



Two Harbors Investment Corp. (TWO)

Updated November 8th, 2024 by Samuel Smith

Key Metrics

Current Price:	\$11.9	5 Year CAGR Estimate:	11.7%	Market Cap:	\$1.2 B
Fair Value Price:	\$13.4	5 Year Growth Estimate:	-1.3%	Ex-Dividend Date:	1/3/24 ¹
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.5%	Dividend Payment Date:	1/29/24 ²
Dividend Yield:	15.1%	5 Year Price Target	\$13	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Two Harbors Investment Corp. is a residential mortgage real estate investment trust (mREIT). As such, it focuses on residential mortgage-backed securities (RMBS), residential mortgage loans, mortgage servicing rights, and commercial real estate. The trust derives nearly all of its revenue in the form of interest through available-for-sale securities.

On October 28, 2024, Two Harbors Investment Corp. (NYSE: TWO), a Mortgage Servicing Rights (MSR)-focused real estate investment trust (REIT), announced its financial results for the third quarter ended September 30, 2024. The company reported earnings per share (EPS) of \$0.13, which missed analyst expectations by \$0.23, and revenue of negative \$42.29 million, a decline of 14.54% year-over-year, falling short of projections by \$7.29 million. Despite these misses, Two Harbors achieved a reported book value of \$14.93 per common share and declared a third-quarter common stock dividend of \$0.45 per share, resulting in a 1.3% quarterly economic return on book value. For the first nine months of 2024, the company generated a total economic return of 7.0% on book value.

In terms of comprehensive income, Two Harbors reported \$19.3 million, or \$0.18 per weighted average basic common share, for Q3 2024. The increase in net income of \$125,000, or \$0.01 per diluted share, compared to Q3 2023 was primarily driven by an aggregate net increase of \$451,000 in income generated across various properties. This gain was partially offset by a \$326,000 increase in interest expenses due to higher average outstanding borrowings and a slight rise in the average borrowing rate.

Funds from Operations (FFO) for the third quarter stood at \$11.3 million, or \$0.82 per diluted share, up marginally from \$11.2 million, or \$0.81 per diluted share, in Q3 2023. For the nine-month period ended September 30, 2024, net income rose to \$14.6 million, or \$1.05 per diluted share, compared to \$11.8 million, or \$0.85 per diluted share, in the first nine months of 2023. This year-to-date improvement of \$2.8 million, or \$0.20 per diluted share, was driven by a \$2.5 million increase in income from properties and a \$1.9 million reduction in expenses related to the Chicago property, including lower demolition costs and property tax reductions. However, these gains were partially offset by a \$1.6 million rise in interest expenses.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$10.8	\$8.12	\$7.24	-\$2.12	-\$9.80	\$7.88	\$3.12	\$3.28	\$2.50	-\$0.07	\$1.85	\$1.50
BVPS	\$85.2	\$80.0	\$80.8	\$59.6	\$59.2	\$58.88	\$30.52	\$28.16	\$17.72	\$15.21	\$14.93	\$14.00
DPS	\$8.32	\$7.44	\$8.04	\$7.52	\$6.96	\$6.40	\$2.24	\$2.72	\$0.68	\$1.80	\$1.80	\$1.50
Shares³	45.8	43.5	43.6	43.9	62.8	68.4	68.4	86.0	96.6	103.4	103.7	95.0

Two Harbors has a history of generating strong total returns for investors, despite book value per share declining significantly over the years. As a result, TWO recently had to complete a 4 for 1 reverse stock split to prop up the share price and encourage more fund inclusion. Since its inception in October 2009, the stock has outperformed the BBG REIT

¹ Estimate

² Estimate

³ In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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MTG index's total return. The three main reasons for this are that it pairs its MSR assets with Agency RMBS, utilizes a variety of instruments to hedge interest rate exposure, and utilizes a unique portfolio of legacy non-agency securities. Given economic and industry headwinds as well as the high payout ratio, we are forecasting book value to remain about where it is over the next five years.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/B	0.91	0.87	0.85	0.89	0.94	0.88	1.02	0.84	0.88	0.78	0.80	0.90
Avg. Yld.	10.1%	11.2%	10.9%	11.2%	13.4%	13.4%	10.6%	9.0%	11.0%	15.0%	15.1%	11.9%

Two Harbors has historically traded at a sizable discount to book value due to its riskier (highly leveraged) business model and the trust's nearly annual dividend cuts. As a result, we assume a fair value P/B estimate of 0.90, meaning that the stock is undervalued based on its current multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	77%	92%	111%	NA	NA	81%	72%	83%	27%	NA	97%	100%

