

Equity Research

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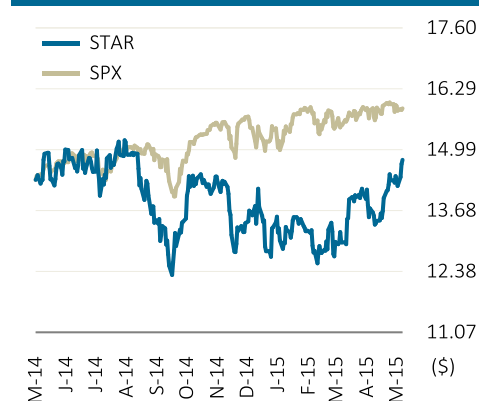
STAR **\$14.77**

12 month target \$17.00
Upside 15.1%

BUY

52 week range \$12.30 - \$15.19
Market Cap (m) \$1,922

Price Performance



Source: IDC

Financials

iStar Financial, Inc.

Upcoming Investor Presentation a Potential Watershed Event for STAR

When asked about the wide gap between our take on iStar Financial's asset value and business prospects and the company's share price, we point to two main factors that we believe largely account for the disconnect. One is the fact that the stock does not fit neatly into a single coverage category for analysts on the buy-side or the sell-side. The company is a REIT and has assets typical of a REIT, but given that it has not paid a dividend since prior to the financial crisis, it is avoided or overlooked by REIT analysts. STAR also has assets that would typically be associated with a homebuilder stock, but doesn't really fit into that category either.

- ▶ The other factor is that STAR's inherent value is not readily apparent from a GAAP accounting standpoint such that the stock does not screen well. The company has made significant progress in monetizing and repositioning its portfolio of legacy commercial real estate and land assets and then investing the proceeds that result in new projects. However, the resulting improvement in earnings power has remained largely obscured.
- ▶ We have stated that we believe 2015 is likely to be a pivotal year for STAR. We anticipate the monetization of the company's legacy assets will accelerate, providing more transparency with regard to their value, while the deployment of capital into new investments should continue apace after it achieved \$1.3bn in loan commitments during 2014. As STAR's value becomes more apparent – the long-awaited sale of a portion of the \$1.1bn in land assets it acquired via foreclosure during the financial crisis should be a key part of this revelation – the stock should finally break out to the upside, in our view.
- ▶ **Valuation:** Our \$17 price target for STAR is based on 0.75x our estimate of the company's residual value per diluted share available to the equity as derived from our waterfall analysis.

Estimates

	1Q14 A	2Q14 A	3Q14 A	4Q14 A	FY14 A	1Q15 A	2Q15 E	3Q15 E	4Q15 E	FY15 E	FY16
Net Income (Adj.)	(27)	(16)	22	(28)	(49)	(23)	(7)	(1)	5	(25)	-
Diluted EPS (Adj.)	(0.31)	(0.19)	0.17	(0.33)	(0.51)	(0.26)	(0.08)	(0.01)	0.04	(0.26)	-
Finance Income	109	130	113	110	462	113	116	119	121	469	-

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

Please Read: Important disclosures and analyst's certification appear in Appendix

- ▶ As such, we believe STAR's investor presentation on Wednesday at 9:30am ET in New York City at the Warwick Hotel, across the street from NAREIT's ongoing REITWeek, could be a watershed event for the company and the stock. Management has said that the presentation will provide a roadmap for how it intends to unlock the inherent value of its legacy assets and to position itself for future earnings growth. While such increased clarity would be important for investors in any company, we think it could be even more significant for STAR given some investors' frustration with what they perceive as the company's lack of transparency. "During our June meeting, we'll give you a comprehensive overview of how we see the world," STAR CEO Jay Sugarman during the company's 1Q15 conference call on April 29.

