# GLAUCUS RESEARCH GROUP

*"Winter is Coming."* - ***George R.R. Martin, Game of Thrones***

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SHORT: Altisource Asset Management Corp | NYSE: AAMC
LONG: Altisource Residential Corp | NYSE: RESI
INDUSTRY: Real Estate Finance

Ticker:
AAMC
Recommendation:
Strong Sell
Price:
$1,023.81
As of Market Close 03/18/2014
Market Cap:
$2.7 billion
Price Target:
$130.07

Ticker:
RESI
Recommendation:
Strong Buy
Price:
$31.04
As of Market Close 03/18/2014
Market Cap:
$1.8 billion
Price Target:
$66.31

ALTISOURCE ASSET MANAGEMENT CORP (NYSE: AAMC) ("AAMC"), a recent spinoff from Bill Erbey's empire of distressed real estate and mortgage interests, is the asset manager for ALTISOURCE RESIDENTIAL CORP (NYSE: RESI) ("RESI"), which owns a portfolio of non-performing mortgages ("NPLs") and foreclosed single-family homes. In exchange for these services, AAMC receives a quarterly incentive fee, which in Q4 2013 was **equal to 32% of RESI's dividends paid to shareholders** (the "Incentive Fee").

We believe that AAMC's Incentive Fee is at **least four to seven times higher than the compensation received by similarly situated asset managers**, and as such, is a sweetheart deal that will unjustly enrich insiders with a beneficial stake in AAMC at the expense of RESI's shareholders.

As shareholders of RESI, we believe that RESI's independent directors **have a fiduciary duty to either terminate or substantially renegotiate its asset management agreement with AAMC**. To terminate the Asset Management Agreement between AAMC and RESI at the earliest date permitted under the contract (**December 21, 2014**), RESI's independent directors must give notice of their intent to do so by **June 24, 2014** (97 days from today). We expect to **sue RESI's independent directors** for violating their fiduciary duty of loyalty to RESI's shareholders unless they address the lopsided compensation deal given to AAMC. RESI's independent directors are as follows:

- Michael A. Eruzione (former captain of 'miracle on ice' 1980 U.S. Olympic Hockey team)
- Robert J. Fitzpatrick (CFO of Institutional Mortgage Capital Canada, Inc.)
- James H. Mullen, Jr. (President of Allegheny College in Meadville, PA)
- David B. Reiner (Managing Director of Regional Real Estate Investment Corporation)

1. **A Clear Conflict of Interest**. **RESI** does not have its own executives. Rather, AAMC's management team serves in a dual role as both asset managers and executives of RESI, even though they owe **no fiduciary duty to RESI's shareholders**. Furthermore, AAMC's Incentive Fee is calculated by an opaque methodology and is therefore difficult to model (evidenced by the fact that Wall St. consensus estimates *underestimated it by 454% in Q4 2013*), giving AAMC significant discretion in calculating its own paycheck. Because AAMC's executive team today owns far more equity in AAMC than RESI, AAMC's management team **is financially incentivized to generate large asset management fees at the expense of RESI's shareholders**.

2. **RESI Massively Overpays AAMC**. Wall St. analysts estimate that AAMC's Incentive Fee will be 45% of RESI dividends in 2015, rising steadily from 32% for Q4 2013. We believe this compensation is significantly **higher than the market compensation paid to similarly situated asset managers**.

   a. **AAMC's Incentive Fee is Worth $2.7 billion**. AAMC's market capitalization reflects the net present value that the market places on AAMC's rights under the Asset Management Agreement. By firing or internalizing its asset manager (or substantially renegotiating AAMC's fees), RESI's independent directors could capture much of the

value of AAMC's management fees for RESI's shareholders, which we estimate would **increase RESI's share price by 114%** **and** **boost its 2015 dividends by at least $0.15 per quarter per share**.

b. **Internally Managed REITs**. Analysts expect RESI to pay **40%-45%** of its dividends to rent a small management team (AAMC has seven employees and no material assets). By comparison, four internally managed mortgage REITs (NYSE: MFA, CMO, CYS and NLY) recently paid an average of **6.2%** of their distributable dividends as compensation to their respective internal asset managers, suggesting that RESI pays AAMC **over 7x what similarly situated mortgage REITs are paying for internal asset management**.

c. **Externally Managed REITs**. Widening the comp set to include twelve externally managed mortgage REITS shows that RESI pays AAMC around **4x more** than the amount paid by other REITs to external asset managers.

d. **AAMC's Straw Man**. RESI's management presentation includes a misleading comparison of its asset management fees with SWAY, a REIT with virtually the same strategy and an almost identical portfolio of NPLs and single-family homes. This comparison is blatantly misleading, as SWAY's asset manager has 545 employees and performs both asset management and property management functions. RESI is paying more for less: at an 8% ROE, SWAY's manager receives roughly **$50,000 in fees per employee** whereas AAMC receives **$3.4 million per employee**!

3. **RESI has the Contractual Right to Revisit the Asset Management Agreement**. A termination provision in the Asset Management Agreement gives RESI's independent directors the right to cancel or renegotiate the contract in the event that two-thirds of RESI's independent directors believe that AAMC's Incentive Fee is unreasonable, which in our opinion, is self-evident given that AAMC is paid four to seven times more than comparable (not to mention larger and more experienced) asset managers.

4. **Independent Directors Have A Fiduciary Duty to Fire AAMC or Lower the Incentive Fee**. We believe that RESI's independent directors face the material risk of a shareholder derivative suit over the Asset Management Agreement with AAMC. A potential plaintiff could easily argue that the independent directors violated their **duty of loyalty** to the corporation by giving AAMC a sweetheart deal on terms that are 4-7x above the market price for an asset manager.

a. **Limited Disruption**. RESI shareholders need not fear disrupting its relationships with Ocwen Financial (NYSE: OCN) (its mortgage servicer) or Altisource Portfolio Solutions (NASDAQ: ASPS) (its property manager), both related parties under the Erbey empire. RESI barely needs ASPS right now because it has few rental properties (RESI paid ASPS $2.8 million for property management and other expenses in 2013), making switching costs to another property manager painless. As for Ocwen (RESI paid OCN $9.3 million in 2013), mortgage servicers are a dime a dozen (Ocwen is fourth in the US residential space with 5% market share), making it highly likely that RESI can quickly and easily find a replacement.

5. **Valuation**. We believe that RESI's independent directors have a fiduciary duty to terminate the Asset Management Agreement or, at the very least, significantly renegotiate AAMC's Incentive Fees. The market believes that the NPV of AAMC's Incentive Fee is a staggering $2.7 billion. We project that RESI's share price will increase by up to 114% and its dividends **will increase by $0.15 per quarter per share** if it captures ¾ of these expected cash flows. We also estimate that AAMC's share price will fall by up to 87% as its compensation is brought in line with market rates.

RESI's independent directors must act quickly: with each passing quarter, AAMC's Termination Fee will only get larger. We estimate that if RESI terminates the contract in December 2014, the Termination Fee under the contract will be ~**$55 million**. By December 2015, we estimate that the Termination Fee will rise to a whopping ~**$120 million**. Winter is coming.

# Disclaimer

*We are biased. So are other investors. So is AAMC. So is RESI. So are the banks that raised money for both companies. If you are invested (either long or short) in AAMC or RESI, so are you. Just because we are biased does not mean that we are wrong. We, like everyone else, are entitled to our opinions and to the right to express such opinions in a public forum. We believe that the publication of our opinions and the underlying facts about the public companies we research is in the public interest.*

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**"TANGLED WEB OF CONFLICTS"**

ALTISOURCE ASSET MANAGEMENT CORP ("AAMC") (NYSE: AAMC), a recent spinoff from Bill Erbey's empire of distressed real estate and mortgage interests, is the asset manager for ALTISOURCE RESIDENTIAL CORP ("RESI") (NYSE: RESI), which owns a portfolio of non-performing mortgages ("NPLs") and foreclosed single-family homes.

On February 26, 2014, New York State's banking regulator, Benjamin M. Lawsky, supervisor of the state's Department of Financial Services, released a letter to Ocwen Financial Corporation ("Ocwen") (NYSE: OCN), RESI's mortgage servicer, stating that his office found a "number of potential conflicts of interest between Ocwen and other public companies (including RESI and AAMC) with which it is closely affiliated." Mr. Lawsky expressed concern that such a **"tangled web of conflicts could create incentives that harm borrowers and push homeowners unduly into foreclosure**."

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

February 26, 2014

Timothy Hayes
General Counsel
Ocwen Financial Corporation
1661 Worthington Road, Suite 100
West Palm Beach, FL 33409

Dear Mr. Hayes:

The Department's ongoing review of Ocwen's mortgage servicing practices has uncovered a number of potential conflicts of interest between Ocwen and other public companies with which Ocwen is closely affiliated. Indeed, the facts our review has uncovered to date cast serious doubts on recent public statements made by the company that Ocwen has a "strictly arms-length business relationship" with those companies. We are also concerned that this tangled web of conflicts could create incentives that harm borrowers and push homeowners unduly into foreclosure. As such, we are demanding additional information on these issues as part of our review.

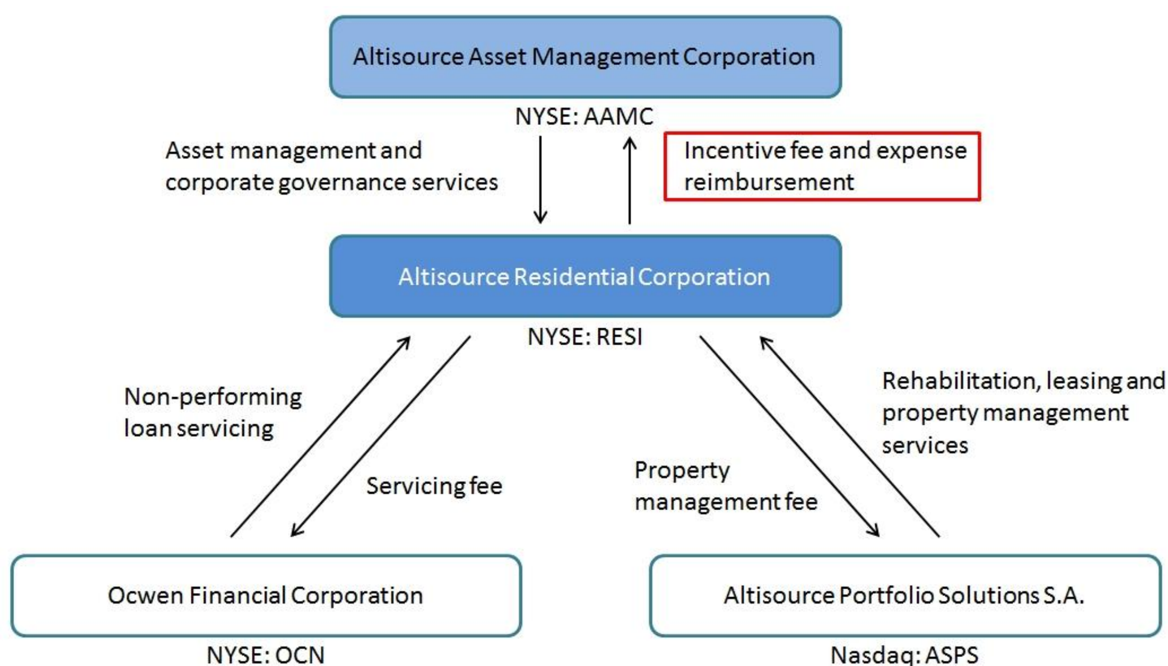
Pursuant to the December 4, 2012 Consent Order between Ocwen and the Department, we have engaged an independent on-site compliance monitor at Ocwen to conduct a comprehensive review of Ocwen's servicing operations. It is in the course of the monitorship that we uncovered these potential conflicts between and among Ocwen, Altisource Portfolio Solutions, S.A. ("Altisource Portfolio"), Altisource Residential Corporation, Altisource Asset Management Corporation, and Home Loan Servicing Solutions Ltd. (together, the "affiliated companies"), all of which are chaired by William C. Erbey, who is also the largest shareholder of each and the Executive Chairman of Ocwen.

