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New Rec: American Home Mortgage (AHH $24.40) May 23, 2004

Position: Buy Target: $31* Timing: 2 (1=aggressive; 5=cautious)

$MM	Q104a	Q204e	Q304e	Q404e	F2004e	F2005e
Revenue	84.3	106.1	117.4	101.3	409.2	396.3
EPS$*	0.70	0.87	0.96	0.85	3.42	3.54
Y/Y Growth	-27.4%	-44.0%	-9.1%	46.1%	-16.2%	3.5%
PSR	na	na	na	na	2.4	2.5
PE	na	na	na	na	7.1	6.9
Consensus	0.70	0.88	0.91	0.90	3.39	3.50

N.B: AHH is expected to pay about $2.44 in dividends over the next 12 months. If AHH shares reach our target price of $31 in 12 months, total return with the dividend would equal 37%.

Shares Out: 39.9M Market Cap: 973.0M FYE: Dec

Summary: American Home Mortgage (AHH) is a prime mortgage REIT with origination capability. The business consists of two key operating segments: a taxable REIT subsidiary (TRS) and a Qualified REIT Subsidiary (QRS). The TRS originates and services loans, thereby earning fully taxable fee income, gains on sales, and servicing revenue. Once a loan application has been originated at the TRS, management decides whether the assets will be securitized and held on the balance sheet or sold. As part of AHH's strategy, fixed rate mortgages are typically sold in the open market, while adjustable rate mortgages (ARMs) are securitized and held. Once securitized, these ARMs generate tax-free net interest income that serves as the core earnings component of the REIT.

This "hybrid" REIT structure represents a change in strategy for AHH. Prior to Q403, the company was structured as a traditional "originate and sell" mortgage bank. As we discuss below, this new organizational structure will allow AHH to leverage its expertise in origination and servicing, while simultaneously reaping the benefits of the tax-advantaged REIT structure.

Key to AHH's business model is the yield advantage that it is able to generate through the origination of loans. Mortgage REITs can build the MBS (mortgage-backed securities) portfolio in two ways. One way (the traditional way) is to simply purchase securities in the open market. Another way (AHH's strategy) is to originate the portfolio of loans. Self-origination is advantageous because intermediary costs, such as securities dealer costs, can be avoided. Thus, AHH is able to generate a yield advantage of 35 - 60 bps vs. open market purchases. Why don't all mortgage REIT's pursue this strategy? Because they do not have the origination network that AHH has built. Over the last 5 years, management has grown via 7 acquisitions, expanding to 279 loan origination offices in 37 states. In 2003, AHH originated $21.7Bn in loan volume, and it controls approximately a 0.96% share of the nationwide origination market. We think this nationwide footprint and growing market share will assure a continued ability to access the purchase market, which will be strategically important as refinancings slow.

To fully realize this yield advantage, management plans to significantly alter the MBS portfolio in two important ways. First, total MBS held on the balance sheet will grow from $1.8Bn on 12/31/03 to at least $6.6Bn by 12/31/04. AHH is ahead of schedule in this regard, as total MBS had already increased to $5.4Bn as of 5/6/04. As this QRS portfolio grows, it produces a growing stream of tax-free, yield advantaged net interest income (projected to comprise 68% of total earnings in FY04). Second, management plans on altering the portfolio's asset mix so that 100% of the MBS portfolio consists of self-originated ARMs. Currently, self-originated ARMs comprise 28% of the portfolio. Management estimated on the recent earnings call that it would take until year-end to achieve this goal. The

primary advantage to holding ARMs instead of fixed rate mortgages is that they offer interest rate mitigation, as discussed below.

One of the key risks to a mortgage REIT is interest rate risk. AHH has mitigated interest rate risk in several ways. First, AHH uses interest rate swaps to create a duration neutral portfolio. Given the likelihood of eventual interest rate increases, this appears to be a prudent decision. Second, as discussed above, the MBS portfolio will eventually consist entirely of ARMs, as self-originated fixed rate mortgages will be sold in the open market. This is advantageous because as interest rates rise, the interest rates on the ARMs adjust upward as well, so net interest income spread will not tighten as it would with a fixed income portfolio. Third, because a servicing portfolio performs better in a rising interest rate environment, this serves as a natural hedge against AHH's origination business.

In addition to interest rate mitigation, investors in AHH should enjoy a relatively stable dividend stream. By law, REITs are required to distribute 90% of income to investors in the form of dividends. In AHH's case, the projected FY04 dividend of $2.44 is stabilized by the income created by the taxable subsidiary (the taxable subsidiary, which is not subject to the 90% rule, can either use its earnings to reinvest in the business or to pay additional dividends). In FY04, it appears that AHH has chosen to use taxable earnings to increase dividends. For example, FY04 EPS guidance is $3.25 – $3.40. Management has stated that it expects the REIT to comprise 68% of the earnings stream, which would be approximately $2.31 (assuming 3.40 in EPS). If AHH were to pay out 100% of REIT earnings in dividends (vs. the 90% that is required), then that would equal $2.31 in dividends. Given that current FY04 dividend guidance is $2.44, we can surmise that management plans for the taxable subsidiary to supplement approximately $0.13 in dividends. Traditional mortgage REITs without origination and servicing businesses obviously would not have this flexibility.