Among the questions we believe management should address during their presentation are the following:

- ▶ Sugarman, during STAR's 1Q15 call, pointed to "some fairly significant technological changes taking place that are impacting real estate," a theme that the company would look to pursue. Sugarman did not elaborate, stating that he would address the topic during the upcoming presentation. **What are the changes to which Sugarman alluded, and how does STAR intend to pursue them? What is management's take on the potential upside associated with this initiative, and what would be the associated costs?**
- ▶ STAR's tax asset of over \$750mm provides it with a benefit enjoyed by few REITs, which are required to pay out at least 90% of their taxable income to shareholders in the form of dividends. While most REITs must sell stock or other securities to raise capital, STAR for several years will be able to increase its capital base and thereby create more dry powder to be deployed into new loans and leases without the need for dilution. **What is management's take on how it views capital management, leverage (STAR was at the lower end of management's targeted range of 2.0x-2.5x at March 31) and the potential to use a portion of its capital to pay a dividend?**
- ▶ Sugarman, during the 4Q14 call, noted that STAR management believed it was "at what we perceive as a pretty topy part of the market." He also stated during the 1Q15 call that the market was "very competitive" and that "we're seeing lots of new entrants into the market." At the same time, STAR has been steadily deploying capital, as it exceeded its target of \$200mm in new investments per quarter for three straight quarters: \$205.6mm in 3Q14, \$456.4mm in 4Q14 and \$274.0mm in 1Q15. Sugarman has explained in the past that STAR has proven itself able to engage in deals that the company's would-be competitors either can't or won't pursue, an ability that has given it a solid pipeline of opportunities with strong risk-adjusted returns. "There are always pockets to play in," the CEO said during the 1Q15 call. "Part of our skill set has been to try to find those pockets, and you'll hear us talk a lot more about that in June." **What are examples of such pockets, and what factors allow STAR to exploit them?**

Waterfall Analysis:

(\$ in mms)	
Collateral Pool Asset Value	
Real Estate Finance	1,307.2
Net Lease Assets	1,116.2
Operating Properties	560.0
Land	882.0
Strategic Investments	71.9
Total Encumbered Pool Asset Value	3,937.3
<u>1st Lien Debt</u>	
1st Lien Claims	834.6
<i>1st Lien Debt Coverage %</i>	<i>472%</i>
Remaining Asset Value Available for Unsecured Debt	3,102.7
<u>Unencumbered Asset Value</u>	
Residual Encumbered Asset Value	3,221.6
	3,102.7
Asset Value Available for Unsecured Debt	6,324.3
<u>Unsecured Debt</u>	
Asset Value Available for Unsecured Debt	6,324.3
Unsecured Debt	3,426.9
<i>Unsecured Debt Coverage %</i>	<i>185%</i>
Value Available for Preferred Stock	2,897.4
<u>Preferred Stock</u>	
Asset Value Available for Preferred Stock	2,897.4
Preferred Stock	545.0
<i>Preferred Stock Coverage %</i>	<i>532%</i>
Value Available for Convertible Preferred Stock	2,352.4
<u>Convertible Preferred Stock</u>	
Asset Value Available for Preferred Stock	2,352.4
Preferred Stock	115.0
<i>Preferred Stock Coverage %</i>	<i>2046%</i>
Value Available for Common Stock	2,237.4
<u>Common Equity</u>	
Outstanding Shares	98.1
Value per Share	\$22.80