We believe that we have identified another significant potential conflict of interest in the Erbey empire, this time between AAMC and the interests of RESI's shareholders. Specifically, we believe that RESI massively overpays AAMC to manage its assets, so much so that in our opinion, RESI's independent directors **have a fiduciary duty, prior to June 24, 2014, to provide written notice to AAMC of their intent to terminate or renegotiate** the Asset Management Agreement by the earliest date permitted under the contract: December 21, 2014.

RESI purchases non-performing residential mortgages at a discount to face value. It owns the right to collect mortgage payments from the debtors, and in case of a default, to foreclose on the underlying real estate. After seizing properties through foreclosure, RESI rents out the homes as single-family units. As a REIT, RESI is not permitted to retain its earnings and by law must pay at least 90% of its REIT taxable income in the form of shareholder dividends each year.

RESI is a variable interest entity ("VIE"). As the primary beneficiary of the VIE, AAMC reports on a consolidated basis (with RESI), but to be clear, RESI owns all of the real estate and NPLs. AAMC owns none. AAMC's **only material source of income** is the Incentive Fee pursuant to the Asset Management Agreement with RESI. But RESI **does not have its own management or executive team to safeguard the interests of its shareholders**. Rather, AAMC's executives' serve in a dual role as both asset managers and RESI's executives.

RESI separately pays Ocwen Financial Corporation ("Ocwen"; NYSE: OCN) to service its acquired loans. In addition, RESI's pays a property management fee to Altisource Portfolio Solutions S.A. (NASDAQ: ASPS) ("ASPS") to manage any homes it has acquired through foreclosure on an NPL. RESI sits at the epicenter of a labyrinthine structure, with AAMC at the top. The following diagram illustrates the interlocking relationships between the four companies and the flow of funds within the structure.




Ultimately, we believe that AAMC earns too much to do too little. We estimate that RESI pays AAMC seven times more than what internally managed mortgage-REITs pay their asset managers. AAMC's Incentive Fee appears to be a sweetheart deal that enriches the beneficial owners of AAMC at the expense of RESI's shareholders.

As a shareholder of RESI, we believe it is of paramount importance that RESI's independent directors renegotiate or terminate this egregious contract by the end of 2014. Not only would such a reduction in asset management fees (especially if RESI internalized AAMC's team) be a boon to **RESI shareholders**, it would signal to the market and regulators the independence of RESI and its directors from the other companies in the Ocwen empire.

**A CLEAR CONFLICT OF INTEREST**

The letter recently released by Benjamin Lawsky, the supervisor of New York's Department of Financial Services, raised the regulator's concerns that Ocwen's management has "**the opportunity and incentive to make decisions** concerning Ocwen that are intended to benefit the share price of affiliated companies, **resulting in harm to … Ocwen's shareholders as a result**."

The letter highlighted that Ocwen's chief risk officer was also the chief risk officer of ASPS "and reported directly to Mr. Erbey in both capacities. This individual seemed not to appreciate the potential conflicts of interest posed by this dual role, which was particularly alarming given his role as Chief Risk Officer."

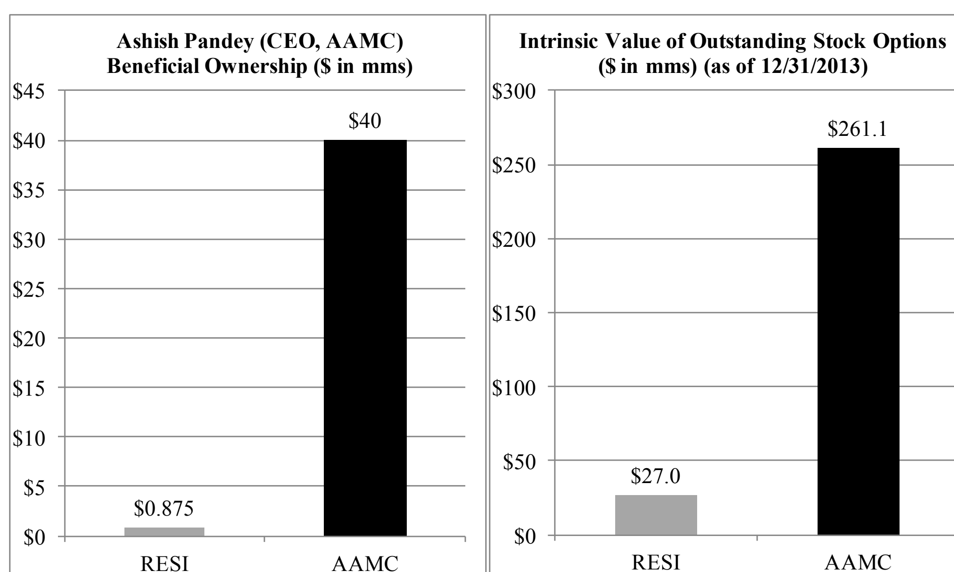
We believe that the conflict of interest is just as clear in the case of AAMC and RESI. **RESI** does not have its own executives or management team. Rather, AAMC's management team serves in a dual role as both asset managers and a rental executive team for RESI and, critically, report to Bill Erbey in both capacities (Erbey is the chairman of the board of both companies).

RESI's prospectus makes clear that **AAMC and its officers do not have a fiduciary duty to RESI** shareholders:

***AAMC has a contractually defined duty to us rather than a fiduciary duty.***

Under the asset management agreement, AAMC has a contractual, as opposed to a fiduciary, relationship with us that limits AAMC's obligations to us to those specifically set forth in the asset management agreement. The ability of AAMC and its officers and employees to engage in other business activities may reduce the time AAMC spends managing us. In addition, unlike the fiduciary relationship we have with our directors, there is no statutory standard of conduct under the Maryland General Corporation Law, which we refer to as "MGCL," for officers of a Maryland corporation. Instead, officers of a Maryland corporation including our officers who are employees of AAMC, are subject to general agency principles including the exercise of reasonable care and skill in the performance of their responsibilities as well as the duties of loyalty, good faith and candid disclosure.

Even more critically, AAMC's management team is financially incentivized **to increase AAMC's fees**, even though higher fees reduce dividends paid to RESI's shareholders. **AAMC CEO Ashish Pandey owns 45 times more equity in AAMC than RESI**: as of February 24, 2014, he currently **owns over $40mm** in restricted stock and options in AAMC and a paltry $875,000 in shares of RESI.



Note: Ownership includes restricted stock and options.

Further, outstanding stock options granted under AAMC's options plan have **almost 10 times the intrinsic value** of the options granted by RESI.

In our view, this could not be a clearer conflict of interest. RESI does not have a single executive, officer or employee to safeguard the interests of RESI's shareholders, or to ensure that AAMC is not overreaching with its Incentive Fee. Just as Mr. Lawsky recently objected to, the same executives report to Bill Erbey in both capacities. Furthermore, because AAMC's CEO owns far more equity in AAMC than RESI, AAMC's management team **has every financial incentive to increase AAMC's asset management fees at the expense of RESI's shareholders**.

As if such misaligned incentives were not enough, the methodology used to calculate the Incentive Fee is opaque, and in our view, may be subject to tinkering and gamesmanship by AAMC.

Investors should fear what they do not understand. They should fear even more what Wall St. analysts, whose ubiquitous access to the management team and expertise in modeling, do not remotely understand.

Prior to AAMC's February 2014 earnings announcement and annual report, investors and Wall St. analysts modeled AAMC's Incentive Fee as a percentage of cash dividends to RESI's shareholders (a figure driven by REIT taxable income). It therefore came as a great surprise to experts and laymen alike when AAMC announced that its Q4 2013 Incentive Fee was **454% higher than consensus estimates**. In the following chart, we compare the *ex-ante* estimates for RESI's dividends and asset management fee to the reported figures.

**Q4 2013 Street Estimates vs. Actual**

| **RESI Dividends Paid** | **4Q 2013** |
|---|---|
| Credit Suisse | $ 0.25 |
| Deutsche Bank | $ 0.25 |
| Piper Jaffray | $ 0.24 |
| **ACTUAL RESI Dividends Paid** | **$ 0.33** |
| ***% Difference*** | **34%** |

| **AAMC Incentive Fee** *(in $USDmm)* | **4Q 2013** |
|---|---|
| Credit Suisse | $ 1.0 |
| Deutsche Bank | $ 0.7 |
| Piper Jaffray | $ 0.9 |
| **ACTUAL AAMC Incentive Fee Paid** | **$ 4.8** |
| ***% Difference*** | **454%** |

Source: Analyst reports from January 2014.

Actual RESI dividends paid of $0.33 includes special dividend of $0.08 per share.

This chart only serves to illustrate that while analysts accurately predicted RESI's dividends, there was absolutely no understanding of how RESI's performance influenced AAMC's Incentive Fee. This ambiguity permits AAMC significant leeway to determine its own compensation.

