starwood managed to maintain dividend coverage during 2020 despite the overall challenges and even execute aggressive investments, we believe that payouts should be relatively safe for now. Still, the trust's dividend should not be seen as a "sleep-well-at-night" one. It could easily be cut following weaker results.

Final Thoughts & Recommendation

Like many other mortgage REITs, Starwood is at risk of a dividend cut and permanent capital destruction if the economy were to undergo a prolonged recession. As a result of paying out most of what it earns, we expect very stagnant earnings in the years to come and would not be surprised if the REIT ended up being forced to cut its dividend at some point. We forecast 10.5% annualized total returns over the next half-decade, primarily driven by Starwood's dividend yield. Overall, the stock can be a decent income generator going forward, while the discounted valuation offers some margin of safety. Hence, while we rate Starwood Property a buy, we suggest investors remain wary of the risks involved.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	496	630	608	665	629	836	959	822	885	1450
SG&A Exp.	227	293	291	335	347	393	397	403	339	331
D&A Exp.	15	17	27	62	91	131	113	94	85	54
Net Profit	305	495	451	365	401	386	510	332	448	871
Net Margin	61.5%	78.6%	74.2%	54.9%	63.7%	46.1%	53.1%	40.4%	50.6%	60.1%
Free Cash Flow	326	221	606	557	(247)	585	(13)	1046	(990)	214
Income Tax	24	24	17	8	32	15	13	20	8.7	(62)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	110771	116099	85698	77256	62941	68262	78042	80870	83850	79040
Cash & Equivalents	318	255	369	616	369	240	478	563	217	261
Accounts Receivable	38	40	34	28	48	60	64	96	116	169
Goodwill & Int. Ass.	318	285	342	360	324	405	346	330	323	329
Total Liabilities	106443	112216	81527	72696	58362	63362	72905	76010	77200	71840
Accounts Payable	225	145	157	198	185	218	212	207	190	299
Long-Term Debt	3,437	4,685	5,392	6,201	7,972	10757	11763	7000	7480	9708
Shareholder's Equity	4,283	3,861	4,140	4,522	4,478	4,603	4,700	4489	6073	6462
LTD/E Ratio	0.80	1.21	1.30	1.37	1.78	2.34	2.50	1.56	1.23	1.50

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.5%	0.4%	0.4%	0.4%	0.6%	0.6%	0.7%	0.4%	0.5%	1.1%
Return on Equity	8.7%	12.2%	11.3%	8.4%	8.9%	8.5%	11.0%	7.2%	8.5%	13.9%
ROIC	5.1%	6.1%	5.0%	3.6%	3.4%	2.7%	3.1%	2.8%	3.5%	5.6%
Shares Out.	166.4	214.9	233.4	238.5	259.6	275.7	290	282	297	315.7
Revenue/Share	2.98	2.88	2.60	2.75	2.40	2.90	3.31	2.91	2.98	4.59
FCF/Share	1.96	1.01	2.59	2.30	(0.94)	2.03	(0.05)	3.70	(3.34)	0.68

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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