Source: BTIG Research Estimates and Company Documents

Income Statement

iStar Financial - Operating Model	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Dec-16
(\$ in millions)	2013A	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15E	3Q15E	4Q15E	2015E	2016E
Operating lease income	234.6	62.1	61.0	60.7	59.3	243.1	59.1	60.6	61.2	61.8	242.8	253.6
Interest income	108.0	27.9	35.1	31.1	28.6	122.7	34.9	35.2	35.6	36.0	141.7	147.4
Other income	48.2	14.6	29.3	18.4	18.8	81.0	10.6	10.8	10.8	10.9	43.1	44.6
Land sales revenue	-	4.1	4.5	3.3	3.3	15.2	8.3	9.5	10.9	12.6	41.2	67.0
Total revenues	390.8	108.7	129.8	113.5	110.0	462.0	112.9	116.1	118.6	121.2	468.8	512.7
Interest expense	266.2	57.5	56.5	55.4	55.1	224.5	54.6	54.6	54.6	54.6	218.5	221.3
Real estate expense	157.4	42.6	40.6	41.3	38.9	163.4	39.6	39.2	38.8	38.5	156.2	157.7
Land cost of sales	-	3.7	3.6	2.8	2.8	12.8	6.9	6.9	6.9	6.9	27.6	30.3
Depreciation and amortization	71.3	18.6	18.8	17.7	18.4	73.6	18.5	18.6	18.7	18.8	74.6	76.1
General and administrative	92.1	19.8	26.6	23.4	19.0	88.8	20.8	20.3	20.1	19.9	81.2	80.7
Provision for (recovery of) loan losses	5.5	(3.4)	(2.8)	(0.7)	5.2	(1.7)	4.3	4.3	4.3	4.3	17.2	20.6
Impairment of assets	12.6	3.0	3.3	15.5	12.9	34.6	-	-	-	-	-	-
Other expense	8.1	0.2	4.7	(0.3)	1.2	5.8	2.1	1.0	1.0	1.0	5.1	10.6
Total costs and expenses	613.1	141.9	151.3	155.1	153.5	601.8	146.8	145.0	144.5	144.0	580.3	597.3
Income (loss) before earnings from equity method investments	(222.4)	(33.2)	(21.5)	(41.6)	(43.5)	(139.8)	(34.0)	(28.9)	(25.9)	(22.8)	(111.5)	(84.6)
Loss on early extinguishment of debt	(33.2)	(1.2)	(23.6)	(0.2)	(0.4)	(25.4)	(0.2)	-	-	-	(0.2)	-
Earnings from equity method investments	41.5	3.2	24.1	49.6	2.5	79.3	6.5	6.6	6.7	6.7	26.6	27.7
Loss on transfer on unconsolidated subsidiary	(7.4)	-	-	-	-	-	-	-	-	-	-	-
Income (loss) from continuing operations before taxes	(221.4)	(31.2)	(21.0)	7.8	(41.5)	(85.9)	(27.6)	(22.2)	(19.2)	(16.0)	(85.1)	(57.0)
Income tax expense (benefit)	0.7	0.5	0.2	(0.1)	(4.5)	(3.9)	(5.9)	-	-	-	(5.9)	-
Income (loss) from continuing operations	(220.8)	(30.7)	(20.8)	7.7	(46.0)	(89.8)	(33.5)	(22.2)	(19.2)	(16.0)	(90.9)	(57.0)
Income from discontinued operations	0.6	-	-	-	-	-	-	-	-	-	-	-
Gain from discontinued operations	22.2	-	-	-	-	-	-	-	-	-	-	-
Income from sales of real estate	86.7	16.5	17.2	27.8	28.5	89.9	21.2	27.5	30.3	33.3	112.2	135.5
Net income (loss)	(111.2)	(14.2)	(3.6)	35.5	(17.6)	0.2	(12.3)	5.3	11.0	17.3	21.2	78.5
Net income (loss) attributable to noncontrolling interest	(0.7)	(0.5)	(0.3)	0.4	1.1	0.7	1.8	-	-	-	1.8	-
Net income attributable to STAR	(112.0)	(14.6)	(3.9)	35.9	(16.5)	0.9	(10.5)	5.3	11.0	17.3	23.1	78.5
Preferred dividends	(49.0)	(12.8)	(12.8)	(12.8)	(12.8)	(51.3)	(12.8)	(12.8)	(12.8)	(12.8)	(51.3)	(51.3)
Net income (loss) attributable to HPU holders	5.2	0.9	0.5	(0.7)	0.9	1.6	0.7	0.7	0.7	0.7	3.0	3.9
Net income (loss) attributable to common shareholders	(155.8)	(26.6)	(16.2)	22.3	(28.4)	(48.8)	(22.6)	(6.8)	(1.1)	5.2	(25.2)	31.1
EPS Diluted	-\$1.83	-\$0.31	-\$0.19	\$0.17	-\$0.33	-\$0.51	-\$0.26	-\$0.08	-\$0.01	\$0.04	-\$0.26	\$0.24
Adjusted EPS Diluted	-\$0.27	-\$0.07	\$0.34	\$0.44	\$0.16	\$0.98	\$0.10	\$0.23	\$0.29	\$0.24	\$0.87	\$1.08
Diluted shares outstanding	85.1	84.8	85.2	130.2	85.2	96.3	85.5	85.5	85.5	131.1	96.9	131.4

