Altisource Asset Management (AAMC) – How Will it End?

Date: June 23, 2014

On May 6, I wrote a note calling Altisource Asset Management (AAMC) a 2 billion dollar parasite (here). My conclusion was that RESI (the host REIT) and AAMC (the parasitic management company) were both set to tumble. Judging by the performance of each versus the market, I was dead on:

AAMC down 14%
RESI down 6%
S&P up 4%

The question that stands before us today is: what's next? For that, I'll rehash what I wrote on May 6:

> Well, absent the market miraculously waking up from its stupidity-induced coma, there's one other catalyst on the horizon: June 24th. You see, Glaucus has written letters to independent RESI board members attempting to get the current Asset Management Agreement replaced with an at-market rate (thereby eliminating the massive value transfer from RESI to AAMC) and June 24th is the last date the independent directors must give notice to terminate or replace the contract.

Tomorrow is D-Day for AAMC. Either the independent directors do the right thing and replace / terminate the asset management contract, or they do nothing and AAMC will continue to siphon money from RESI at the expense of RESI shareholders.

Here's the thing: **I fully expect the Board to do nothing.** Because of Bill Erbey and Luxor Capital, AAMC is likely to continue to gorge itself on RESI's cash distributions. **Which means short-sellers today are going to be disappointed tomorrow.**

But this is a sideshow from the real story. The real story is what's going on in RESI's core business. You see, for RESI's model to work, they need to continually source distressed portfolios of single family homes, raise capital above book value and plow it back into even more distressed single family homes. It's a simple business and it can work – **but only if the cycle continues**. The problem for RESI (and its parasitic partner AAMC) is two-fold: (1) RESI now trades substantially below net asset value, making future equity capital raises dilutive (and therefore untenable), and (2) the once-distressed single family home market is becoming less distressed by the day.

To get a sense for how quickly the market is improving, read this (here):

> Private equity firm Lone Star Funds submitted successful bids for $3.9B of soured home loans sold this month by HUD, Bloomberg reported on Friday night. This was the first

> time that a single bidder had won all of the loans being offered in such a sale of debt previously insured by the Federal Housing Administration, the news service quoted HUD as saying. **Lone Star paid an average of about 75c on the dollar, versus the going rate of about 65c at previous HUD auctions**, Asset-Backed Alert reported. Other bidders were angered by Lone Star's bid, the website quoted an unnamed source as saying. Lone Star negotiated with HUD beforehand to acquire all of the available loans, another source told the website. ANALYST REACTION: **In a note to investors, Piper Jaffray analyst Michael Grondahl wrote that Lone Star paid about 77.6% of estimated current prices for the loans, versus the 68%-69% that Alitsource had previously paid for similar loans.**

This isn’t a small improvement. This is an order of magnitude improvement in the valuation of distressed single-family homes. And it’s driven by two forces that aren’t slowing down anytime soon: (1) a better real estate market led by an improving economy, and (2) increased capital entering the space and competing away margins. These two factors are breaking the back of RESI and AAMC’s business model.

To get a sense for just how much RESI / AAMC will be impacted, consider this:

Moving from a 34% discount to fair market value (what RESI was paying 1 year ago to acquire assets) to a 22% discount (what Lone Star just paid) means RESI will go from making $43,100 per property to just $18,850. That’s a decrease in profit of nearly 60%.

So the real story of RESI and AAMC is this: the business they sold investors as “secular” is actually “cyclical”. And the cycle is now over.