BEHIND THE NUMBERS
Quality of Earnings Analysis

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Starwood Property Trust, Inc. (STWD)
Earnings Quality Update- 6/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of STWD at 5+ (Strong).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

STWD's 2Q21 met forecasts at 51-cents of Distributable Earnings per Share or core EPS. That was hurt by 2-cents from taxes to transfer a condo building to the property segment and it was helped by 4-cents from CECL reserves declining. There are often some lumpiness issues with STWD due to timing and items it does not consider part of Distributable Earnings such as a $9.7 million gain on a property sale that lowered the Distributable EPS figure by 3-cents. STWD also continues to operate with more cash than normal with is also a drag on earnings.

There are three factors that continue to point to more improvement at STWD:

- STWD's focus on the financing side should continue to help results if interest rates rise. The bulk of investments are variable rate and should see higher cash flow if rates increase. Yet, if rates decline, there are still LIBOR floors in place. More importantly, being able to issue CLOs, A-Notes, and other non-recourse financing removes a large part of mark-to-market risk of having assets marked down triggering debt calls – STWD is increasingly insulated from higher rates.

- Special Servicing produces longer-term results and they are lumpy as STWD is often paid more money as complicated deals are resolved. The amount of unpaid balances on special servicing deals also gives STWD insight and control over assets that may be worth buying and others to kick out of portfolios. It's worth noting that after servicing about $80 billion of unpaid balances for several quarters, STWD added over $12 billion of new deals after 2Q21.

- Foreign deals are becoming a greater focus with better cap rates and where spreads should be wider due to fewer competitors. This could add incremental earnings going forward too.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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