Source: BTIG Research Estimates and Company Reports

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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Stocks in coverage as of the end of the most recent calendar quarter (March 31, 2015): 142

The percentage of Investment banking services is calculated as of March 31, 2015. Distribution of investment Banking Relationships: BUY: 83% NEUTRAL: 17% SELL: 0%

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iStar Financial, Inc. (STAR)

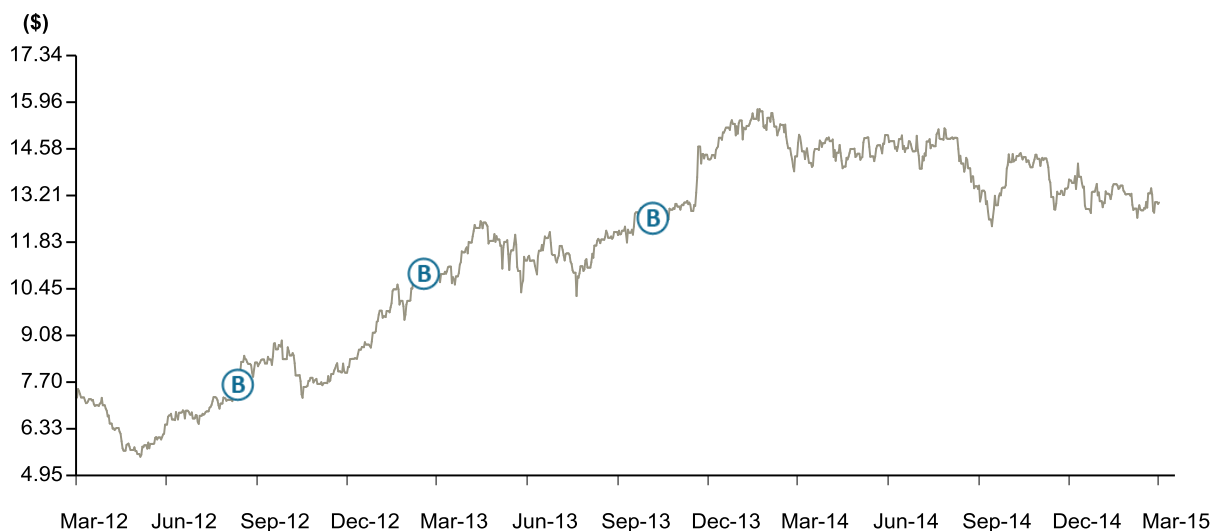
Valuation

Our \$17.00 price target is based on 1.75x our estimate of STAR's residual value per diluted share available to the equity as derived from a waterfall analysis.

Risks

The primary risks to achieving our price target include vulnerability to weakness in the commercial and residential real estate markets, a meaningful percentage of loans that are nonperforming, a cost of capital higher than that of many of its peers, and vulnerability to significantly higher interest rates.

iStar Financial, Inc. (STAR)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
11-Sep-12	7.61	11	Mark Palmer	BUY
18-Mar-13	10.89	13	Mark Palmer	BUY
04-Nov-13	12.53	17	Mark Palmer	BUY

Other Disclosures

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