

# **Invesco Mortgage Capital Inc.**

## **2013 Second Quarter Earnings Call**

**August 1, 2013**

**Richard King**  
**President & Chief Executive Officer**

**John Anzalone**  
**Chief Investment Officer**

**Donald Ramon**  
**Chief Financial Officer**

**Rob Kuster**  
**Chief Operating Officer**



# Forward-Looking Statements

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This presentation, and comments made in the associated conference call today, may include “forward-looking statements” within the meaning of the U.S. securities laws as defined in the Private Securities Litigation Reform Act of 1995, and such statements are intended to be covered by the safe harbor provided by the same. Forward-looking statements include our views on the economy, the positioning of our portfolio to meet current or future economic conditions, our core earnings, our views on the change in our book value, our ability to continue performance trends, the stability of portfolio yields, and our views on leverage and equity allocation. In addition, words such as “believes,” “expects,” “anticipates,” “intends,” “plans,” “estimates,” “projects,” “forecasts,” and future or conditional verbs such as “will,” “may,” “could,” “should,” and “would” as well as any other statement that necessarily depends on future events, are intended to identify forward-looking statements.

Forward-looking statements are not guarantees, and they involve risks, uncertainties and assumptions. There can be no assurance that actual results will not differ materially from our expectations. We caution investors not to rely unduly on any forward-looking statements and urge you to carefully consider the risks identified under the captions “Risk Factors,” “Forward-Looking Statements” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our annual report on Form 10-K and quarterly reports on Form 10-Q, which are available on the Securities and Exchange Commission’s website at [www.sec.gov](http://www.sec.gov).

All written or oral forward-looking statements that we make, or that are attributable to us, are expressly qualified by this cautionary notice. We expressly disclaim any obligation to update the information in any public disclosure if any forward-looking statement later turns out to be inaccurate.

# Q2 Overview

## Current Market Conditions

- In Q2 rates increased ~70 bps on concerns that the Federal Reserve will begin tapering of asset purchases later this year
- MBS, RMBS, and CMBS underperformed swap hedges mainly due to spreads
- Higher rate volatility is likely going forward
- Housing market continues to improve

## Portfolio Positioning

- Maintained duration gap discipline
- Increased hedging
  - Added \$1.6bn in swaps and \$1.4bn in swaptions
  - Increased swap ratio to 113% of agency repo and 82% of total repo
- Added credit assets

## Results

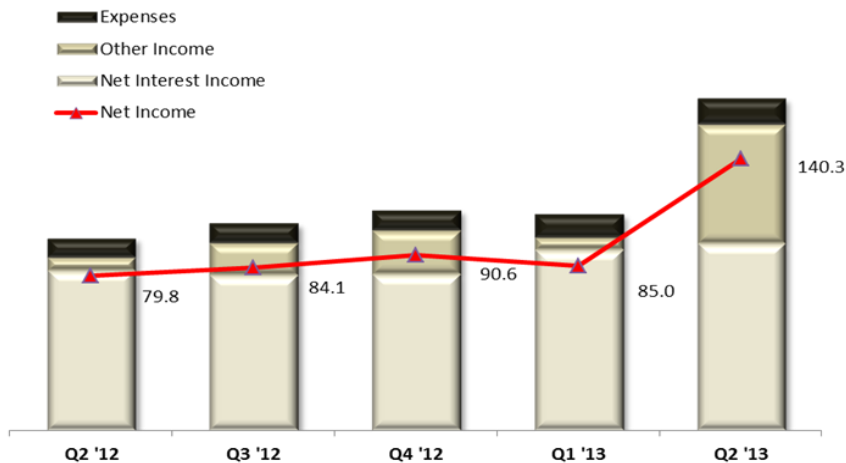
- |                          |         |   |
|--------------------------|---------|---|
| ▪ GAAP EPS:              | \$1.03  | ▪ Swaption gains contributed \$0.39 of which \$0.20 were realized |
| ▪ Core EPS:              | \$0.59* | ▪ Core earnings declined ~\$0.03 on lower asset yields            |
| ▪ Common Stock Dividend: | \$0.65  | ▪ Book value decline of \$2.54 from Q1                            |
| ▪ Book Value:            | \$17.88 |   |

\* Core earnings is a non-GAAP financial measure. We calculate core earnings as GAAP net income attributable to common shareholders excluding gain/loss on sale of investments and realized and unrealized gain/loss on interest rate swaps and swaptions.