Because the company's REIT structure requires 90% of net interest income be paid out as dividends, maintaining sufficient access to capital markets is crucial. Currently, AHH funds the bulk of operations via two sources: reverse repurchase agreements and warehouse lines of credit. At Q103, it had $3.4Bn in reverse repurchase agreements outstanding (out of approx. $7.0Bn in total capability) and $1.3Bn of warehouse lines of credit. While access to the repurchase market could be squeezed if the value of the MBS portfolio should decline significantly, this risk is mitigated by the high credit quality of the portfolio. Historically, higher rated portfolios have proven to be a more resilient source of repo financing than lower rated portfolios. Other factors that strengthen liquidity are as follows: First, AHH has $600M+ of additional capacity in warehouse lines of credit. Second, the

company recently completed a $360M equity offering. Third, at Q104 there was $97M in cash on the books, up from $53M at year-end.

AHH's earnings growth is primarily driven by net interest income, gains on sales, and servicing fees.

For net interest income (MBS on B/S x net interest spread), we think management's MBS projection of $5.7Bn in Q2 is very likely to be achieved given that AHH is already at $5.4Bn as of 5/6/04. Q3 and Q4 total MBS estimates are $6.3Bn and $6.8Bn. Net interest margin, which was 1.2% in Q1, should continue to rise due to the increased percentage of higher yielding self-originated assets. We have modeled a 40 bp margin increase by year-end, which is consistent with guidance.

Gain on Sale Income equals loans originated times percent of loans sold times gain on sale margin. We have estimated total origination volume by applying AHH's 0.96% market share to a conservative national origination estimate of $2.0 Trillion (note that Fannie Mae's current estimate is $2.5 Trillion). The percent of loans sold should decline as the company implements its "originate and hold" strategy. We have modeled a decrease from FY03 levels of over 90% sold to 75% through FY05. Gain on sale margins of 1.83% are assumed to remain stable through 2005.

Net servicing fees are comprised of three components: servicing fees, amortization, and impairment reserve. In our model we have projected total servicing assets to grow to $12Bn by year-end and servicing fees to decline by 0.5 bps on an annualized basis. We project servicing amortization to decrease by 5% per quarter. Finally, as management stated in the recent earnings call, the impairment reserve from Q1 is expected to reverse in Q2. Given the likely upward trend in rates, we forecast that no impairment reserve will be necessary in Q304 through Q405.

Our EPS projections are $3.42 in FY04 (vs. management guidance of $3.25 – $3.40) and $3.54 in FY05. Mean "street" estimates are $3.39 and $3.50, respectively. We think that management is being conservative in its guidance and that FY04 results could provide an upside surprise. We think there is significant upside to the stock price, as we discuss below.

We estimated AHH's current fair value using two approaches. Our first method is a P/E valuation based on comparables. At only 7.1x our 2004 EPS projection, we think that the benefits of AHH's new REIT platform with origination capability have not been fully recognized by the market. For example,

AHH’s closest competitors, Thornburg Mortgage and Redwood Trust, trade at an avg. P/E of 8.4x. If AHH were awarded this 8.4x P/E multiple, the current implied price is $28.76.

Our second method is a blended valuation in which we divide the company into two distinct businesses and value them separately. Here we use management guidance that 68% of 2004 earnings will come from the REIT subsidiary and 32% of earnings will come from the taxable subsidiary. Applying a 10% yield to the REIT subsidiary and a 6.5x multiple on the taxable subsidiary (which reflects the multiple awarded traditional mortgage banks) results in an implied current price of $30.37.

The average of these two methods is the basis for our current intrinsic value of $29.50. Note that if we included a P/B comparables analysis as part of our analysis, then the average of the three valuation techniques would be $28.87.

Our projected EPS for 2005 is $3.54. Again using the average of the two valuation methods described above, we think the shares will be worth at least $31 one year from now. This is our initial price target.

In addition, over the next year, shareholders will collect at least $2.44 in dividends. At its current price of $24.40, and assuming the $31 target is reached and the dividend is paid out, AHH offers significant total return potential in one year of at least 37% with very little risk. As we noted above, AHH currently sells at 1.3x book value.

Background:

In December, 2003, AHH acquired Apex Mortgage Capital, Inc., a mortgage REIT. As a result of this merger, AHH reorganized itself into a hybrid mortgage REIT. The primary strategic goal of this reorganization was to realize the benefits of holding a portfolio of self-originated mortgage-backed securities.

Apex was formed on September 15, 1997, primarily to acquire United States agency and other highly rated, single-family real estate adjustable and fixed rate mortgage-related assets. Apex commenced operations on December 9, 1997, following the initial public offering of Apex's common stock.

Historically, AHM Corp. operated as an independent mortgage lender. On June 15, 1999, AHM Holdings was formed to serve as a holding company for AHM Corp. On October 6, 1999, AHM Holdings completed its initial public offering of common stock and became the parent holding company of AHM Corp.

