Municipal Mortgage & Equity, LLC [MMAB]
Q1 2014 Results and Business Update
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Company Representatives:
Michael Falcone; President, CEO
Lisa Roberts; CFO

Analysts and Investors:
Jesse Greenfield; Greenfield Investments

Presentation

Operator: Good afternoon, ladies and gentlemen, and welcome to the Municipal Mortgage & Equity, LLC first quarter 2014 conference call. My name is Gary and I will be your coordinator for today. At this time, all participants are in a listen-only mode. We will facilitate a question-and-answer session at the end of this conference call.

Some comments today will include forward-looking statements regarding future events and projections of financial performance of MuniMae, which are based on current expectations. These comments are subject to significant risks and uncertainties, which include those identified in filings with the Securities and Exchange Commission that could cause actual results to differ materially from those expressed in these forward-looking statements. The Company undertakes no obligation to update any of the information contained in the forward-looking statements.

I would now like to turn the call over to Mr. Michael Falcone, CEO of Municipal Mortgage & Equity, LLC.

Michael Falcone: Thank you, Gary. Good afternoon, everyone, and welcome. With me on the call today are Lisa Roberts, our Chief Financial Officer, and Executive Vice Presidents Gary Mentesana and Earl Cole. Lisa and I together will deliver our prepared remarks and then I will close and we will all take questions.

The primary purpose of our call today is to review our first quarter results, but I will also address recent developments in our share buyback plan.

With respect to our first quarter results, which Lisa will review in detail later, we ended the quarter with $97.6 million of unrestricted cash and $80.7 million of common equity, which represented $2.02 of equity per share. Common equity increased by $15.4 million during the first quarter, largely as a result of gains on real estate sold during the first quarter.

As discussed last month during our year-end call, we do not see additional near-term opportunities to sell assets, which we carry on our books as real estate, at prices significantly higher than our carrying values. And based on our most recent internal projections, we expect operating results to be roughly breakeven for the remainder of 2014.

As it relates to our strategic direction, Management and the Board continue to review our opportunities to deploy our cash in ways which will increase common shareholder value over time. On a quarterly basis, these increases may be lumpy, as evidenced by our performance expectations for this year. Some of our investments may be in assets, potentially financial total return swaps, and some of them may be in businesses.

As discussed previously, our focus remains in real estate finance in general and multifamily housing investment and finance in particular. Within this space, we can leverage our core competencies.

We continue to favor taxable investments, which allow us to monetize our deferred tax assets, with a goal of generating mid-teens investment returns or higher, in order to reach the market levels of return on equity.

We believe there may be opportunities to invest in US housing finance-related business acquisitions or within our existing international business in ways which could provide attractive return opportunities relative to the risk. Our exploration of these opportunities is ongoing and we may ultimately conclude that these alternatives do not make sense.

As we said on our last call, we do not see many straight, unleveraged investments in multifamily debt or equity in the US widely available today, which generate attractive risk-adjusted returns. However, there are limited niche investment opportunities, such as the repurchase of certain bond investments that we owned prior to our sale of TE Bond Sub, financed through a total return swap or structure, which we believe had the right risk-return profile for us moving forward.

To that end, I would like to review the recent expansion of the total return swap program. As outlined in our quarterly filing in April, we entered into total return swap agreements with a term of 5 years and a total notional amount of $75.2 million, which are effectively financing nine bonds that we owned prior to our sale of TE Bond Sub.

Under the terms of the total return swap agreements, the counterparty is required to pay us an amount equal to the interest payments received on the bonds. And the Company is required to pay the counterparty the rate of SIFMA of the spread of 135 basis points on the notional amount of the TRS.

We also invested directly in four additional bonds using $25.1 million of cash, which will serve as collateral in the new TRS agreements.

As described in our press release issued on Thursday, May 15, this transaction will create additional annualized net income of $4.8 million based on spot rates at April 30, 2014. If short-term rates were to rise over this period, our return would go down. However, our investment decision takes into account an expectation that rates will rise during the 5-year investment period.