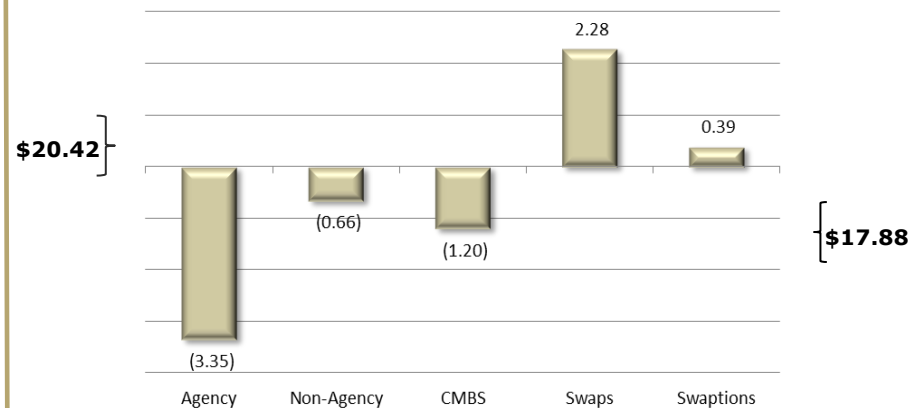
See the information in the Appendix for additional disclosures and a reconciliation to the most comparable U.S. GAAP measure.

# Quarterly Performance

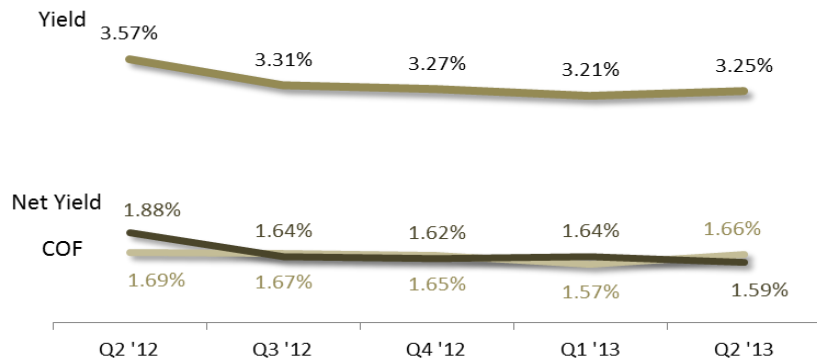
## Net Income (\$ in millions)



## Q2 Book Value Change



## Yield

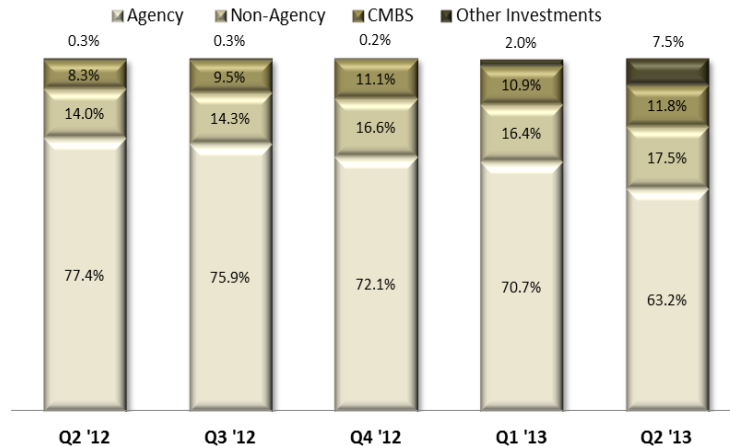


Prior period yields were adjusted to conform with presentation in our quarterly SEC filings

- Net income increased to \$140.3mm primarily driven by gains on swaptions
- BV decreased \$2.54 from Q1
  - Swap adjusted BV contributions
    - Agency \$1.08 or ~ 5%
    - Credit \$1.46 or ~7%
  - Declines were primarily related to spread widening and not rates
- Net portfolio yield increased 2 bps from Q1