Section 4(a) of the Asset Management Agreement provides that, in exchange for managing RESI's portfolio of loans and residential assets, RESI shall pay AAMC an Incentive Fee of between 2% and 50% of the amount of "**cash dividends paid by RESI to its shareholders**" each quarter. The Incentive Fee is structured as a waterfall: the more assets RESI acquires (and the better the returns on such assets), the greater the fee to which AAMC will be entitled. The following is an excerpt of the contract:

4. Compensation of the Asset Manager.

(a) On the last day of each fiscal quarter of Residential, Residential agrees to pay, and the Asset Manager agree to accept, as compensation for the services provided by the Asset Manager hereunder, an incentive fee (the "Incentive Fee") as hereinafter set forth and by way of example on Exhibit I attached hereto:

(i) *first,* 2% of the amount of cash dividends paid by Residential to its shareholders with respect to such cash during such fiscal quarter until the Quarterly Per Share Distribution Amount exceeds the First Threshold during such fiscal quarter, as such amount may be adjusted from time to time pursuant to Section 4(d) hereof;

(ii) *second*, 15% of the amount of additional cash dividends paid by Residential to its shareholders with respect to such cash during such fiscal quarter until the Quarterly Per Share Distribution Amount exceeds the Second Threshold during such fiscal quarter, as such amount may be adjusted from time to time pursuant to Section 4(d) hereof;

(iii) *third*, 25% of the amount of cash dividends paid by Residential to its shareholders with respect to such cash during such fiscal quarter until the Quarterly Per Share Distribution Amount exceeds the Third Threshold during such fiscal quarter, as such amount may be adjusted from time to time pursuant to Section 4(d) hereof; and

(iv) *thereafter*, 50% of the amount of cash dividends paid by Residential to its shareholders with respect to such cash during such fiscal quarter.

Any investor reading this clause would reasonably believe that AAMC's Incentive Fee was calculated from the dividends paid to RESI's shareholders each quarter. RESI quarterly dividends, driven by REIT taxable income, are easily modeled and thus transparent to investors and analysts alike. But as we saw in Q4 2013, this is NOT the case.

In the very next sentence, Section 4(b), the Asset Management Agreement states "for purposes of [calculating AAMC's Incentive Fee], RESI shall be deemed to have made quarterly distributions to its shareholders of all of its "**Available Cash**."

Available Cash is not a GAAP term. Rather, it is a term in the Asset Management Agreement whose definition is so opaque that, in our view, it cannot be reliably predicted or cross-checked. The Asset Management Agreement defines Available Cash as the sum of **all cash receipts of RESI** (plus any reduction in reserves) minus the sum of all cash disbursements (plus any increase in reserves):

(b) For purposes of this Agreement Residential shall be deemed to have made quarterly distributions to its shareholders of all of its Available Cash.

(c) For purposes of this Section 4, the following terms shall have the following meanings:

(i) "Available Cash" shall mean, with respect to any fiscal quarter:

A. the sum of:

(1) all cash receipts of Residential during such quarter from all sources (including, without limitation, distributions of cash received from the Partnership and cash proceeds from Capital Transactions); and

(2) any reduction in reserves with respect to such quarter from the level at the end of the prior quarter;

B. less the sum of:

(1) all cash disbursements of Residential during such quarter, including, without limitation, disbursements for operating expenses, taxes, if any, debt service (including, without limitation, the payment of principal, premium and interest), capital expenditures and contributions, if any, to the Partnership; and

(2) any reserves established with respect to such quarter, and any increase in reserves established with respect to prior quarters, in such amounts as the Board of Directors determines in its reasonable discretion to be necessary or appropriate (x) to provide for the proper conduct of the business of Residential and its subsidiaries (including, without limitation, reserves for future capital expenditures or the purchase or other acquisition of Real Estate Assets) or (y) because the distribution of such amounts would be prohibited by applicable law or by any loan agreement, security agreement, mortgage, debt instrument or other agreement or obligation to which Residential or any of its subsidiaries is a party or by which any of them is bound or by which any of their assets are subject.

The methodology is opaque, as evidence by the significant disparity between Wall St.'s forecasts of AAMC's Incentive Fee and the fee paid in Q4 2013. Whereas it is relatively easy to model RESI's REIT taxable income, it is comparatively difficult to model quarterly cash flows from RESI to AAMC based on the information provided to the market.

To the extent that AAMC's Incentive Fee is based on either the subjective judgment of AAMC's management team (such as the reduction or increase of reserves) or the timing of cash realization events, RESI's shareholders should worry that AAMC's payment is vulnerable to tinkering. The overlapping management, Bill Erbey's control of both companies, and the opaque and unpredictable methodology by which AAMC writes its own paycheck, are compounded by the fact that AAMC's executives are **financially incentivized to generate the highest asset management fees possible**. In our opinion, such incentives create a clear conflict of interest, to the detriment of RESI's shareholders.

**RESI MASSIVELY OVERPAYS AAMC**

Comparing the cost of AAMC's Incentive Fee to the compensation structure of other internal and external asset managers of mortgage and single-family REITs shows just how much RESI is overpaying. A survey of comparable asset managers reveals that AAMC's compensation is currently around **four to seven times higher than the market** value for a manager of a portfolio of residential and/or NPL assets.

1) *AAMC's Incentive Fee is Worth $2.7 billion.*

The simplest way to determine whether AAMC's Incentive Fee is reasonable is to examine the market value of the stream of payments it is entitled to receive under the Asset Management Agreement. AAMC's only customer is RESI, and its **only material** source of revenue is the stream of fees it expects to receive from RESI. In fact, the Asset Management Agreement includes an exclusivity provision preventing AAMC from managing the assets of other REITs. As such, AAMC's market capitalization should reflect the net present value of AAMC's rights under the Asset Management Agreement. AAMC's market capitalization is currently **$2.7 billion**.

$2.7 billion seems *a priori* unreasonable to manage a loan portfolio considering that AAMC does not service the loans, manage RESI's properties, and has only 7 employees, no assets and virtually no infrastructure. To boot, RESI reimburses AAMC for the salaries of AAMC's management team.

**Put simply, we estimate that RESI's independent directors could capture up to 75% of AAMC's $2.7 billion in market value by firing, internalizing or substantially renegotiating the fees of a 7-person asset management team whose salaries it already pays**. RESI's independent directors have a fiduciary duty to investigate whether they can hire a competent asset manager (whether external or internal) for less.

2) *Internally Managed Mortgage REITs*

Another methodology to compare AAMC's Incentive Fee to the asset management fees paid by other REITs is to measure the fees as a percentage of dividends paid to shareholders. The chart below sets forth AAMC's Incentive Fees and RESI's dividends from Q4 2013 as well as the consensus Wall St. estimates for such fees and dividends in both 2014 and 2015.

**AAMC Incentive Fee (as % of RESI Dividends)** *($ in mms)*

| | Q4 2013 | 2014E | 2015E |
|---|---|---|---|
| Piper Jaffray 1/22/2014 | | $99.7 | $130.3 |
| Deutsche Bank 1/17/2014 | | 65.6 | 82.0 |
| Credit Suisse 1/27/2014 | | 75.6 | 120.4 |
| **RESI Dividends Paid** | **$15.1** ‡ | **$80.3** † | **$110.9** † |
| Piper Jaffray 1/22/2014 | | 52.6 | 71.9 |
| Deutsche Bank 1/17/2014 | | 31.5 | 52.9 |
| Credit Suisse 1/27/2014 | | 11.5 | 24.4 |
| **AAMC Incentive Fee** | **$4.8** | **$31.9** † | **$49.7** † |
| **% of RESI Dividends** | **32%** | **40%** | **45%** |

† Consensus average

‡ Q4 2013 dividends paid of $15.1 mm includes the special dividend of $4.5 million ($0.08 per share) announced in Q4 2013.

**Based on Wall St. consensus estimates, AAMC's Incentive Fee will reach a whopping 45% of the dividends paid to RESI's shareholders in 2015.**

In the following table, we calculated the total compensation and benefits, measured as a percentage of dividends, paid by four mortgage REITs (MFA Financial (NYSE: MFA), Capstead Mortgage Corp (NYSE: CMO), CYS Investments (NYSE: CYS) and Annaly Capital Management (NYSE: NLY)) to internal asset managers of their respective loan portfolios.

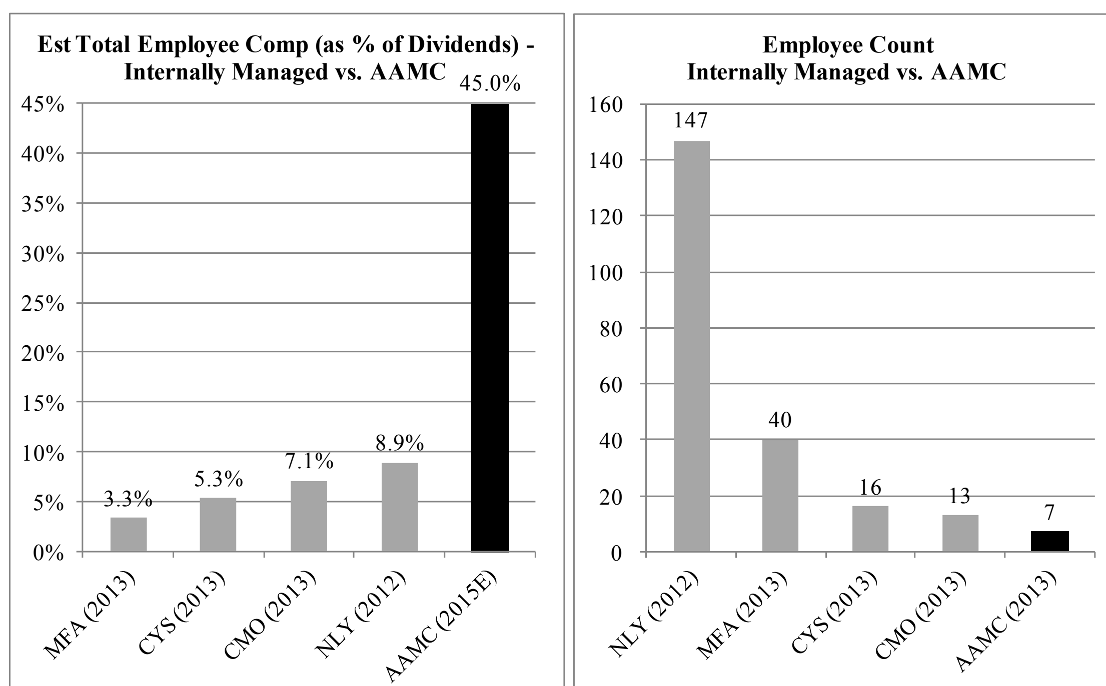
The four mortgage REITs listed below have brought management of their loan portfolios in-house for an average of **6% of their dividends**. **By our estimate, RESI will be obligated to pay AAMC seven times that amount (45% in 2015) or more going forward**.

| **Internally Managed REITs**<br>*$ in mms* | **Year** | **Total Comp & Benefits** | **Dividends Paid** | **Comp as % of Dividends** |
|---|---|---|---|---|
| MFA Financial (NYSE: MFA) | 2013 | $20.3 | $608.6 | 3.3% |
| Capstead Mortgage (NYSE: CMO) | 2013 | 9.3 | 132.2 | 7.1% |
| CYS Investments (NYSE: CYS) | 2013 | 12.6 | 235.8 | 5.3% |
| Annaly Capital Management (NYSE: NLY) | 2012† | 190.7 | 2,149.9 | 8.9% |
| | | | **Average** | **6.2%** |
| **AAMC** | **2015E** | **$49.7** | **$110.9** | **44.8%** |
| | **As multiple of Internally Managed REITs** | | | **7.3x** |

Sources: Company filings.