Using the forward yield curve in place when we entered into the transaction, our expected return on investment was within our targeted mid-teens return objective. These returns are generally included in taxable income, but should be shielded by our net operating loss carry-forwards.

On a combined basis, we now have deployed about $38 million of cash into performing bond investments, with an unpaid principal balance of about $160 million, which are financed by total return swaps with notional amounts of about $126 million.

As mentioned on earlier calls, on the international side of the business, we recently closed on a single-investor fund and are working on closing our second multi-investor fund. On the single-investor fund, approximately $40 million of capital is now committed to investments by the fund in South Africa, including $2 million from us, which represents our 5% co-investment, and $38 million from the third-party investor.

As it relates to our single-investor fund, we are in a fee for services and we have participation rights and profits above a preferred return. We also earn a preferred return on our co-investment.

On the multi-investor front, we are working through due diligence with the latest potential investors and our current expectation is that we will reach a closing and begin investing on our second multi-investor fund by the third quarter. Our co-investment in this fund will be around 2%.

Turning to our share repurchase program, significant progress has been made in the execution of our buyback program. As of today, we have repurchased 3.5 million of common shares at an average price of $1.36 since inception of the program in January 2013.

As a result of the cumulative activity, in particular, our 2014 progress, we have further amended our common share buyback program by raising the total number of shares eligible to be repurchased from 5 million to 7 million. This 2 million share increase in the buyback program allows for the potential repurchase of an additional 3.5 million shares or just fewer than 9% of our current shares outstanding.

The maximum price at which we will make purchases remains at 95% of the Company's last reported common equity per share, and the Company will execute purchases under the plan using open market purchases for the foreseeable future, rather than a 10b5-1 plan.

As stated earlier, our current reported common equity per share is $2.02 at March 31, 2014, making our maximum purchase price $1.92. We want to continue to buy shares to return cash to our shareholders and help provide liquidity to the market for our shares. Although we can currently pay up to $1.92, I do want to emphasize that this is a maximum price and that going forward, we will continue to repurchase shares only at prices that we believe are competitive with alternative investments.

I will now turn the call over to Lisa to review the Company's first quarter 2014 results. Lisa?

Lisa Roberts: Thank you, Mike. We reported common shareholders' equity of $80.7 million at March 31, 2014 as compared to $65.3 million at December 31, 2013. The increase in common shareholders' equity included $16.4 million of comprehensive income, allocable to common shareholders, partially offset by a $900,000 reduction to common equity as a result of our share buyback program, whereby 700,000 shares were repurchased during the first quarter at an average price of $1.28.

Consistent with our recent quarterly financial results press releases, our press release issued on Thursday, May 15, included both an adjusted income statement and an adjusted balance sheet. These reports better enable us to explain our results to you by removing the impact of consolidated funds and ventures and discontinued operations. Due to these adjustments, they are considered non-GAAP metrics. Therefore, we have reconciled them to the published GAAP financial results.

Turning to the adjusted income statement, Exhibit B of our press release, on Exhibit B, line 17 shows total comprehensive income to common shareholders of $16.4 million for first quarter 2014 as compared to $50.3 million for first quarter 2013.

Total comprehensive income for first quarter 2014 is comprised of net income of $13.6 million reported on line 15 and total other comprehensive income of $2.8 million recorded on line 16. A significant portion of our reported total comprehensive income represented $15 million of gains attributable to common shareholders associated with the disposal of real estate reflected on line 11.

Total other comprehensive income of $2.8 million is primarily comprised of $4.9 million of net unrealized bond gains arising during the period, partially offset by the transfer of unrealized bond gains of $2 million [internet] income as a result of real estate consolidation reflected on line 12 having no impact on overall common shareholders' equity.

Starting back at the top of the adjusted income statement, on line 1, adjusted bond interest income was $5.7 million for first quarter 2014, down $11.4 million from first quarter of 2013's adjusted bond interest income of $17.1 million. The majority of this decline was driven by declines in the weighted average bond portfolio, from $1.1 billion for first quarter 2013 to $284.5 million for first quarter 2014 as a result of our sale of our common shares in TEB during the third quarter of 2013.