# Portfolio Update

## % of Assets



- Completed 3 securitizations in the second quarter adding \$1.1bn in consolidated residential loans
- Total MBS portfolio decreased 7% to \$19.8bn
  - Agency RMBS decreased \$1.8b
    - Decreased exposure to lower coupon bonds and some high coupon bonds vulnerable to policy risk
  - Non-Agency RMBS increased \$195mm
  - CMBS increased \$149mm
- Added ~\$9mm in commercial real estate loans (~\$42mm commitment)

# Equity Allocation and Leverage

As of 6/30/13

(\$ in millions)	Agency	Non-Agency	CMBS	Residential Loans	Commercial Loans	Unconsolidated Ventures	Corporate Liability	Total
Repurchase agreements	12,901	2,955	2,023	-	-	-	-	17,879
Asset-backed securities	-	-	-	1,432	-	-	-	1,432
Exchangeable note	-	-	-	-	-	-	400	400
Allocated equity	1,350	943	515	125	9	36	(394)	2,584
Debt / Equity	9.6x	3.1x	3.9x	11.5x	-	-	-	7.6x
% of Total equity	52.3%	36.5%	19.9%	4.8%	0.3%	1.4%	-15.2%	100%
Excluding Unsettled Trades	9.0x	3.0x	3.9x	11.5x	-	-	-	7.3x

As of 3/31/13

(\$ in millions)	Agency	Non-Agency	CMBS	Residential Loans	Commercial Loans	Unconsolidated Ventures	Corporate Liability	Total
Repurchase agreements	13,546	2,521	1,807	-	-	-	-	17,874
Asset-backed securities	-	-	-	374	-	-	-	374
Exchangeable note	-	-	-	-	-	-	400	400
Allocated equity	1,492	1,140	615	31	-	37	(400)	2,915
Debt / Equity	9.1x	2.2x	2.9x	12.0x	-	-	-	6.4x
% of Total equity	51.2%	39.1%	21.1%	1.1%	-	1.2%	-13.7%	100%

- Leverage increased on lower equity levels and credit asset purchases
- Leverage allocated to repo<sup>(1)</sup> in Q2 was 6.1x (adjusted for unsettled trades) compared to 5.5x in Q1
- Q3 leverage is expected to be unchanged

(1) Leverage allocated to repurchase agreements is total repurchase agreements/total allocated equity for Agency RMBS, Non-Agency RMBS and CMBS

# Interest Rate Hedges

Swaps	As of 3/31/13			As of 6/30/13		
	Notional Amount (\$ in millions)	Average Fixed Pay Rate	Average Maturity (Years)	Notional Amount (\$ in millions)	Average Fixed Pay Rate	Average Maturity (Years)
1 year or less	300	1.76%	0.2	-	-	-
Greater than 1 year and less than 3 years	1,500	2.04%	2.3	5,100	2.25%	2.7
Greater than 3 years and less than 5 years	4,600	2.20%	3.4	2,500	1.51%	4.6
Greater than 5 years	4,250	2.06%	8.7	4,600	2.22%	9.0
	<u>10,650</u>	<u>2.11%</u>	<u>5.3</u>	<u>12,200</u>	<u>2.09%</u>	<u>5.4</u>

Swaptions (\$ in millions)	Notional Amount 3/31/13	Additions	Termination/ Expiration	Notional Amount 6/30/13
	1,000	3,150	(1,750)	2,400

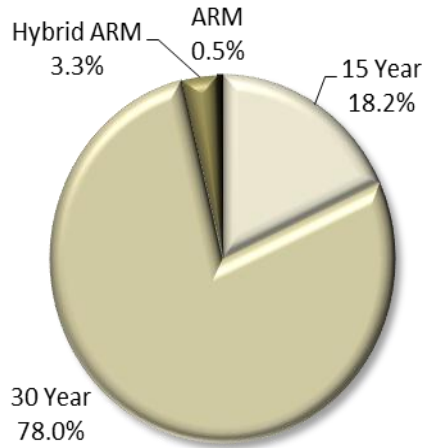
**Note:** Underlying swap for option contracts were each 10 years

- Target duration gap in 1.0 to 1.5 year range
- Added \$1.85bn in swaps (maturities: 5 year - \$1.3bn, 7 year - \$0.55bn) and \$300mm matured
- Net increase in swaptions was \$1.4bn
- Fixed rate on swaps decreased to 2.09% from 2.11%
- Increased percentage of repo hedged with swaps and swaptions:

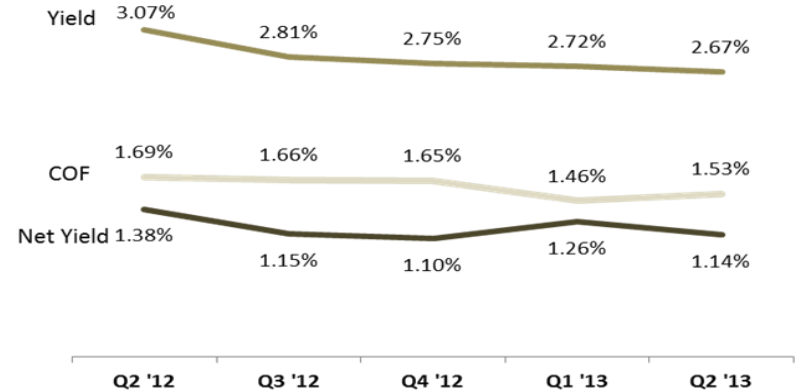
	6/30/13	3/31/13
Agency Repo	113%	86%
Total Repo	82%	65%

# Agency

## Agency Detail (% of Total Agency)

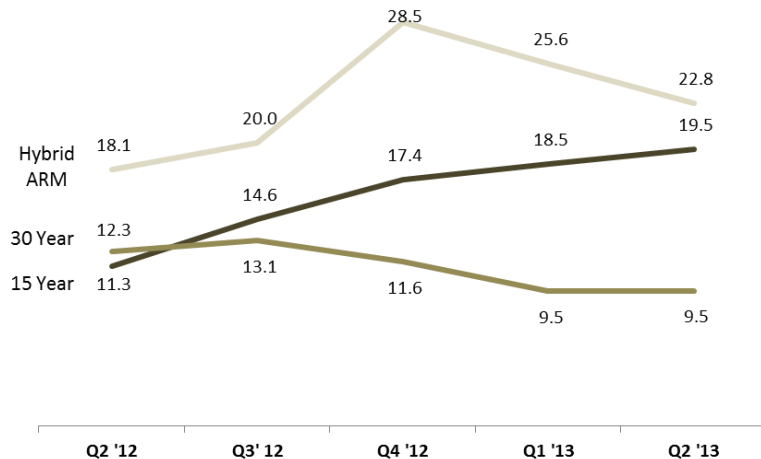


## Yield



Prior period yields were adjusted to conform with presentation in our quarterly SEC filings

## Agency CPR



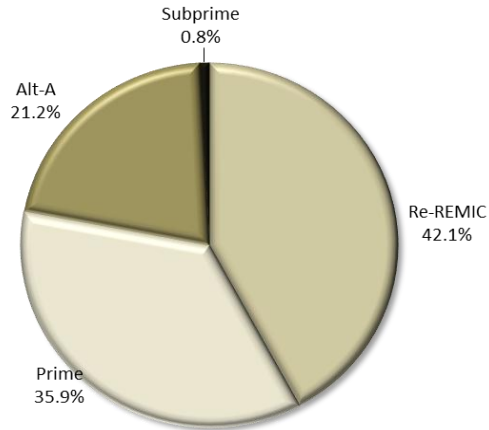
- Reduced Agency portfolio \$1.8bn
- Q2 Agency leverage of 9.6x, up from 9.1x in Q1
  - Accounting for unsettled trades, agency leverage would be ~ 9.0x
  - 113% of Agency repo hedged up from 86%
- Prepayment speeds decreased slightly with the exception of 15 year

	<u>3 Month CPR</u>	<u>IVR</u>	<u>Cohorts</u>
15 Year		19.5	27.8
30 year		9.5	15.8