† NLY was converted to external management in 2013.

We believe that the four REITs identified above are suitable comps because their management teams perform a similar function to AAMC: developing and implementing an investment strategy, identifying which loans to acquire and determining how much to pay for new loans. Despite only having seven employees, RESI pays seven times as much as the four mortgage REITs to manage a portfolio of loans.



Both charts above show that RESI is paying more for less when compared to other internally managed REITs. AAMC has seven employees, no material assets and a limited operating history. AAMC does not service RESI's loans (outsourced to Ocwen). AAMC does not service the properties it obtains through default (outsourced to ASPS).

AAMC simply provides the experience and expertise of a small management team, led by 40-year-old Chief Executive Officer, Ashish Pandey, who as recently as 10 years ago was an 'Associate Consultant' with Tata Strategic Management Group and fresh off his MBA from Indian Institute of Management.

The following table is the cash compensation paid to AAMC's management team:

| **AAMC Management Cash Compensation - 2013** | | | | | |
|---|---|---|---|---|---|
| **Name** | **Title** | **Age** | **Salary** | **Target Bonus** | **Total** |
| Ashish Pandey | CEO | 37 | $ 325,000 | $ 325,000 | **$ 650,000** |
| Salah Saabneh | EVP, Corp Dev | 44 | 350,000 | 350,000 | **700,000** |
| Stephen H. Gray | General Counsel & Sec | 42 | 248,000 | 152,000 | **400,000** |
| Kenneth D. Najour | CFO | 53 | 206,150 | 206,150 | **412,300** |
| *As of 4/19/2013* | | | | **TOTAL** | **$ 2,162,300** |
| https://www.sec.gov/Archives/edgar/data/1555074/000155507413000010/aamc-2013proxystatement.htm | | | | | |

RESI is bestowing the right to a stream of payments currently valued (or overvalued) by the market at an exorbitant $2.7 billion to rent a seven-person management team who agreed to do the job for **just over $2 million** in base compensation. AAMC does not even bear the cost of its management team's salaries, as they are reimbursed by RESI.

Assuming an even moderately efficient labor market, RESI's independent directors could obtain comparable talent for $10 million in base compensation per year, which would **allow RESI to boost its consensus 2015 annual dividend by around $40 million ($0.17 per quarter per share)**.

*3) Externally Managed REITs*

Widening the comp set to include management fees paid to external asset managers of single-family REITs further underscores that RESI overpays AAMC to manage its portfolio.

In the following table, we have outlined the actual compensation paid to the asset managers of twelve externally managed mortgage REITS. Despite the fact that AAMC has by far the fewest employees, it is paid an average of **4x more**.

**AAMC Comps - Externally Managed REITS**

| | Year | Mgmt Fee Arrangement (% of BV) | Mgmt Fee (mms) | Dividends Paid (mms) | Mgmt Fee (as % of Dividends) | Employees (or access to) |
|---|---|---|---|---|---|---|
| **Two Harbors Investment Corp (NYSE: TWO)** | | | | | | |
| PRCM Advisors LLC (Asset Mgr) | 2013 | 1.50% | 41.7 | 591.5 | **7.1%** | 423 [1] |
| **Annaly Capital Management (NYSE: NLY)** | | | | | | |
| Annaly Management Co (Asset Mgr) | 2013 | 1.05% | 167.4 | 1,640.7 | **10.2%** | 147 |
| **PennyMac Mortgage Investment Trust (NYSE: PMT)** | | | | | | |
| PNMAC Capital Management (Asset Mgr) | 2013 | 1.50% | 32.4 | 147.6 | **22.0%** | 1,370 |
| **Colony Financial (NYSE: CLNY)** | | | | | | |
| Colony Financial Manager, LLC (Asset Mgr) | 2013 | 1.50% | 26.3 | 111.3 | **23.6%** | NA |
| **AG Mortgage Investment Trust (NYSE: MITT)** | | | | | | |
| AG REIT Management, LLC (Asset Mgr) | 2013 | 1.50% | 10.7 | 93.7 | **11.4%** | 18 |
| **ARMOUR Residential REIT (NYSE: ARR)** | | | | | | |
| ARRM (Asset Mgr) | 2013 | 1.13% | 28.1 | 292.6 | **9.6%** | 19 |
| **Hatteras Financial Corp (NYSE: HTS)** | | | | | | |
| Atlantic Capital Advisors LLC (Asset Mgr) | 2013 | 0.73% | 18.2 | 283.3 | **6.4%** | 16 |
| **American Capital Mortgage Investment (MGTE)** | | | | | | |
| American Capital MGTE Mgmt (Asset Mgr) | 2013 | 1.50% | 18.7 | 167.3 | **11.2%** | NA |
| **Anworth Asset Mgmt Corp (NYSE: ANH)** | | | | | | |
| Anworth Management LLC (Asset Mgr) | 2013 | 1.20% | 12.0 | 87.0 | **13.7%** | 12 |
| **Apollo Residential Mortgage (NYSE: AMTG)** | | | | | | |
| ARM Manager LLC (Asset Mgr) | 2013 | 1.50% | 11.6 | 98.5 | **11.8%** | 710 [2] |
| **Invesco Mortgage Capital (NYSE: IVR)** | | | | | | |
| Invesco Advisors (Asset Mgr) | 2013 | 1.50% | 42.6 | 332.8 | **12.8%** | 60 [3] |
| **Chimera Investment Corp (NYSE: CIM)** | | | | | | |
| FIDAC (Asset Mgr) | 2012 | 1.50% | 44.8 | 410.7 | **10.9%** | 35 |
| **Median** | | **1.50%** | | | **11.3%** | |
| **Altisource Residential (NYSE: RESI)** | | | | | | |
| **AAMC (Asset Mgr)** | **2015E** | | **49.7** | **110.9** | **44.8%** | **7** |
| | | | | | **4.0x** | |

Sources: Company filings.

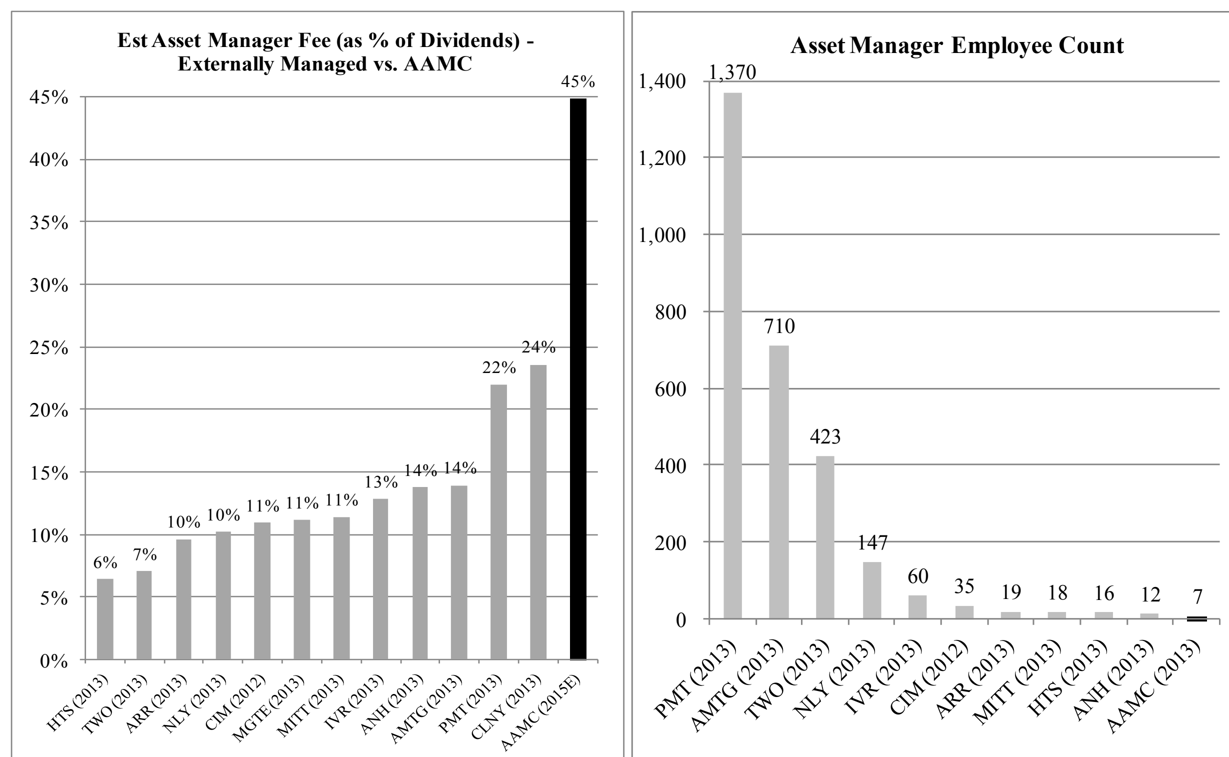
[1] via relationship with Pine River Capital Management

[2] via relationship with Apollo Capital Management

[3] via relationship with WL Ross & Co. LLC and Invesco

Assuming an even moderately efficient market for external asset managers, RESI's independent directors could obtain a perfectly competent external asset manager for $18 million in compensation per year (1.5% of book value of $1.2 billion), which would **allow RESI to boost its consensus 2015 annual dividend by around $32 million ($0.14 per quarter per share)**.

In addition, AAMC is performing fewer services for RESI than other external asset managers are performing for their respective REITs. AAMC has seven employees, while other asset managers have over **300**. Despite the fact that it has far fewer resources, AAMC is paid on average 4x more.




In our opinion, the two charts above show just how little RESI's shareholders are getting for their money. AAMC's paltry infrastructure, assets and human resources stand in stark comparison to the handsomeness of its Incentive Fee.

Recently, American Homes 4 Rent (NYSE: AMH) took its asset management in-house, acquiring its portfolio and property managers rather than continuing to pay a 1.75x-book-value incentive fee. In its public filings, AMH spoke of the **savings it believed it could achieve by internalizing these services**:

> Our results will be significantly impacted by the Management Internalization. We no longer pay the advisory management fee that it had been paying to our former manager and no longer pays property management or leasing fees to our former property manager. In addition, by December 10, 2014, we will no longer be obligated to pay to the sponsor an acquisition or renovation fee. We believe that elimination of these fees will be offset to some extent by an increase in expenses as we have assumed direct responsibility for managing our properties. However, we believe that, over time, the increases in expenses will be significantly less than the reduction in the fees associated with the Management Internalization.