Since its initial public offering, the Company has grown primarily by acquisition. The Company's major acquisitions are as follows:

1. December 1999 -- acquired Marina Mortgage Company, Inc., a California mortgage banking corporation. After initially operating as a wholly-owned subsidiary of AHM Holdings, it was merged into AHM Corp. on December 31, 2001.
2. June 2000 -- acquired First Home Mortgage Corp. Before the acquisition, First Home was an independent mortgage lender based in metropolitan Chicago.
3. October 2000 -- acquired four loan origination offices from Roslyn National Mortgage Corporation.
4. March 2001 -- acquired the Pennsylvania and Maryland loan origination offices of ComNet Mortgage Services, the residential mortgage division of Commonwealth Bank.
5. June 2002 -- acquired Columbia National, Inc., a Maryland corporation, and its captive reinsurance subsidiary, CNI Reinsurance, Ltd. Prior to the acquisition, Columbia was an independent mortgage lender and servicer based in Columbia, Maryland.
6. March 2003 – acquired certain assets of Principal Residential Mortgage, Inc., the mortgage banking subsidiary of the Principal Financial Group, including Principal's 75 mortgage branches located in 21 states and Principal's mortgage loan application pipeline.
7. June 2003 -- acquired six mortgage loan origination offices from American Mortgage LLC and American National Bank.
8. August 2001 -- entered into an agreement to acquire Valley Bancorp, Inc. and its wholly-owned subsidiary, Valley Bank of Maryland, a federal savings bank located in suburban Baltimore, Maryland. This transaction is subject to regulatory approval.

On March 3, 2004, AHH closed a $359.3 million public offering. The transaction involved the offering of 14.375 million shares of common stock priced at $25 per share. Friedman, Billings, Ramsey led the offering. Currently, the only insider to own more than 1% of outstanding shares is CEO Strauss, who owns approximately 10.6% of AHH. Over the last quarter, insiders have been buying.

Before AHH converted into a REIT, AHH's business strategy was to sell virtually all of the loans it originated. As such, the largest component earnings was gain on sale income. Since the REIT conversion, the primary strategy is to hold the MBS. Therefore, the largest component of future earnings should be generated by net interest income.

Discussion:

1. The combination of strong origination capability and a tax-favored REIT structure creates a significant yield advantage versus companies that acquire their MBS in the open market.

AHH's self-origination capabilities create a significant yield advantage vs. companies that acquire market purchased securities. Without the capacity to originate new loans, competitors are forced to purchase all MBS in the open market, thereby incurring intermediary costs (mostly consisting of securities dealer costs). In contrast, AHH's extensive retail network effectively creates a vertically integrated mortgage REIT. The "taxable" segment sources new loans and the REIT subsidiary earns the spread. Further, the company's classification as a REIT means that this interest income is not taxable (in contrast to the old model where taxes were incurred as securitized loans were sold in the market).

The net result is a yield advantage over securities purchased in the open market of between 31 and 66 bps under current market conditions. The following chart outlines this yield advantage:

Self-Originated	Short-Reset ARMs	3/1 ARMs	5/1 ARMs
Gross Coupon	3.50%	4.25%	4.87%
Credit Enhancement	-0.10%	-0.25%	-0.25%
Servicing	-0.38%	-0.38%	-0.38%
Origination Amort.	-0.15%	-0.40%	-0.41%
Net Yield	2.87%	3.22%	3.83%
Purchased in Open Mkt.	Short-Reset ARMs	3/1 ARMs	5/1 ARMs
Current Coupon	3.02%	3.63%	4.25%
Yield	2.56%	2.57%	3.17%
Origination Advantage	**0.31%**	**0.65%**	**0.66%**

Note that in our conversations with AHH management we learned that the company is using a 50 bps advantage in its forecasts. In general, the origination advantage should be between 35 - 60 bps.

Of course, as interest rates rise and assuming refinancing volume slows, sourcing loans becomes more difficult, not only because volumes fall but also because of increased competition (the same number of industry competitors chasing fewer assets). Were AHH's origination capability to weaken, then management could choose to buy loans in the open market, thereby reducing the cost advantage. However, AHH's proven track record and extensive retail

distribution system make this scenario unlikely. Over the last 5 years, management has grown via 7 acquisitions, expanding its network to 279 loan origination offices in 37 states. Further, AHH was recently ranked by The National Mortgage News as the 24th largest residential mortgage lender. In 2003, *Inside Mortgage Finance* estimated that AHH captured approximately 0.58% of the origination market, or $21.7Bn in volume. More importantly, share estimates that include the full-year effect of 2003 acquisitions peg current market share at 0.96%. AHH's nationwide footprint and growing market share should assure a continued ability to access the purchase market, which will be strategically important if refinancings slow.

2. Stable dividend stream creates a significant margin of safety

AHH plans on paying $2.44 in dividends per share in 2004, a current yield of approximately 10%. Therefore, even in a rising interest rate environment, investors will be collecting dividend payments that are competitive with other mortgage REITs, whose yields range from 4.4% - 13.8%.

AHH's dividend stream should grow at a similar pace as the assets held in the QRS, because all REIT's must by law distribute 90% of QRS income to investors in the form of dividends. This creates a relatively stable dividend source. Additionally, the dividend stream's stability is enhanced by the income created by the TRS. Because TRS income is not subject to the 90% rule, AHH has discretion as to how to allocate those funds (via dividend or reinvestment in the business). Therefore, if weakness at the QRS causes the projected dividend stream to fall short of investor expectations, AHH still has the ability to maintain its dividend via reallocation of the TRS income.

3. Interest rate risk and credit risk are mitigated by the following:

A. Portfolio is duration neutral

AHH's model is not based on "out-managing" competitors by making successful interest rate bets. In contrast to some companies that actively expose themselves to interest rate risk in the hope of earning a higher return, AHH's strategy is a more conservative one in which it focuses on limiting this risk. In practice, AHH's liabilities primarily consist of termed repurchase agreements with maturities of less than 1 year. The company uses interest rate swaps to extend the duration of these liabilities to match the duration of its assets. As of 4/28/04, the duration gap was less than 1 month.