On line 2, income from preferred stock was flat at $1.3 million for first quarter 2014 and first quarter 2013.

On line 3, adjusted asset management fees includes asset management fees from the international funds and the US tax credit equity funds we manage. We earned $1.4 million for first quarter 2014, up about $400,000 from first quarter 2013, largely due to fees earned during first quarter 2014 related to the South Africa partnership, which was entered into during fourth quarter 2013.

On line 4, adjusted other income, which includes revenue from our remaining solar facilities, interest on short-term investments, and other miscellaneous items, was $400,000 and fairly consistent with amounts reported for first quarter 2013.

On line 6, adjusted interest expense includes interest expense on debt, but also includes interest payments on interest rate contracts and distribution on TEB's preferred shares prior to the sale.

Adjusted interest expense was $4.9 million for first quarter 2014, down $7.8 million from first quarter 2013's adjusted interest expense of $12.7 million. The majority, or $7 million, of this reduction was due to interest and distributions on TEB-related debt and preferred shares that was transferred as part of the sale of TEB.

Interest expense on our subordinate debt also decreased $700,000 quarter-over-quarter as a result of a debt buyback completed during first quarter 2013.

On line 7, adjusted operating expenses include salaries and benefits, general and administrative expenses, professional fees and other miscellaneous expenses. These expenses were $6.3 million for first quarter 2014, down $2.7 million from first quarter 2013, driven by a reduction in operating costs across the board.

On line 9, adjusted gains and losses on assets and derivatives includes a $300,000 unrealized loss on a derivative recorded during first quarter 2014 in order to reflect our derivatives at their estimated fair value.

Net gains of $1.5 million for first quarter 2013 were primarily related to net gains on loans of $1.2 million comprised of $900,000 in cash proceeds received on loans which had no carrying value and a lower cost to market gains of $300,000.

On line 10, we reported net gains on early extinguishment of liabilities of $36.3 million for first quarter of 2013, which included a $37.9 million gain on the repurchase of $45.5 million of subordinate debt unpaid principal balance or $17.4 million, plus accrued interest that had a book carrying basis of $56.9 million. Partially offsetting this gain was a $1.5 million loss on the redemption of certain preferred shares held by TEB prior to the sale.

On line 11, adjusted net gains on the sale of real estate were $15 million for first quarter 2014 as compared to $3.6 million for first quarter of 2013.

As discussed during our last call, in 2012, we began a disposition plan for a subset of six multifamily properties serving as collateral to our bonds. During the first quarter of 2013, one of these properties was sold, resulting in gains to the common shareholders of $3.6 million. During the first quarter of 2014, we sold the remaining two properties, resulting in gains to the common shareholders of $14 million.

These gains from the sales were largely a result of value (inaudible) over the past several years that were not reflected in our book basis because we were accounting for these investments as real estate instead of bonds during the time period that values were rising. As you may recall, our bonds are reflected at their estimated fair value. However, value appreciation above cost basis for real estate cannot be recognized for GAAP accounting purposes until the value appreciation is realized through a disposition.

We discussed earlier the activity reported on line 12 relates to real estate that we foreclosed on during first quarter that resulted in unrealized gains reported on the underlying bond being transferred out of accumulated other comprehensive income, and [internet] income having no impact on equity.

Line 13, adjusted other net losses, includes various asset impairments, depreciation, income and loss allocations on certain equity investments and other miscellaneous items. The decline in losses from first quarter 2013 to first quarter 2014 was mainly due to lower equity and losses from lower tier property partnerships quarter-over-quarter.

Finally, on line 14, the income tax benefit of $1.5 million during first quarter of 2013 was driven by the favorable outcome on our amended Massachusetts tax returns, for years 2004 through 2006, whereby we received a $1.8 million refund during 2013.