CYS also recently elected to internalize its external asset manager, noting in its public filings that there was **virtually no impact to the results of its operations**.

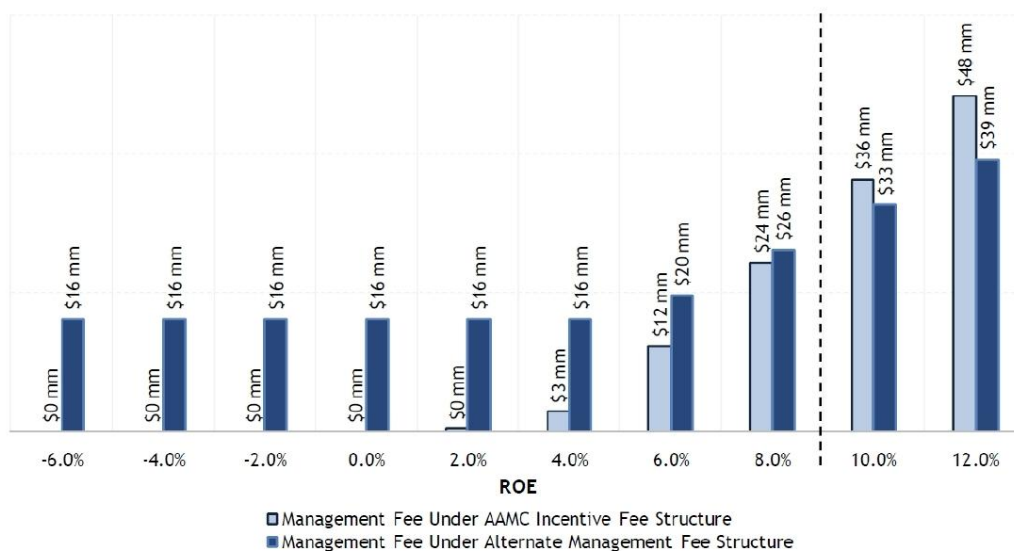
> agreements related thereto were terminated. No termination fee was incurred or paid as a result of terminating those agreements. In connection with the Internalization, the Company changed its name from "Cypress Sharpridge Investments, Inc." to "CYS Investments, Inc." on September 1, 2011. The results of the Internalization were not material to the Company's results of operations.

If AMH and CYS believed they could save on asset management by moving to internal management with **limited disruption to their operations**, and they were already paying at least **50% less than RESI**, then RESI is surely being ripped off by AAMC.

*4) AAMC'S STRAW MAN: SWAY*

RESI's most recent management presentation includes a slide which, at least first glance, appears to show investors that AAMC's asset management fee is reasonable when compared to the fees paid by an alternative company, which clearly appears to be Starwood Waypoint Residential Trust (NYSE: SWAY), a similarly situated REIT.

Comparison of Management Fee Structures




Note: This is a hypothetical illustration of management fee under the AAMC Incentive Fee Structure and an Alternate Management Fee Structure. Asset manager's fee under the Alternate Management Fee Structure is calculated as 1.5% per annum of the market capitalization. Market capitalization is determined by the net returns realized by shareholders and a market clearing yield requirement of 4%. Market capitalization is subject to a floor of 0.9x book value of equity. Assumes book value of equity of ~$1.2 billion and ~57 million shares outstanding for calculating management fee under AAMC Incentive Fee Structure. Assumes book value of equity of ~$1.2 billion in calculating management fee under the Alternate Management Fee Structure.

7

Source: RESI Q3 2013 management presentation, page 7.

We believe that this slide is **blatantly misleading**.

In January 2014, Starwood Property Trust Inc. (STWD) spun off SWAY, which will directly compete with RESI to purchase NPLs for single-family homes. SWAY currently owns 6,700 NPLs (versus RESI's 8,054 NPLs) and trades for a market cap of $1.1 billion. SWAY is managed by privately held SWAY Management, LLC ("¨SWAY's Manager"), for a per annum fee of 1.5% of SWAY's market capitalization.[1]

The reason that the slide above is misleading is that SWAY's Manager has more resources and provides more services for SWAY than AAMC does for RESI. Compare SWAY's Manager, with 545 dedicated employees, against the 7 employees at AAMC. Per RESI's own management slide, assuming an 8% return on equity, AAMC's Incentive Fee generates over **$3.4 million per employee**, whereas SWAY's Manager will earn less than $50,000 per employee.[2]

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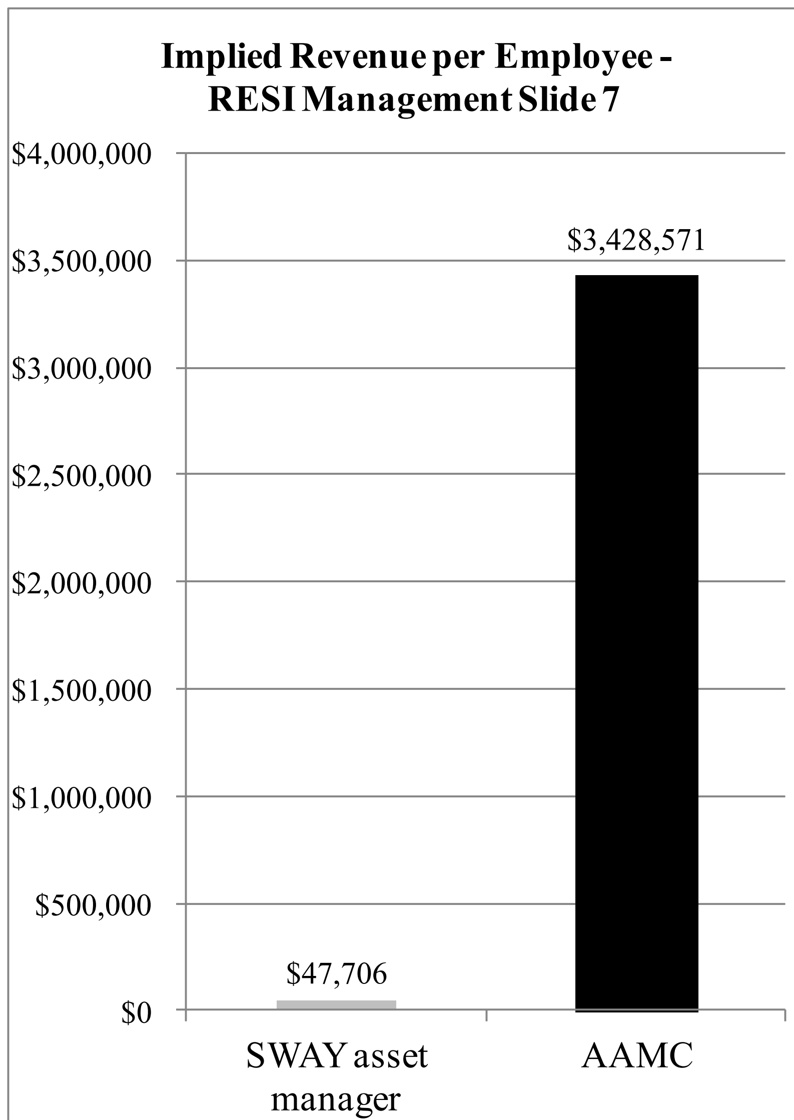
[1] SWAY also reimburses Sway's Manager for certain expenses, which are enumerated in its public filings (available here: http://investors.starwoodwaypoint.com/Cache/21620019.pdf?IID=4423541&FID=21620019&O=3&OSID=9)

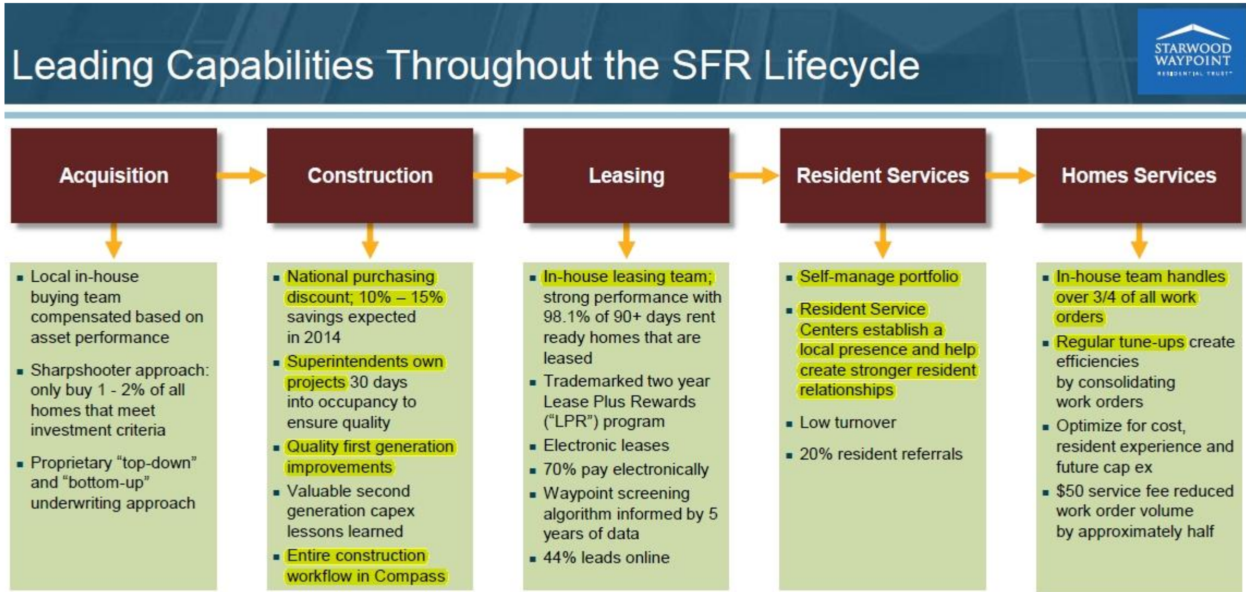
[2] SWAY's Manager also manages a legacy portfolio of single-family rentals for Waypoint Legacy Funds, but this portfolio is not expected to grow and we estimate that it will comprise less than 20% of the assets managed by SWAY's Manager in 2-3 years. http://www.sec.gov/Archives/edgar/data/1579471/000104746913011360/a2217784zex-10_2.htm




Note: Assumes an 8% ROE on book value of $1.2 billion.

This simple comparison shows that RESI is getting a lot less for its money than SWAY. AAMC receives **more than 70 times the revenue per employee** in this scenario is that SWAY's Manager is not only performing the asset management functions performed by AAMC, but also the life-cycle management of single-family units which RESI outsources to its sister company, ASPS.