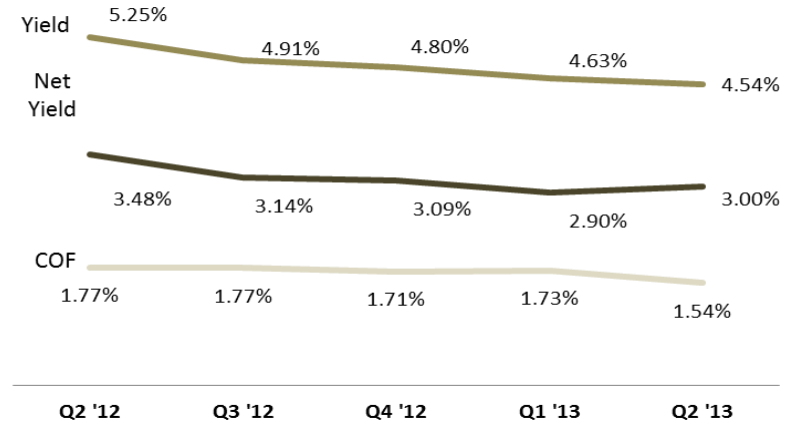


# Non-Agency

## Non-Agency Detail (% of Total Non-Agency)

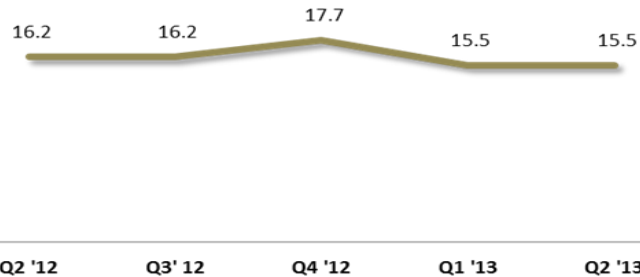


## Yield



Prior period yields were adjusted to conform with presentation in our quarterly SEC filings

## Non-Agency CPR

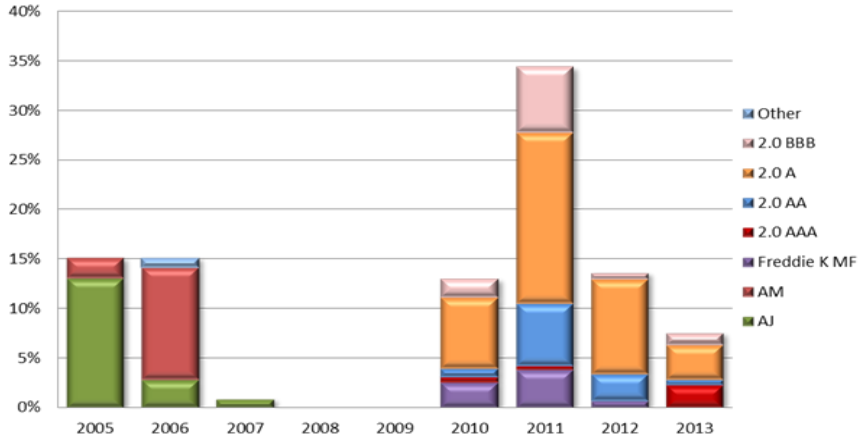


- Non-Agency RMBS increased \$195mm
- Housing fundamentals continue to improve
- Favorable return profile in a rising rate environment
- Yields declined as hybrid ARM coupons reset lower and new positions were added at lower nominal yields
- Leverage is 3.1x in Q2 vs. 2.2x in Q1