As the table below illustrates, AHH's hedging activity produces a significantly higher cost of funds relative to some of its peers:

1Q04 Cost of Funds				
AHH	ANH	NLY	MFA	LUM
2.10%	1.52%	1.48%	1.46%	1.20%

We think this hedging cost is money well spent. As a direct result of this hedging activity, the company did not experience significant mark-to-market gains in 1Q04 as interest rates fell. Going forward, however, we think that this strategy will prove wise, as AHH will limit the mark-to-market losses and increased earnings volatility that would accompany rising interest rates.

B. Portfolio primarily composed of ARMs

Holding ARMs (adjustable rate mortgages) instead of fixed rate mortgages hedges interest rate risk and reduces earnings volatility.

Basically, AHH securitizes and sells the more interest rate sensitive loans (i.e. fixed rate loans), while keeping ARMs on the balance sheet. This strategy provides protection no matter which way interest rates move. For example, if interest rates fall, the fact that the mortgages rates are adjustable means that prepayment will be slower than with a fixed rate portfolio. This mitigates contraction risk (when prepayments leave a company with funds that cannot be as profitably deployed). However, if rates rise, the net interest spread will not tighten as it would with a fixed income portfolio. The following table illustrates that even as the on balance sheet portfolio has grown in size, it remains firmly comprised of relatively short-term ARMs:

On Balance Sheet Portfolio	1Q04		4Q03	
Product (in $000's)	Carrying Val.	% of Total	Short-Reset ARMs	3/1 ARMs
1 month ARM	184,200	4.60%	189,771	10.76%
6 month ARM	577,013	14.41%	182,559	10.35%
1x1 ARM	312,059	7.80%	30,338	1.72%
3/1 Hybrid ARM	1,058,932	26.45%	548,693	31.11%
5/1 Hybrid ARM	1,870,875	46.74%	752,828	42.69%
7/1 Hybrid ARM	0	0.00%	59,439	3.37%
Total	**4,003,079**	**100.00%**	**1,763,628**	**100.00%**

The fact that AHH holds ARMs on the balance sheet also means that in a period of rising rates and declining origination volume, a larger percentage of AHH's profits will be derived from net interest income. In contrast, pure mortgage banks depend solely on the fees and gains produced by origination volume. As a

result, the earnings at AHH should be less volatile than at pure mortgage banking companies.

C. Servicing revenues are countercyclical to origination volume, providing a natural hedge

Servicing includes processing loan payments, supervising foreclosures, answering questions from customers, and other general administrative duties. As of 3/31/04, AHH serviced 70,536 loans for a total of $9.0B in assets. For loans that AHH securitizes and holds, it typically receives a servicing fee of 25 – 37.5 bps on the principal loan balances. As of 3/31/04, AHH's weighted-average servicing fee was 36.3 bps, up from 34.7 bps q/q.

Because servicing revenues are generated as a percentage of the portfolio's average outstanding principal balance, the servicing portfolio will perform better in a rising interest rate environment. Here is the logic. When interest rates rise, two important changes occur from the servicer's perspective: prepayments slow and adjustable rates increase. Both of these are advantageous to AHH's servicing revenue stream because they result in higher average principal balances (slower prepayments for obvious reasons and higher adjustable rates because a greater portion of a mortgage-holder's monthly payment will go toward interest and a smaller amount will be applied to principal).

This "hedge" worked in reverse in Q104, as reduced interest rates y/y resulted in net loan servicing fees of -$9.6M vs. -$7.4M in 1Q03. More specifically, this increased loss was a direct result of the temporary impairment provision that AHH incurred in the quarter. Without going to deeply into the details of MSR accounting, it is enough to understand that the impairment provision is based on a set of management assumptions, the most important of which is future prepayment speeds. As interest rates declined y/y, companies increased the future prepayment speed assumption, resulting in an increased impairment charge. Most important in all of this is the fact that the company expects to fully recover this impairment reserve in Q2 as rates rise.

Relatively speaking, AHH's servicing component is a fairly small percentage of revenue (our projections estimate FY04 total servicing fees will account for approximately 4% of total sales). However, as interest rates rise and as declining origination volumes drive lower fee income and gain on sale income, we project that this natural hedge will increase to approximately 7% of total revenue in 2005.

D. Credit risk is mitigated because the majority of the company's holdings are either AAA-rated securities or obligations of Fannie Mae or Freddie Mac

In addition to being a prime lender, AHH purchases credit enhancement from Fannie Mae or Freddie Mac to mitigate potential default losses. As a result, most of the securities held in the REIT are very highly rated:

Security Type	Carrying Value	% of Total
Agency	1,549,677	38.71%
AAA	2,019,173	50.44%
AA	364,726	9.11%
A	27,564	0.69%
BBB	10,867	0.27%
Unrated [1]	31,072	0.78%
Total	**4,003,079**	**100.0%**

1. Unrated securities consist of credit enhancements

4. Portfolio transformation is progressing as planned

AHH's transformation from a pure mortgage company to a hybrid REIT appears to be progressing at a rapid but appropriate pace.