> "our Manager will seek to retain approximately 545 employees currently employed by the Waypoint manager who will provide our Manager with in-house operations associated with every stage of the life cycle of a home… [including] **renovations, marketing and leasing, repairs and maintenance, portfolio reporting and property management of homes**"
>
> -SWAY public filing, page 1

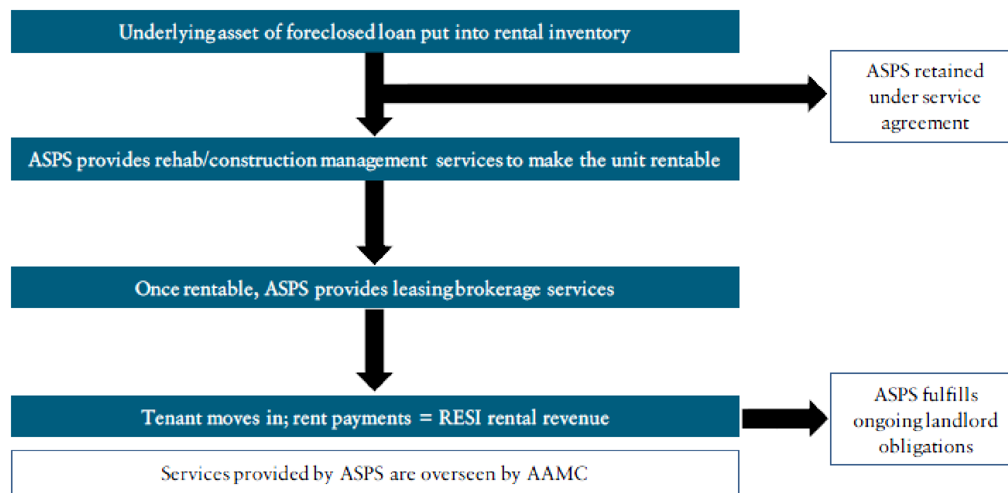



SWAY Q4 2013 management presentation, slide 17

By comparison, RESI outsources virtually all of these property management functions to ASPS. The following slide, courtesy of Piper Jaffray, nicely outlines ASPS's function with respect to RESI's portfolio.

Exhibit 4

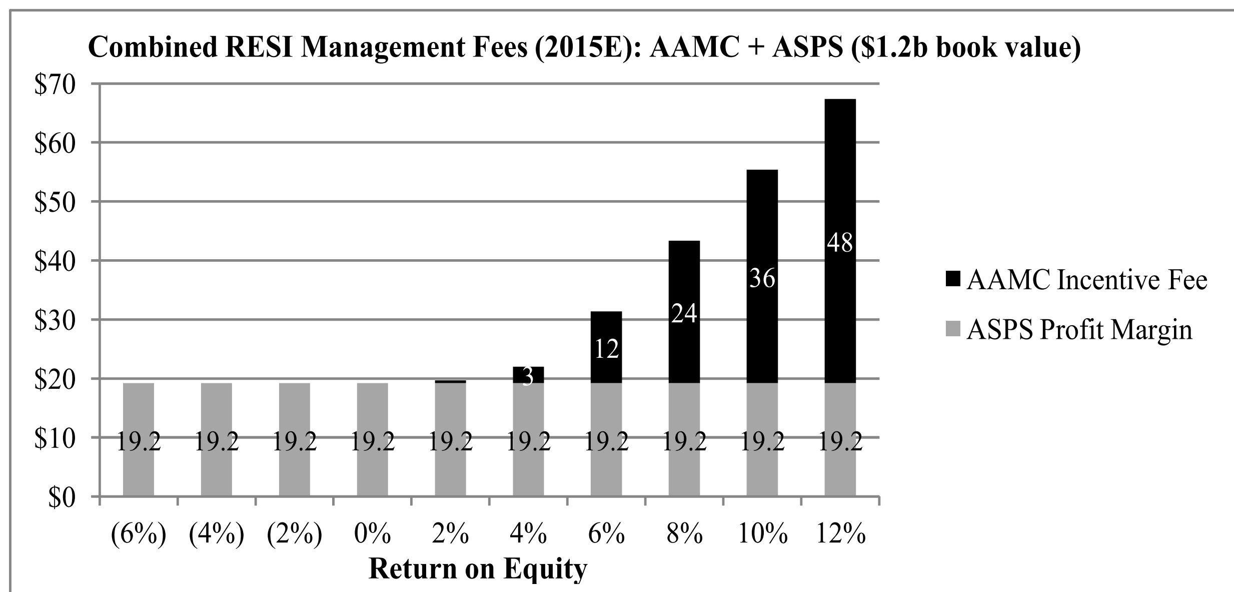
FORECLOSED-TO-RENTAL PROCESS




Source: Piper Jaffray Research, Company Filings

Ultimately, the slide put forth by RESI comparing its fee structure to SWAY's is misleading because **SWAY's asset management fees *include*** compensation for both asset and property management, whereas AAMC only performs basic asset management services.

Profit margin earned by ASPS on RESI property management services are expected to be highly material in 2015. The following slide shows the combined incentive fees to AAMC plus the expected profit margin to ASPS in 2015. The chart below reflects RESI's current book value of ~$1.2 billion.




AAMC Incentive Fee based on RESI Q4 2013 management presentation, slide 7; ASPS Profit Margin of $19.2 million in 2015E estimated based on a 30% general contractor markup (actual ASPS Mortgage Servicies operating margin was 36% in 2013) on non-reimburseable property management expenses provided by ASPS. Property management expenses for 2015E were sourced from Deutsche Bank (3/2014) and Piper Jaffray (1/2014).

Wall St. analysts estimate that RESI will spend between $40-60 million on property management expenses in 2015. In order to make an apples-to-apples comparison, we can strip out the expenses like property taxes that would be 100% reimbursed by RESI and estimate the margin (roughly 30%) captured by ASPS on the remaining property management functions that SWAY's asset manager already provides.

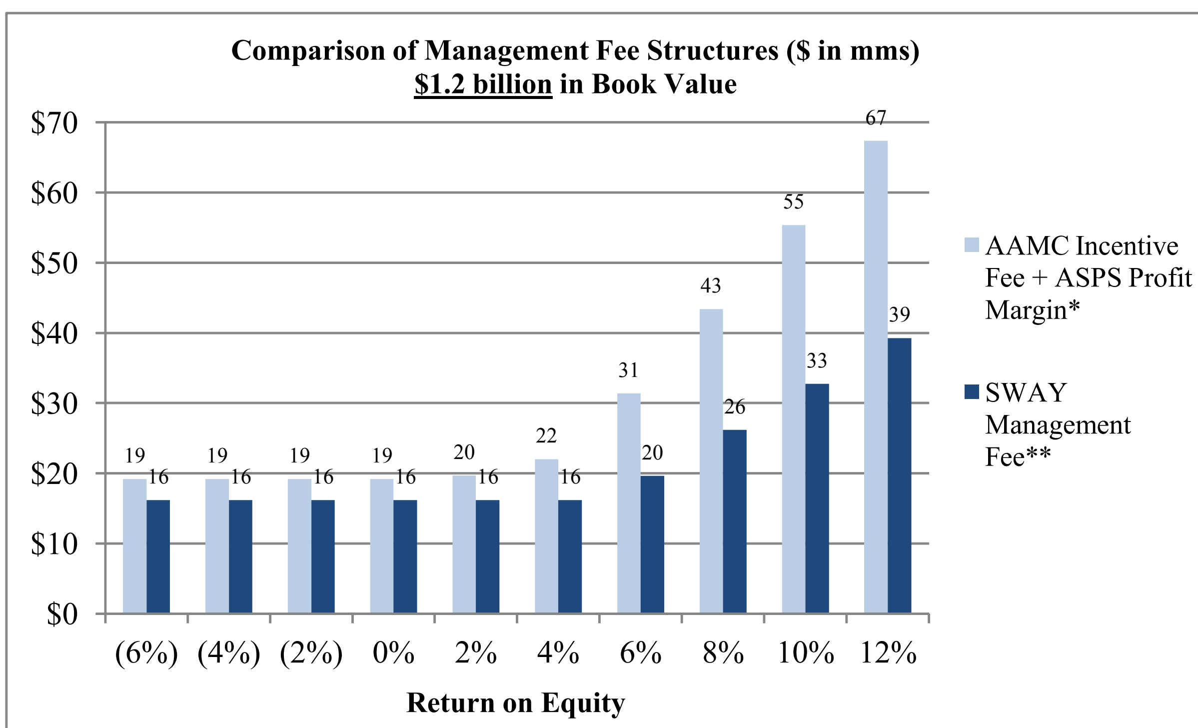
**Estimated ASPS Profit Margin on RESI's 2015 Property Expenses** *($ in mms)*

| *Deutsche Bank 3/4/2014** | **RESI 2015** | **Assumed Margin Captured by ASPS†** | **Incremental RESI Expense Over SWAY**** |
|---|---|---|---|
| Renovations | $51.4 ‡ | 30% | $15.4 |
| Maintenance | 10.3 | 30% | 3.1 |
| Leasing & marketing | 5.4 | 30% | 1.6 |
| Property Taxes | 7.1 | 0% | 0.0 |
| Property Management Fee | 1.2 | 100% | 1.2 |
| **Total** | **75.4** | **28%** | **21.3** |
| *Piper 1/23/2014* | | | |
| Property Mgmt Expenses (REO + Rentals) | $57.5 | 28% | 16.1 |
| Construction & Leasing Fees | 3.4 ‡ | 30% | 1.0 |
| **Total** | **60.9** | **28%** | **17.1** |
| **Average** | | | **$19.2** |

*The Deutsche Bank model assumes a RESI book value of $1.3 billion in Dec 2015, which is consistent with slide 7 of RESI's Q4 management presentation.
**SWAY's asset manager provides renovation, maintenance, and leasing services to SWAY inclusive within its management fee (1.5% of market cap), whereas RESI has to pay AAMC and ASPS separately for the same services. We believe an apples to apples comparison must add ASPS fees to AAMC's Incentive Fee.
† Glaucus estimate based on a typical 30% general contractor markup on non-reimbursable expenses. We believe this is conservative as ASPS earned a 36% operating margin on its Mortgage Services revenue (renovations/asset management) in 2013 (ASPS 2013 10-K, pg 29). Mortgage Services (not Technology) is ASPS's most profitable segment.
‡ Deutsche Bank and Piper Jaffray both assume that RESI pays ASPS ~$15K-$16K per renovation (conversion to REO). However, according to page 8 of Piper's initiating coverage report, renovation fees to ASPS are excluded from construction fees as they are baked into the property balance. Therefore, the fees to ASPS via the Piper model above may be significantly understated.

We estimate that in 2015, RESI's incremental expense associated with ASPS's property management fee will be $19.2 million, which is based on RESI's current book value of ~$1.2 billion.

If we tweak RESI's management slide 7 to *include* the property management fees which RESI currently outsources to ASPS but which are included in SWAY's asset management fees, the comparison looks unfavorable for AAMC.