# CMBS

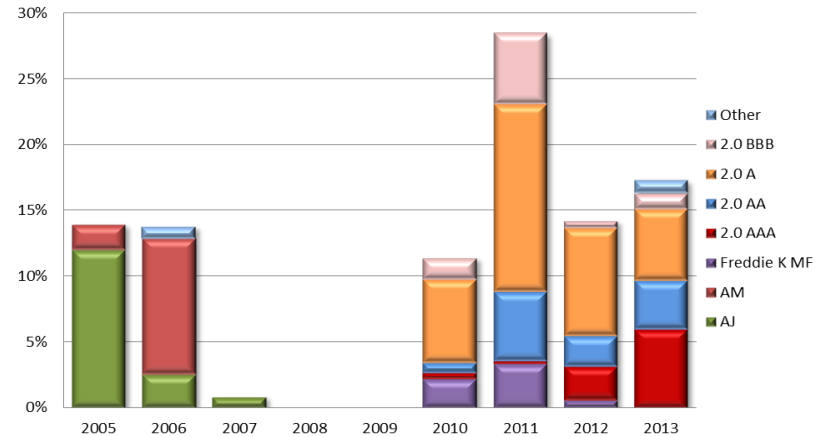
## Q1 2013

IVR CMBS by Vintage

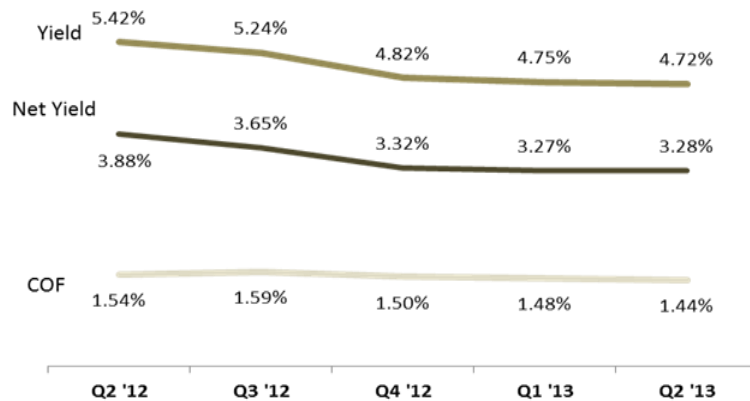


## Q2 2013

IVR CMBS by Vintage



## Yields



Prior period yields were adjusted to conform with presentation in our quarterly SEC filings

- CMBS increased \$149mm
- Increased focus on triple and double-AA purchases
- Continued gradual improvement in CRE fundamentals
- Leverage was 3.9x up from 2.9x in Q1 due to price declines and focus on higher quality bonds

# Residential and Commercial Loans

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## Residential

- Completed three securitizations during Q2 adding \$1.1bn consolidated loans
- Net credit exposure increased to \$121.3mm
- Securitizations provide an opportunity to gain exposure to new production prime jumbo mortgages

## Commercial

- Closed first mezzanine commercial real estate loan in Q2 – approximately \$42mm commitment
- Purchased ~\$25mm in commercial real estate mezzanine loan pass-through certificates
- Actively pursuing new opportunities

# Appendix – Non-GAAP Financial Information

In addition to the results presented in accordance with GAAP, this release contains the non-GAAP financial measure of “core earnings.” The Company’s management uses core earnings in its internal analysis of results and believes this information is useful to investors for the reasons explained below.

We calculate core earnings as GAAP net income attributable to common shareholders excluding gain/loss on sale of investments and realized and unrealized gain/loss on interest rate swaps and swaptions. The Company records changes in the valuation of its investment portfolio and certain interest rate swaps in other comprehensive income. In addition, the Company uses swaptions that do not qualify under GAAP for inclusion in other comprehensive income and, as such, the changes in valuation are recorded in the period in which they occur. For internal portfolio analysis, the Company’s management deducts these gains and losses from GAAP net income to provide a consistent view of investment portfolio performance across reporting periods.

The Company believes that the presentation of core earnings allows investors to evaluate and compare the performance of the Company to that of its peers because core earnings measures investment portfolio performance over multiple reporting periods by removing realized and unrealized gains and losses. As such, the Company believes that the disclosure of core earnings is useful to its investors.

However, the Company cautions that core earnings should not be considered as an alternative to net income (determined in accordance with GAAP), or an indication of our cash flow from operating activities (determined in accordance with GAAP), a measure of our liquidity, or an indication of amounts available to fund our cash needs, including our ability to make cash distributions. In addition, our methodology for calculating core earnings may differ from those employed by other companies for a similarly described measure and, therefore, may not be comparable.

## Reconciliation of Net Income Attributable to Common Shareholders to Core Earnings

	Three Months ended		Six Months ended	
	June 30,		June 30,	
\$ in thousands, except per share data	2013	2012	2013	2012
Net income attributable to common shareholders	138,847	78,821	222,838	161,903
Adjustments				
(Gain) loss on sale of investments, net	(5,692)	(6,098)	(12,404)	(12,143)
Realized (gain) loss on interest rate swaps and swaptions	(27,159)	-	(27,159)	-
Unrealized (gain) loss on interest rate swaps and swaptions	(26,155)	1,533	(24,152)	2,043
Total adjustments	(59,006)	(4,565)	(63,715)	(10,100)
Core earnings	<u>79,841</u>	<u>74,256</u>	<u>159,123</u>	<u>151,803</u>
Earnings per common share (basic)	<u>1.03</u>	<u>0.68</u>	<u>1.69</u>	<u>1.40</u>
Core earnings per share attributable to common shareholders	<u>0.59</u>	<u>0.64</u>	<u>1.21</u>	<u>1.32</u>