A. Management has made substantial progress in increasing MBS on the balance sheet. MBS totaled $4.0Bn at quarter-end, up from $1.8Bn on 12/31/03, as the company had net MBS purchases of $1.3Bn and net securitized originations of $1.0Bn (note that high MBS purchases in the quarter reflect strategic purchasing due to interest rate declines). Even further progress has been made since quarter end. As of 5/6/04, total MBS had increased by another $1.4Bn to $5.4Bn. Management has stated that it is on track to achieve the goal of $5.7Bn by Q2 and at least $6.6Bn by Q4. These targets reflect the company's opinion that originations will slow significantly in 2H04 as interest rates climb.

B. Total originations (fixed and adjustable rate) also increased in Q1, up 2.3% y/y to $4.4Bn, which compares very favorably to the 21% estimated decline in originations nationwide. Again, management guidance of $6.0Bn in Q2, $5.0Bn in Q3, and $4.0Bn in Q4 reflects the view that originations will slow as interest rates climb in 2H04.

C. Management has stated that it intends for self-originated ARMs to comprise nearly 100% of the total portfolio by year-end. As of Q104, this figure

was 28%. Management estimated on the recent earnings call that it would take until year-end to achieve this goal.

Management expects that the mix change in its MBS portfolio will translate into 68% of AHH's total earnings generation from the REIT and 32% from the taxable entity in FY04.

D. Leverage: AHH has a fairly wide-ranging debt / equity target of between 8:1 and 12:1. In a worst-case scenario, an over-leveraged AHH could risk either lowering its dividend or defaulting on its borrowings. We think this risk is mitigated by several of the factors that we have previously discussed: First, AHH is a prime lender, so the incident of default in its portfolio should be relatively benign. Second, AHH has a comparatively efficient cost structure versus most competitors due to its ability to originate loans. Third, AHH mitigates interest rate risk via a duration neutral portfolio.

5. Liquidity is Strong

Because the company's REIT structure requires 90% of net interest income be paid out as dividends, maintaining sufficient access to capital markets is crucial. Currently, AHH funds the bulk of its operations via two sources – reverse repurchase agreements and warehouse lines of credit. At Q103, AHH had $3.4Bn in reverse repurchase agreements outstanding (out of approximately $7Bn in total capability) and $1.3Bn of warehouse lines of credit.

Essentially, reverse repurchase agreements are short-term financing backed by the value of AHH's MBS portfolio. Therefore, if the value of its MBS portfolio should significantly decrease, its access to the repurchase market could be squeezed and margin calls could be initiated. Note, however, that this risk is mitigated by the high credit quality of the portfolio. Historically, higher rated portfolios have proven to be a more resilient source of repo financing than lower rated portfolios.

In addition to reverse repo agreements, the company's liquidity is strengthened by the following: First, the warehouse lines of credit, which are basically syndicated bank facilities backed by loans, have additional capacity of $600M+. Second, the company recently completed a $360M equity offering. Third, at Q104 AHH had $97M in cash on the books, up from $53M at year-end. Fourth, the company's taxable entity provides a source of income not available to a traditional mortgage REIT. In other words, income produced via origination and servicing could be used as supplementary financing for the REIT operations, thereby reducing capital needs compared to non-hybrid competitors.

6. Financial Projection Assumptions

A. Net Interest Income

Net interest income is projected by the following equation:
Net interest income = (avg. MBS on B/S)x(net interest margin)

We think that the MBS projection of $5.7Bn in Q2 is very likely to be achieved given that AHH is already at $5.4Bn as of 5/6/04. Q3 and Q4 total MBS estimates are $6.3Bn and $6.8Bn.

Net interest margin, which was 1.2% in 1Q, should continue to rise due to the increased percentage of higher yielding self-originated assets. We have modeled a 40 bp margin increase by year-end, which is consistent with guidance.

B. Gain on Sale Income

Gain on sale projection = (loans orig.)x(% loans sold)x(gain on sale margin)

Loan origination projections are based on company estimates from the Q3 earnings conference call, which we think are conservative (CEO Strauss stated that he expects Fannie Mae to downwardly revise its $2.5 Trillion national origination estimate for 2004. He further stated that these conservative expectations are fully reflected in guidance). *Inside Mortgage Finance* estimates that AHH had a 0.58% share of the total origination market in 2003. Importantly, however, this estimate does not include a full year benefit of acquisitions that were completed in 2003. The magazine further estimates that had these acquisitions been effective for the full calendar year, AHH would have achieved a 0.96% market share. Applying this percentage to a total origination market that is 20% lower than current estimates ($2.0Trillion) would equate to $19.2Bn in total originations. This is very close to management's guidance of $19.4Bn ($4.4Bn in Q1, $6Bn in Q2, $5Bn in Q3, $4Bn in Q4) and assumes no market share growth. Therefore, we think these projections are achievable.

As AHH implements its "originate and hold" strategy, the percent of loans that it sells will decline. We have modeled a decrease from 2003 levels of selling over 90% to selling about 75% in FY05.

Gain on Sale estimates are based on the assumption that the 1.83% gain on sale margin achieved in Q1 is sustainable through 2005. AHH has been able to

keep prices stable in the past, and its retail strength should aid in sustaining these margins going forward.

C. Servicing Fees

Net servicing fees are comprised of 3 components: servicing fees, amortization, and impairment reserve. In our model we have projected total servicing assets to grow to $12Bn by year-end and servicing fee to decline by 0.5 bps on an annualized basis. We project servicing amortization to decrease by 5% per quarter, which is consistent with “street” estimates. Finally, as management stated in the 1Q04 earnings call, the impairment reserve from Q1 is expected to reverse in 2Q. Given the likely upward trend in rates, we forecast that no impairment reserve will be necessary in 3Q04 through 4Q05.