Turning now to the adjusted balance sheet reported on Exhibit A, Exhibit A adjusts our balance sheet to remove the assets, obligations and third-party equity related to certain funds and ventures that are consolidated on our GAAP balance sheet, even though we have little to no actual equity interest.

Reported on line 1 at March 31, 2014, we had cash and cash equivalents of $97.6 million and on line 2 we reported restricted cash of $35 million.

As reflected on line 3, we had bonds with a book carrying value of $222.6 million, comprised of multifamily tax-exempt bonds and community development district bonds. And as discussed in our filings, we estimated the fair value of these bonds to be $224.7 million at March 31, 2014 or $2.1 million higher than our book carrying value.

As discussed previously, this value has not been recognized for GAAP because in certain instances, we account for the real estate serving as collateral to our bonds and under GAAP, we cannot recognize the value appreciation until the real estate is sold.

As reflected in our filing at March 31, 2014, the unpaid principal balance of our bond portfolio was $265.5 million and the average pay rate on the portfolio was 5.2%. Also, our bond portfolio had $130.2 million of associated debt, mainly total return swap financings, with a weighted average effective interest rate and pay rate of approximately 3%.

Line 4 reflects a $4.8 million book basis in our equity investments in the South Africa ventures we manage. In addition to our equity interests, which give us the right to investment returns, as well as carried interest, our international operations is entitled to fees for providing asset management and other services to the fund.

On line 5, we show a book basis of $24.4 million, which includes a multifamily property in Louisiana, three land investments, one in California, one in Arizona and one in Virginia, and an equity investment in a real estate partnership that holds land in Georgia.

Line 6 shows the real estate we have classified as held for sale at March 31, 2014. This represents three multifamily real estate properties we foreclosed on during first quarter 2014, which served as collateral to three of our bonds. We have classified these as held for sale as we are actively marketing these properties and expect to sell in the foreseeable future.

Also, as reflected in our first quarter filing, we estimate the fair value of the real estate reflected on lines 5 and 6 to be approximately $51.8 million, which is about $6.6 million higher than our current GAAP carrying amount of $45.2 million.

Line 7 shows our investment in preferred stock. As discussed in our disclosures, this is an investment in a private national mortgage lender and servicer specializing in affordable and market-rate multifamily housing, and is the entity we sold our agency lending business back in 2009.

At March 31, 2014 the liquidation preference on these shares, which is the unpaid principal amount payable to us, as well as the estimated fair value of these shares, was $36.6 million and the weighted average pay rate was 14.4%. Also, these investments have $36.6 million of associated debt in the form of total return swaps with an average pay rate of 4.2% at March 31, 2014.

Turning to the liabilities side of the balance sheet, the majority of debt reflected on line 10 of $345.7 million with a weighted average effective rate of 5.4% and a weighted average pay rate of 3.2% at March 31, 2014. Earlier I outlined that $130.2 million of this debt relates to our bond portfolio and $36.6 million relates to our preferred stock investment.

We also have a book basis in subordinated debt of $146 million which is considered corporate debt and not asset-specific debt. The remaining debt balance of $32.9 million is comprised mainly of notes payable and other debt, most of which is not financing interest-earning assets.

With that, I will now turn the call back over to Mike. Mike?

Michael Falcone: Thanks, Lisa. Before opening up the call, I want to take a moment to say that over the intermediate term, we feel there will be opportunities to put capital to work in an effective manner that will create significant shareholder value in the long run. In the interim, we'll continue to look for ways to maintain or improve the attractiveness of an investment in our shares.

As always, we remain committed to our shareholders and thank you for your support.

We'll now open the call to questions. Operator?

Questions & Answers

Operator: (Operator Instructions) Our first question comes from Jesse Greenfield with Greenfield Investments. Please go ahead.

Jesse Greenfield: Mike, first, I want to compliment the management team in its effort to stabilize and turn around MuniMae. I know it's been a long road and you guys seem to be on the right road.

So now, let's discuss what's going forward, which is -- my question is where do we go from here? The Company has a book value just over $2. I could probably make an argument that in liquidation, you might be able to get up to $3.