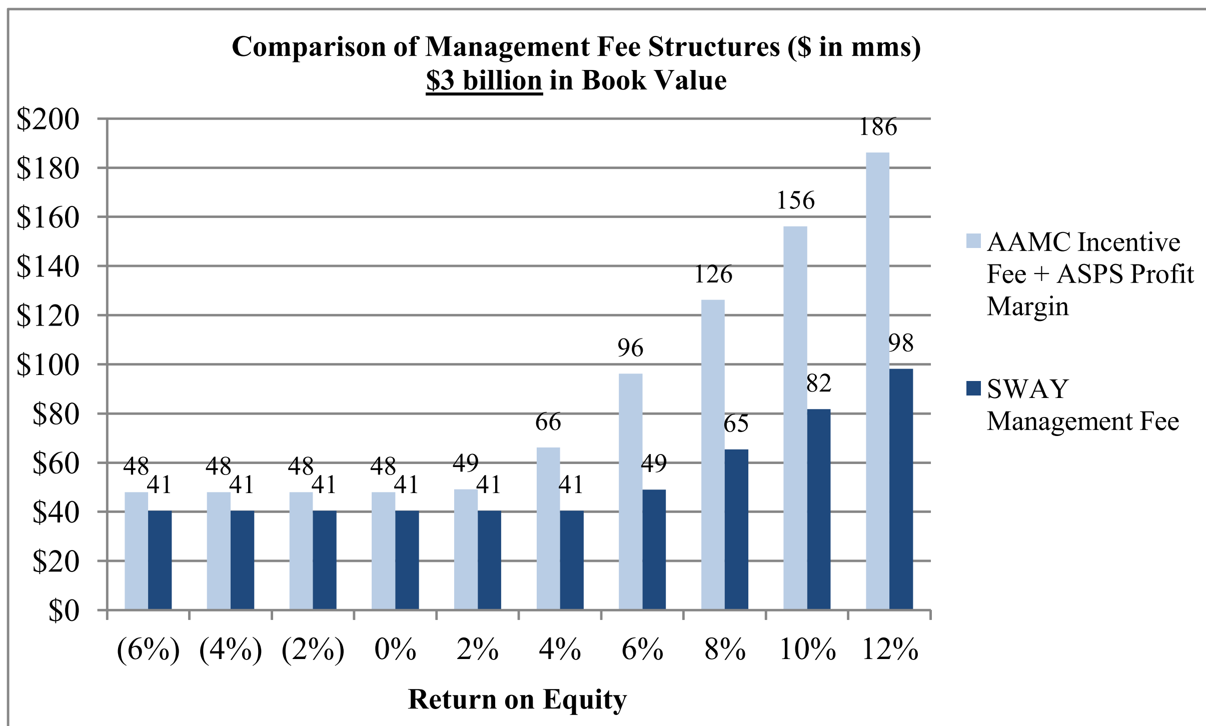

*AAMC Incentive Fee per RESI Q4 2013 management presentation, slide 7; ASPS Profit Margin of $19.2 million based on 30% estimated profit margin (ASPS's Mortgage Services segment reported a profit margin of 36% in 2013) on RESI's property management expenses to ASPS, such as renovations, repairs & maintenance, and leasing. For example, Deutsche Bank (3/2014) estimates property management expenses (excluding property taxes) to ASPS of $68.3 million in 2015E based on book value of $1.3 billion in December 2013, which is consistent with management's original slide 7 book value assumption of $1.2 billion.
**SWAY Management Fee of 1.5% of market cap is based on RESI's Q4 2013 management presentation, slide 7. We believe SWAY's asset manager performs the same activities for SWAY as AAMC and ASPS combined.
Note: Assumptions for book value of $1.2 billion, 57 million RESI shares, 4% yield requirement for SWAY market cap subject to a 0.9x book value floor, are taken from original management slide 7.

Rather than looking reasonable, RESI’s fees look egregious. As shown in the above chart, investors can see that RESI is paying slightly more money in instances of **poor performances**, but **65% more** on the upside.

This should undermine the myth propagated by AAMC that RESI’s shareholders are only obligated to pay hefty fees if the investments generate positive returns on equity. Rather, RESI must pay a property manager irrespective of AAMC’s performance and it must pay AAMC if the investments succeed. Heads, I win. Tails, you lose.

The second reason that RESI’s comparison to SWAY is misleading is that RESI compares returns at a book value of equity at $1.2 billion. AAMC’s management has aggressive growth targets, and if RESI continues to raise money at a rate of $300 million per quarter, RESI’s book value of equity will reach $3 billion by 2015 or 2016.

Such growth would make AAMC’s Incentive Fees even more unreasonable as compared to SWAY’s Manager. If we tweak RESI’s comparison slide 7 to *include both the ASPS property management fees and a book value of $3 billion to match this growth forecast*, AAMC’s fees look downright exploitative.




Note: same assumptions as prior slide, except book value of equity has been increased to $3 billion (and shares outstanding increased to 100 million due to expected equity issuance by RESI) from $1.2 billion. This increases the profits to ASPS on a linear basis to $48 million from $19.2 million as well as increases SWAY's management fee on a linear basis with book value. However, because of AAMC's waterfall fee structure, AAMC's Incentive Fee accelerates as book value is increased on an accretive basis to $3 billion from $1.2 billion. RESI is expected to hit $3 billion in book value by 2016.

Ultimately, we believe that RESI's straw man comparison of AAMC with SWAY, seemingly designed to convince independent directors and shareholders of the reasonableness of AAMC's fees, is further evidence that AAMC is wildly overpaid.

**RESI CAN TERMINATE OR RENEGOTIATE THE CONTRACT**

The foundation for AAMC's soaring stock price is the dangerous assumption that AAMC will be entitled to an increasingly lucrative Incentive Fee (at RESI's expense) as RESI raises equity and acquires more assets. But this is not necessarily so because of a termination provision in the contract which permits RESI's independent directors to terminate or substantially renegotiate AAMC's Incentive Fee.

The Asset Management Agreement (Section 10(b)(ii)) provides that in order to terminate the contract, **two-thirds of RESI's independent directors** must agree that:

> "the compensation payable to the Asset Manager [AAMC] hereunder is **unreasonable**; provided that RESI shall not have the right to terminate this Agreement … if the Asset Manager [AAMC] agrees to continue to provide the services under this Agreement at a reduced fee that at least two-thirds of the Independent Directors determines to be reasonable pursuant to the procedure set forth below."

Once RESI's independent directors deem the Incentive Fee unreasonable, AAMC has the right to ask for a revised compensation structure. If two-thirds of RESI's independent directors believe the revised fee is still unreasonable, RESI has the right to unilaterally cancel the contract.

Critically, the Asset Management Agreement does not define the word 'reasonable' as it relates to AAMC's Incentive Fee, leaving RESI's independent directors with considerable discretion. The simplest way to determine the reasonableness of AAMC's compensation structure is to look at the market price charged by similarly situated asset managers in the mortgage REIT space. As we discussed above, we estimate that AAMC's Incentive Fee is **four to seven times higher** than the compensation paid to other experienced asset managers.

The Asset Management Agreement requires that RESI's independent directors give AAMC 180 days notice of their intent to terminate the contract on the grounds that AAMC's compensation is unreasonable, so in order to cancel the contract at the earliest possible date (**December 21, 2014**), RESI's independent directors must deliver notice no later than **June 24, 2014**.

Notably, Asset Management Agreement provides for a **Termination Fee** (measured as three times the sum of the average of the annual Incentive Fees paid over the previous 24 months) in the event that RESI's independent directors terminate the contract. We estimate that if RESI terminates the contract in December 2014, the Termination Fee under the contract will be ~**$55 million**. By December 2015, we estimate that the Termination Fee will rise to a whopping ~**$120 million**.

RESI's independent directors must act quickly: with each passing quarter, AAMC's Terminate Fee will only get larger. Investors should also note that RESI is not obligated to pay a Termination Fee under the Asset Management Agreement if it *renegotiates (rather than terminates)* AAMC's Incentive Fees. Any investor adverse to paying a Termination Fee or finding a different asset manager (external or internal) would look favorably on simply reducing AAMC's current compensation.

**FIDUCIARY DUTY TO TERMINATE OR MODIFY**

We believe that RESI's independent directors have a **fiduciary duty** to RESI's shareholders to either terminate or renegotiate the Asset Management Agreement to lower RESI's asset management fees.

Skeptics may argue that Bill Erbey has stacked RESI's board with friendly directors who would never authorize a course of action which would be adverse to Erbey's interest, let alone terminating the relationship with AAMC, its sister company. But this misses the point: the independent directors of RESI, regardless of their level of actual or perceived independence, are at risk of **getting sued** if they do not either terminate the Asset Management Agreement or at the very least renegotiate a much lower Incentive Fee.

1) *Potential Breach of Duty of Loyalty*

Under Maryland law, directors of a corporation such as RESI generally owe a duty of care and a duty of loyalty to the corporation. In this case, a breach of the duty of loyalty would involve an alleged conflict of interest with regard to the selection of RESI's asset manager, as well as to the negotiation of AAMC's Incentive Fees.

We believe that RESI's independent directors face the material risk of a shareholder derivative suit over the Asset Management Agreement. A potential plaintiff could easily argue that the independent directors violated their duty of loyalty to the corporation by giving AAMC, a company controlled by Bill Erbey (the chairman of RESI's board of directors) a sweetheart deal on terms that are far above (i.e. four to seven times above) the market price for an asset manager.

A derivative suit against RESI's independent directors would be further bolstered by the facts that:

- The independent directors are contractually permitted to **renegotiate** AAMC's Incentive Fees perhaps without having to pay a Termination Fee under the Asset Management Agreement;
- The independent directors are paying AAMC, by our estimate, four to seven times more than other mortgage REITs are paying external and internal asset managers;
- AAMC is controlled by RESI's chairman and architect of the structure, Bill Erbey, raising the specter of undue influence over RESI's independent directors by virtue of his resources and influence;
- AAMC has only seven employees, no assets and little experience in the asset management market, especially when compared to third party asset managers for companies like NLY or TWO, which have access to hundreds of employees and a highly experienced operating team.
- AAMC's management team is financially incentivized to maximize the Incentive Fee, which results in reducing the dividends payable to RESI's shareholders.

2) *Kinder Morgan: A Noteworthy Precedent*

On February 6, 2014, Jon Slotoroff, an investor in Kinder Morgan Energy Partners LP ("Kinder Morgan MLP"), sued Kinder Morgan Inc. ("KMI"), which serves as KMP's general partner. Slotoroff's complaint alleges that KMI used its control over the Kinder Morgan MLP to allocate cash flow distributions in bad faith. Plaintiffs allege over $3.2 billion in damages since 2010.

The nuances of the allegations are important. KMI's compensation structure should be familiar to shareholders of AAMC and RESI. KMI, as the general partner and asset manager, is entitled to a share of distributable cash dividends from the Kinder Morgan MLP, referred to as Incentive Distribution Rights ("IDRs").