D. Expense Assumptions

For the most part, projected expenses are based on the average expense margin for the previous 8 quarters. Exceptions include salary, occupancy, and other, which we reduced gradually because we think that AHH’s business has some positive leverage. For example, when AHH completes acquisitions, it typically retains the loan production office itself, while eliminating the centralized support system and associated costs. This raises retail outlet productivity (management confirmed that productivity per retail outlet improved in Q104). Further, the company has continued to automate its servicing platform so that it is scalable well beyond its current level of use.

7. Valuation

We have estimated AHH’s intrinsic value using two primary valuation techniques:

A. First, we applied a P/E valuation using AHH’s comparables universe. AHH’s P/E multiple of 7.1x our projected 2004 EPS of $3.42 looks moderately attractive when compared with other residential mortgage REITs, which are trading within a range of 6.3x – 8.9x. However, we think the true universe of comparables should be prime residential mortgage REITs with origination capabilities. This smaller universe, which currently consists of Thornburg Mortgage and Redwood Trust, trades at an average P/E of 8.4x (and has traded in excess of 10.0x within the last quarter). This higher multiple is justified by the cost savings that these companies generate by originating versus purchasing in the open market. If AHH were awarded this 8.4x P/E multiple, the current implied price is $28.76.

Broad Mtge. REIT Univ. (Prime, Non-Prime, w/Orig., w/out Orig.)

	Price	2004 EPS est.	Current P/E	BV/share	P/B
NLY	$16.64	$2.32	7.2x	$13.45	1.2x
ANH	$11.41	$1.70	6.7x	$11.54	1.0x
MFA	$8.71	$1.19	7.3x	$8.64	1.0x
IMH	$19.55	$3.11	6.3x	$9.72	2.0x
LUM	$12.29	$1.77	6.9x	$11.38	1.1x
TMA	$25.36	$2.85	8.9x	$17.85	1.4x
RWT	$47.21	$5.96	7.9x	$30.72	1.5x
Average			7.3x		1.3x

Prime mtge. REIT's with Orig. Capabilities (True Comps Universe)

	5/21/04 Price	2004 EPS est.	P/E	BV / Share	P/B
TMA	$25.36	$2.85	8.9x	$17.85	1.4x
RWT	$47.21	$5.96	7.9x	$30.72	1.5x
Average			8.4x		1.5x

Implied P/E

	2004 EPS est.	Broad Univ. Avg. P/E	Sub-Univ. Avg. P/E	Broad Univ. Implied Price	Sub-Univ. Implied Price
AHH	$3.42	7.3x	8.4x	$25.04	**$28.76**

Note that following the same logic on a Price/Book basis implies a current price of $27.49.

Implied P/B

	2004 BV/S est.	Broad Univ. Avg. P/B	Sub-Univ. Avg. P/B	Broad Univ. Implied Price	Sub-Univ. Implied P/B
AHH	$18.59	1.3x	1.5x	$24.65	**$27.49**

B. Our second method is a blended valuation in which we divide the company into two distinct businesses and value them separately. Here we use management guidance that 68% of 2004 earnings will come from the REIT subsidiary and 32% of earnings will come from the taxable subsidiary. Applying a 10% yield to the REIT subsidiary and a 6.5x multiple on the taxable subsidiary (which reflects the multiple awarded traditional mortgage banks) results in an implied current price of $30.37.

2004 Blended Valuation	Avg. P/E
Value of REIT subsidiary	$23.26
Value of Taxable Subsidiary	$7.11
Implied Price	**$30.37**

The average of the P/E analysis and blended valuation is the basis for our current intrinsic value of $29.50.

Our projected EPS for 2005 is $3.54. Again using the average of the P/E and blended valuation methods described above, we think the shares will be worth at least $31 one year from now. This is our initial price target.

In addition, over the next year, shareholders will collect at least $2.44 in dividends. At its current price of $24.40, and assuming the $31 target is reached and the dividend is paid out, AHH offers significant total return potential in one year of at least 37% with very little risk. As we noted above, AHH currently sells at 1.3x book value. Tangible book value was 88.7% of total book value at Q104.

Projections:

$000	Q104a	Q204e	Q304e	Q404e	Q105e	Q205e	Q305e	Q405e
Net Interest Income	12,772	20,235	26,730	27,540	30,294	33,020	35,662	38,158
Gain on Sale Income	80,133	67,440	83,400	65,100	48,038	54,900	54,900	61,763
Servicing Fees	10,318	11,339	12,336	13,307	13,552	13,799	14,050	14,302
Amortization/Impair.	-7,346	-6,979	-6,630	-6,298	-5,983	-5,684	-5,400	-5,130
Impairment Reserve	-12,584	12,584	0	0	0	0	0	0
Net Servicing Fees	-9,612	16,945	5,706	7,009	7,569	8,115	8,650	9,172
Other Non-Interest Inc	978	1,505	1,607	1,689	1,626	1,463	1,491	1,500
Total Revenue	84,271	106,125	117,444	101,338	87,526	97,499	100,703	110,593
Salary, Comm, Benefits	39,782	45,634	50,501	42,562	36,761	40,950	41,288	45,343
Occupancy/Equipment	8,094	7,430	8,222	7,095	5,252	5,850	6,042	6,636
Data Processing	3,213	3,530	3,907	3,371	2,912	3,243	3,350	3,679
Office Expenses	3,118	3,231	3,576	3,085	2,665	2,968	3,066	3,367
Marketing/Promotion	2,212	3,291	3,642	3,142	2,714	3,023	3,123	3,429
Travel/Entertainment	2,577	2,430	2,690	2,321	2,004	2,233	2,306	2,533
Professional Fees	2,428	2,362	2,614	2,255	1,948	2,170	2,241	2,461
Other	5,438	5,175	5,727	4,941	3,414	3,802	3,927	4,313
Total Non-Interest Exp	66,862	73,083	80,877	68,773	57,669	64,240	65,344	71,761
Net Inc Before Taxes	17,409	33,042	36,566	32,565	29,857	33,259	35,359	38,832
Provision for Inc Taxes	-3,814	-1,652	-1,828	-1,628	-896	-998	-1,061	-1,165
Net Inc Before Min Int	21,223	34,694	38,395	34,194	30,753	34,257	36,420	39,997
Minority Interest	0	0	0	0	0	0	0	0
Net Income	21,223	34,694	38,395	34,194	30,753	34,257	36,420	39,997
Diluted EPS	0.70	0.87	0.96	0.85	0.77	0.86	0.91	1.00

Y/Y Change	Q104a	Q204e	Q304e	Q404e	Q105e	Q205e	Q305e	Q405e
Net Interest Income	18.6%	74.4%	116.2%	164.6%	137.2%	63.2%	33.4%	38.6%
Gain on Sale Income	-9.2%	-47.8%	-21.0%	10.0%	-40.1%	-18.6%	-34.2%	-5.1%
Servicing Fees	-7.3%	2.2%	28.2%	19.2%	31.3%	21.7%	13.9%	7.5%
Amortization/Impair.	-42.5%	-70.6%	-6.3%	-23.4%	-18.5%	-18.5%	-18.5%	-18.5%
Impairment Reserve	120.3%	na	na	-100.0%	-100.0%	-100.0%	na	na
Net Servicing Fees	30.7%	-233.8%	124.1%	-53.3%	-178.7%	-52.1%	51.6%	30.9%
Other Non-Interest Inc	-66.6%	21.3%	13.0%	3.2%	66.3%	-2.8%	-7.2%	-11.2%
Total Revenue	-10.9%	-18.0%	-3.7%	17.6%	3.9%	-8.1%	-14.3%	9.1%
Salary, Comm, Benefits	-10.9%	-15.8%	-19.5%	-1.9%	-7.6%	-10.3%	-18.2%	6.5%
Occupancy/Equipment	43.9%	11.2%	12.0%	-3.8%	-35.1%	-21.3%	-26.5%	-6.5%
Data Processing	4.4%	28.5%	6.1%	-8.7%	-9.4%	-8.1%	-14.3%	9.1%
Office Expenses	3.1%	-16.0%	0.5%	6.9%	-14.5%	-8.1%	-14.3%	9.1%
Marketing/Promotion	-21.0%	17.3%	12.7%	-7.7%	22.7%	-8.1%	-14.3%	9.1%
Travel/Entertainment	29.7%	-15.9%	-13.9%	18.2%	-22.2%	-8.1%	-14.3%	9.1%
Professional Fees	31.9%	41.2%	12.7%	31.5%	-19.8%	-8.1%	-14.3%	9.1%
Other	48.4%	-34.5%	15.4%	12.3%	-37.2%	-26.5%	-31.4%	-12.7%
Total Non-Interest Exp	0.3%	-11.7%	-11.0%	-0.1%	-13.7%	-12.1%	-19.2%	4.3%
Net Inc Before Taxes	-37.6%	-29.3%	18.0%	87.3%	71.5%	0.7%	-3.3%	19.2%
Provision for Inc Taxes	-132.9%	-108.6%	-115.1%	-131.2%	-76.5%	-39.6%	-42.0%	-28.5%
Net Inc Before Min Int	30.1%	26.6%	103.3%	181.1%	44.9%	-1.3%	-5.1%	17.0%
Minority Interest	na	-100.0%	-100.0%	-100.0%	na	na	na	na
Net Income	30.1%	29.1%	105.4%	187.1%	44.9%	-1.3%	-5.1%	17.0%
Diluted EPS	-27.4%	-44.0%	-9.1%	46.1%	10.5%	-1.3%	-5.1%	17.0%