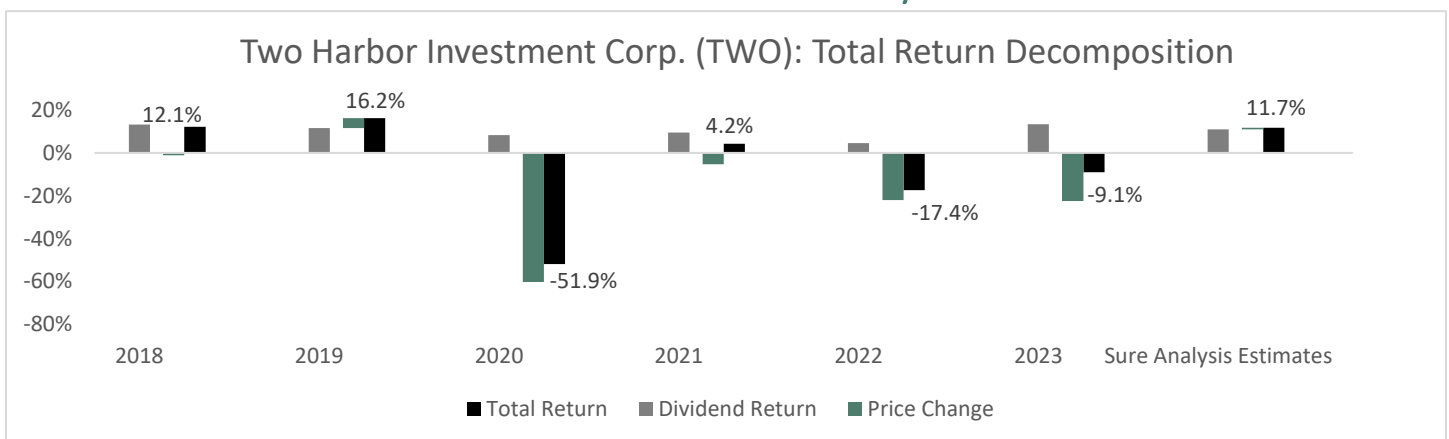
Two Harbors' high dividend yield indicates that the market has some concerns about the safety of its current dividend payment as well as the sustainability of the business model as a whole. In general, the non-recurring nature of the loans within the mortgage REIT business model make Two Harbors somewhat less of a sleep-well-at-night stock than some of its peers in the equity REIT universe. We have serious questions about its dividend safety through all economic environments, particularly in light of its very high current payout ratio. While the REIT was founded in the wake of the last recession, we believe that – due to its high leverage ratio – it will struggle in the next economic downturn.

The trust lacks any significant competitive advantage other than some economies of scale and significant diversification that add some stability to performance. However, we see nothing that will lead to outsized returns in the future – all conditions being constant. We believe past outperformance was largely due to a strategy that aligned with market forces, though some of it was due to a shareholder-friendly dividend policy and solid management performance.

Final Thoughts & Recommendation

Two Harbors offers an attractive 15.1% dividend yield. However, investors should be cautioned that a great deal of risk and uncertainty is associated with this yield. Therefore, the expected 11.7% annualized total returns should only be pursued by those with a high risk tolerance. Conservative investors looking for stable income should steer clear of this stock, and we rate it a speculative buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	203	590	435	392	186	428	(1,562)	255	407	32
SG&A Exp.					36	33	38	35	41	53
D&A Exp.	2	1								
Net Profit	167	492	353	349	(44)	324	(1,630)	187	220	(106)
Net Margin	82.3%	83.4%	81.2%	88.8%	-23.8%	75.8%	104.4%	73.4%	54.1%	-335%
Free Cash Flow	(727)	(2,060)	(78)	123	(274)	443	9	(319)	(6)	
Income Tax	(74)	(17)	12	(10)	42	(14)	(36)	4	104	23

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	21,084	14,576	20,112	24,789	30,132	35,922	19,516	12,114	13,466	13,139
Cash & Equivalents	1,006	738	351	419	410	558	1,385	1,154	683	730
Goodwill & Int. Ass.	452	494	694	1,087	1,993	1,909	1,596	2,192	2,985	3,052
Total Liabilities	17,016	10,999	16,711	21,218	25,878	30,951	16,427	9,370	11,283	10,935
Accounts Payable	24	19	29	88	160	150	22	18	94	142
Long-Term Debt	3,710	5,785	7,107	1,518	1,459	1,189	966	1,242	1,799	1,893
Shareholder's Equity	4,068	3,577	3,401	2,869	3,277	3,993	2,111	2,041	1,553	1,590
LTD/E Ratio	0.91	1.62	2.09	0.43	0.34	0.24	0.31	0.45	0.82	0.86

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	0.9%	2.8%	2.0%	1.6%	-0.2%	1.0%	-5.9%	1.2%	1.7%	-0.8%
Return on Equity	4.2%	12.9%	10.1%	11.1%	-1.4%	8.9%	-53.4%	9.0%	12.3%	-6.8%
ROIC	2.7%	5.7%	3.6%	4.5%	-0.8%	5.5%	-31.9%	4.7%	5.5%	-2.6%
Shares Out.	45.8	43.5	43.6	43.9	62.8	68.4	68.4	86.0	96.6	103.2
Revenue/Share	4.44	12.93	10.00	8.34	3.61	6.39	(22.84)	3.43	4.24	0.33
FCF/Share	(15.89)	(45.13)	(1.79)	2.61	(5.31)	6.62	0.13	(4.28)	(0.07)	

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

Disclaimer

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