So I'd like you to explain what the game plan is to justify going forward as an operating company and what you see as growth areas. And how do stockholders get a significantly better return than that $3 figure that I just threw out? I think it's really important for the stockholders for you to articulate your vision as to where the Company is going.

Michael Falcone: Sure. And I guess we ought to start with the value of the Company as we see it today. The vast majority of our assets are mark to market today and those that are not, we've disclosed, or the majority of those that are not, we've disclosed in a footnote related to REO.

The big asset, if you will, that's not on our books is the net operating loss carry-forwards and those get eliminated in a liquidation. So I'm not sure I can totally agree with your premise as to where liquidation value may get to. The flip side though is, I think, the important question, which is how do we create value for our shareholders moving forward. And what we're seeing is there are really two categories there of opportunities. One is essentially investment opportunities and the other in investment in businesses.

On the investment opportunity side, we have seen total return swap investments, both with our old bonds, and we're also looking at other opportunities that are producing substantial returns in the mid-teens, and in the short term, even higher, mid-teens over the expected life of the investment. So we think that there are attractive investment returns.

At the same time, we can put money to work in our existing business internationally and get substantial returns on the capital we put to work, as well as getting returns from asset management fees and promote, which generate quite attractive IRRs in that business.

And we are looking for similar business opportunities, whether abroad or more likely, I think, in the US, where we can put our skills to work as investment managers, as asset managers, as experts in the housing space, in order to try to drive value. And we think over time, we can produce returns on equity which are certainly competitive with what investors can achieve in similar investments in real estate investment companies. And those returns are shielded by the net operating losses.

We are disadvantaged, frankly, by being a smaller company and so our overhead, relative to being public, is a higher number than for most companies, but we benefit from the net operating losses in a way which enables us, we believe, to achieve competitive returns over time.

Jesse Greenfield: Okay. Also, Mike, there seems to be zero coverage in the investment community for MuniMae. Is there any plan of attack to see if we can get some better coverage and is the story worth telling to other people?

Michael Falcone: We certainly believe the story is worth telling. We are looking at opportunities to improve the way the stock trades. We've been trying to be proactive in the use of the share buyback program to return capital to the investors and to keep the stock relatively liquid. We are looking at the question of whether or not we should return to an exchange, and if so, which exchange. That's something we're working on this summer, and we'll probably have more to talk about that as time goes on.

Jesse Greenfield: Okay. And lastly, Mike, there's three members of the Board just recently retired. What is the process in selecting replacements? And frankly, how do we keep the Board to be independent and objective?

Michael Falcone: Frankly, we, at this point, have four independent Board members, only one insider and that's me. We have known that the existing -- the Board members who retired were headed toward retirement. Given their age, it was not a surprise.

And the Board, over the last few years, has added younger Board members who are independent in all respects, who have got significant business experience. And at this point, we don't believe a big board is appropriate for a company of our size. Whether we add additional Board members over time will be a decision for the Board going forward.

But I think that this transition was one that was expected and we have added Board members with particular expertise in expectation of Board members stepping down.

Jesse Greenfield: Okay. Thanks, Mike, I appreciate it.

Michael Falcone: Thank you, Jesse.

Operator: (Operator Instructions). As we have no further questions, this concludes the question-and-answer session. I would like to turn the conference back over to Michael Falcone for any closing remarks.

Michael Falcone: Thanks, Operator. Again, on behalf of Management and the Board, the remaining Board members, I would like to thank the Board members who have recently retired. We will be speaking to their service again tomorrow at our annual meeting, but Mark Joseph, Fred Pratt and Doug McGregor provided excellent service to the shareholder through very trying times and they will be missed.

But I think part of their contribution to the Company was that they planned well for their departures and we've got a very strong Board moving forward with a wide degree of experience. And we're excited about the future of the Company, given where we've gotten to over the last couple of years. So thank you all for your support and we look forward to continuing to move the Company forward. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.