Plaintiffs allege that KMI, in bad faith, caused the Kinder Morgan MLP to misallocate capital expenditures to 'expansion' instead of maintenance,' thus boosting distributions to KMI and diluting the value of assets held at the Kinder Morgan MLP.[3] The plaintiffs are alleging a breach of fiduciary duty to the shareholders (in this case limited partners) by engaging in accounting gimmicks to maximize the amount of distributable profits to the asset manager at the cost of the long-term financial health of the MLP.

This case is not perfectly analogous to the AAMC-RESI situation. We are not alleging that AAMC is engaging in manipulative accounting tactics to artificially inflate the cash distributions to which it is entitled. But it is critical because it is one of the first examples where shareholders are beginning to push against the asset manager of an MLP-type structure where the company holding the assets (i.e., RESI and Kinder Morgan MLP) has been cleaved from the asset manager (i.e., AAMC and KMI).

*3) Limited Disruption to Existing Relationships*

It possible, however unlikely, that AAMC attempts to keep its outlandish fee by threatening that Ocwen and ASPS will cease to be RESI's mortgage servicer and property manager (respectively) in the event RESI cancels or reduces AAMC's Incentive Fees. Indeed, in the event of the termination of the Asset Management Agreement between AAMC and RESI, RESI's contracts with ASPS and Ocwen will terminate within 30 days.

Both Ocwen and ASPS are public companies, and their respective officers and managers are bound by fiduciary duties of both care and loyalty. For either Ocwen or ASPS to reject an existing revenue stream simply out of spite or misplaced fealty to a sister company would raise problematic questions as to whether their respective officers and directors were acting in the best interests or the corporation and their shareholders or in the best interests of the Erbey empire. We do not believe OCN or ASPS shareholders would allow it.

RESI paid ASPS **$2.8 million in 2013,** only $0.8 million of which was related to property management. As such, **from RESI's perspective**, it currently has so few rental properties that **switching costs to another property manager are low**. By contrast, ASPS derives 75% of its revenue from related parties, and although RESI currently possesses few rental properties, its fees to its property manager will increase in the future. We therefore believe that ASPS has every incentive to continue its relationship with RESI and has almost no leverage to walk away.

Ocwen, on the other hand, is a large mortgage servicer that would barely notice if it lost RESI's business. This should not be confused with **leverage over RESI**, because mortgage servicers are a dime a dozen. Ocwen is the **fourth largest mortgage servicer in the United States** (for single-family residential), yet it only controls a 5% market share over the residential home mortgage servicing market.

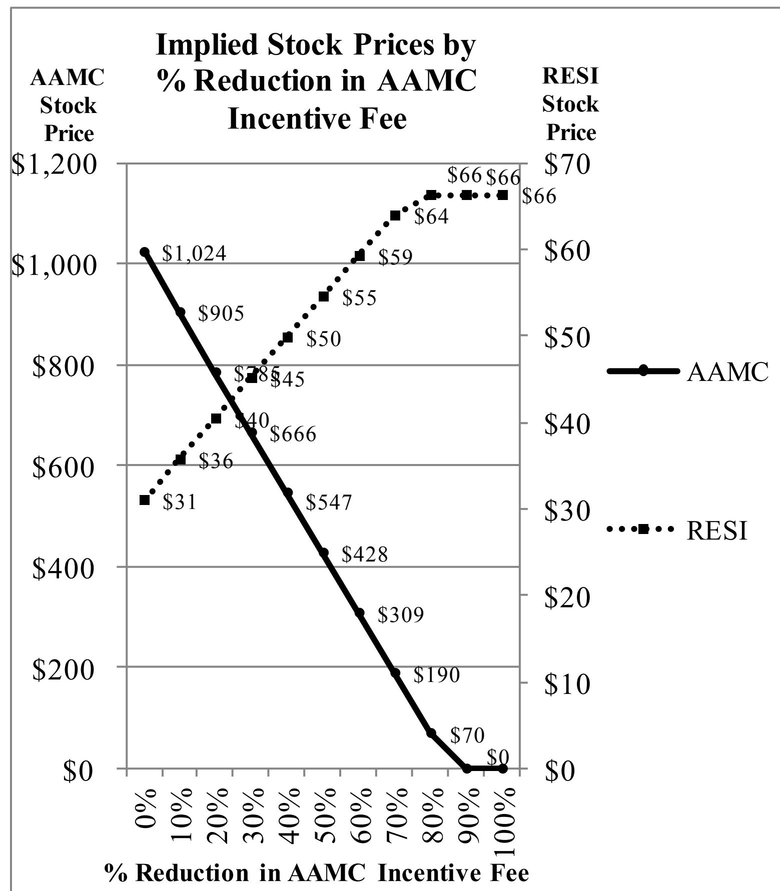
The mortgaging service market is highly fragmented and intensely competitive, making it more than likely that if Ocwen wants to depart in a huff over AAMC, RESI could quickly find a suitable alternative.

[3] For a detailed discussion by the excellent analyst who originally alerted investors to problems at Kinder Morgan MLP, please refer to Kevin Kaiser at (https://medium.com/p/edf43bc25909).

**VALUATION**

We believe that RESI's independent directors have a fiduciary duty to terminate the Asset Management Agreement or, at the very least, significantly renegotiate AAMC's Incentive Fees. The market believes that the NPV of AAMC's Incentive Fee is a staggering $2.7 billion. RESI's shareholders should be overjoyed because RESI's market capitalization should increase as it captures the majority of these expected cash flows. We project that **RESI's shares will increase by up to 114%** if RESI captures 75% of the market cap of AAMC, whereas in the same scenario, **AAMC's share price has up to 87% to fall**.

The following sensitivity analysis shows our projected reduction in AAMC's share price and the commensurate increase in RESI's share price with each 10% reduction in AAMC's Incentive Fees.




The implications for both companies are clear. If RESI's independent directors fulfill their fiduciary duties to shareholders, RESI's shareholders should expect a significant increase in the REIT's dividends and share price. By contrast, this sensitivity analysis reveals that even a 50% decrease in AAMC's Incentive Fees, which would still leave its overall compensation structure significantly above market for an asset manager, will send AAMC's share price to $428 per share (and this assumes AAMC continues to trade at an absurd and unsustainable multiple).

If, as we expect, RESI's independent directors bring AAMC's Incentive Fees down to market rates (a 75% decrease), it will reduce AAMC's estimated distributable 2015 dividends by 87%.

AAMC's issuance on March 18, 2014, of $250 million in redeemable preferred stock only puts AAMC's common shareholders in a more precarious position. AAMC issued the preferred shares, which are akin to debt as they sit at the top of the capital structure, to ostensibly fund the repurchase of common stock. However, the holders of the preferred shares may require AAMC to redeem them for cash in March 2020. In the event that RESI substantially reduces AAMC's Incentive Fee or terminates the Asset Management Agreement, such preferred shares would be difficult for AAMC to redeem assuming the Company already spent the proceeds of the issuance.

**AAMC 2015 Dividends (Lowered Fees by 75%: ~$38mm)**

| *Figures are in $USDmm* | 2015 Consensus | Pro Forma | Change |
|---|---|---|---|
| **AAMC Mgmt Fee (consensus)** | **$ 50** | **12** | (75%) |
| Less: Unreimbursed G&A | (7) | (7) | |
| Pretax income | 43 | 5 | (87%) |
| Less: repatriation tax (34%) | (15) | (2) | |
| **Implied AAMC Dividends** | **$28** | **$4** | (87%) |

*Source: Analyst reports 1/2014; Glaucus estimates.*

The potential benefits to RESI's shareholders are enormous.

**Pro Forma Valuations - Renegotiated Fee**

*Figures are in mm (except per share amounts)*

| | AAMC | RESI |
|---|---|---|
| Share Price (3/18/2014) | $1,023.81 | $31.04 |
| 2015 Dividends (consensus)† | $ 28 | |
| Diluted Shares (incl options, excl Luxor convertible preferred) | 2.65 | 57.7 |
| 2015 Dividends per Share‡ | $10.63 | $1.55 |
| **Implied Current 2015 P/E** | **96.3x** | **20.0x** |
| **Analysis of revised Dividends between RESI and AAMC** | | |
| 2015 Dividends (revised) | $ 4 | |
| Diluted Shares (incl options, excl Luxor convertible preferred) | 2.65 | 57.7 |
| 2015 Dividends per Share (revised)* | $1.35 | $2.20 |
| Current Market Cap | $2,713 | $1,791 |
| Plus: Preferred Stock (Luxor redemption @ $1000 per sh) | $250 | |
| Less: Excess Cash (Luxor convertible preferred raise) | ($250) | |
| Adjusted Market Cap | $2,713 | $1,791 |
| Estimated Market Cap Transfer** | ($2,368) | $ 2,035 |
| **Pro Forma Market Cap**** | **$345** | **$ 3,826** |
| **GRG Adjusted Estimated Value** | | |
| **Implied share price** | **$130.07** | **$66.31** |
| **% increase (decrease)** | **(87%)** | **114%** |

Source: Company filings; Glaucus estimates.

† Based on 2015E consensus AAMC Incentive Fee of $50 mm less estimated internal operating expenses and repatriation taxes.

‡ RESI 2015 dividends per share based on Jan 2014 analyst consensus.

* RESI 2015 revised dividends per share based on 75% AAMC fee reduction ($38mm).

** RESI pro forma market cap based on capture of 75% of AAMC market cap. AAMC pro forma market cap based on current AAMC p/e multiple applied to revised AAMC dividend. The loss of market cap for AAMC is greater than the gain in market cap for RESI due to AAMC operating leverage.

We project that RESI's shares will increase by up to 114% if RESI captures a significant part of the market cap of AAMC, whereas AAMC's share price has up to 87% to fall. As a shareholder of RESI, we therefore believe it is of paramount importance that RESI's independent directors renegotiate or terminate this egregious contract.

As a first step, we expect RESI's independent directors to hire an **independent advisor** to conduct a market survey of asset management fees. We believe that this will confirm that AAMC is vastly overpaid and the independent advisor can counsel RESI's independent directors in either renegotiating the fees with AAMC, internalizing their asset management team (our preferred approach) or finding another more reasonably priced external manager. Not only would such a reduction in asset management fees (especially if RESI internalized AAMC's team) be a boon to **RESI shareholders**, it would signal to the market and regulators the independence of RESI and its directors from the other companies in the Ocwen empire.

In order to terminate the Asset Management Agreement by **December 21, 2014**, RESI's independent directors must give notice of their intent to do so by **June 24, 2014** (97 days from today). Because any Termination Fee would be much larger in 2015, we believe that any delay would cause material harm to RESI's shareholders. RESI's independent directors must act quickly. Winter, as they say, is coming.

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