% of Total Revenue	Q104a	Q204e	Q304e	Q404e	Q105e	Q205e	Q305e	Q405e
Net Interest Income	15.2%	19.1%	22.8%	27.2%	34.6%	33.9%	35.4%	34.5%
Gain on Sale Income	95.1%	63.5%	71.0%	64.2%	54.9%	56.3%	54.5%	55.8%
Servicing Fees	12.2%	10.7%	10.5%	13.1%	15.5%	14.2%	14.0%	12.9%
Amortization/Impair.	-8.7%	-6.6%	-5.6%	-6.2%	-6.8%	-5.8%	-5.4%	-4.6%
Impairment Reserve	-14.9%	11.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Servicing Fees	-11.4%	16.0%	4.9%	6.9%	8.6%	8.3%	8.6%	8.3%
Other Non-Interest Inc	1.2%	1.4%	1.4%	1.7%	1.9%	1.5%	1.5%	1.4%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Salary, Comm, Benefits	47.2%	43.0%	43.0%	42.0%	42.0%	42.0%	41.0%	41.0%
Occupancy/Equipment	9.6%	7.0%	7.0%	7.0%	6.0%	6.0%	6.0%	6.0%
Data Processing	3.8%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%
Office Expenses	3.7%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Marketing/Promotion	2.6%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%
Travel/Entertainment	3.1%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
Professional Fees	2.9%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%
Other	6.5%	4.9%	4.9%	4.9%	3.9%	3.9%	3.9%	3.9%
Total Non-Interest Exp	79.3%	68.9%	68.9%	67.9%	65.9%	65.9%	64.9%	64.9%
Net Inc Before Taxes	20.7%	31.1%	31.1%	32.1%	34.1%	34.1%	35.1%	35.1%
Provision for Inc Taxes	-4.5%	-1.6%	-1.6%	-1.6%	-1.0%	-1.0%	-1.1%	-1.1%
Net Inc Before Min Int	25.2%	32.7%	32.7%	33.7%	35.1%	35.1%	36.2%	36.2%
Minority Interest	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income	25.2%	32.7%	32.7%	33.7%	35.1%	35.1%	36.2%	36.2%
Diluted EPS	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

$000	2003a	2004e	2005e
Net Interest Income	45,148	87,277	137,135
Gain on Sale Income	382,236	296,073	219,600
Servicing Fees	43,008	47,301	55,703
Amortization/Impair.	-51,824	-27,253	-22,198
Impairment Reserve	6,334	0	0
Net Servicing Fees	-2,482	20,048	33,506
Other Non-Interest Inc	7,229	5,780	6,080
Total Revenue	432,131	409,178	396,321
Salary, Comm, Benefits	204,939	178,479	164,342
Occupancy/Equipment	27,015	30,841	23,779
Data Processing	13,200	14,021	13,184
Office Expenses	13,312	13,010	12,066
Marketing/Promotion	12,239	12,287	12,290
Travel/Entertainment	9,964	10,018	9,076
Professional Fees	7,547	9,658	8,820
Other	20,930	21,281	15,457
Total Non-Interest Exp	309,146	289,595	259,013
Net Inc Before Taxes	122,985	119,583	137,308
Provision for Inc Taxes	48,223	-8,923	-4,119
Net Inc Before Min Int	74,762	128,506	141,427
Minority Interest	-967	0	0
Net Income	73,795	128,506	141,427
Diluted EPS	4.07	3.42	3.54

Y/Y Change	2003	2004	2005
Net Interest Income	90.7%	93.3%	57.1%
Gain on Sale Income	76.5%	-22.5%	-25.8%
Servicing Fees	71.1%	10.0%	17.8%
Amortization/Impair.	41.1%	-47.4%	-18.5%
Impairment Reserve	na	-100.0%	na
Net Servicing Fees	-78.6%	-907.7%	67.1%
Other Non-Interest Inc	74.3%	-20.0%	5.2%
Total Revenue	85.6%	-5.3%	-3.1%
Salary, Comm, Benefits	91.7%	-12.9%	-7.9%
Occupancy/Equipment	74.2%	14.2%	-22.9%
Data Processing	68.1%	6.2%	-6.0%
Office Expenses	104.5%	-2.3%	-7.3%
Marketing/Promotion	53.1%	0.4%	0.0%
Travel/Entertainment	117.2%	0.5%	-9.4%
Professional Fees	38.7%	28.0%	-8.7%
Other	118.5%	1.7%	-27.4%
Total Non-Interest Exp	88.1%	-6.3%	-10.6%
Net Inc Before Taxes	79.7%	-2.8%	14.8%
Provision for Inc Taxes	71.8%	-118.5%	-53.8%
Net Inc Before Min Int	85.2%	71.9%	10.1%
Minority Interest	8.3%	-100.0%	na
Net Income	86.9%	74.1%	10.1%
Diluted EPS	53.6%	-16.2%	3.5%

% of Total Revenue	2003	2004	2005
Net Interest Income	10.4%	21.3%	34.6%
Gain on Sale Income	88.5%	72.4%	55.4%
Servicing Fees	10.0%	11.6%	14.1%
Amortization/Impair.	-12.0%	-6.7%	-5.6%
Impairment Reserve	1.5%	0.0%	0.0%
Net Servicing Fees	-0.6%	4.9%	8.5%
Other Non-Interest Inc	1.7%	1.4%	1.5%
Total Revenue	100.0%	100.0%	100.0%
Salary, Comm, Benefits	47.4%	43.6%	41.5%
Occupancy/Equipment	6.3%	7.5%	6.0%
Data Processing	3.1%	3.4%	3.3%
Office Expenses	3.1%	3.2%	3.0%
Marketing/Promotion	2.8%	3.0%	3.1%
Travel/Entertainment	2.3%	2.4%	2.3%
Professional Fees	1.7%	2.4%	2.2%
Other	4.8%	5.2%	3.9%
Total Non-Interest Exp	71.5%	70.8%	65.4%
Net Inc Before Taxes	28.5%	29.2%	34.6%
Provision for Inc Taxes	11.2%	-2.2%	-1.0%
Net Inc Before Min Int	17.3%	31.4%	35.7%
Minority Interest	-0.2%	0.0%	0.0%
Net Income	17.1%	31.4%	35.7%
Diluted EPS	0.0%	0.0%	0.0%