

PennyMac Mortgage Investment Trust

First Quarter 2022 Earnings Transcript

May 5, 2022

Introduction

Good afternoon, and welcome to the first quarter earnings discussion for PennyMac Mortgage Investment Trust. The slides that accompany this discussion are available on PennyMac Mortgage Investment Trust's website at www.PennyMac-REIT.com. Before we begin, let me remind you that our discussion contains forward-looking statements that are subject to the risks identified on Slide 2 that could cause our actual results to differ materially.

Now I'd like to introduce David Spector, PMT's Chairman and Chief Executive Officer, who will discuss the Company's first quarter 2022 results.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Isaac.

For the first quarter 2022, PMT reported a net loss attributable to common shareholders of 29.6 million dollars, or 32 cents per common share, as fair value declines in its credit sensitive strategies due to credit spread widening and a tax provision in its taxable REIT subsidiary more than offset strong performance from the interest rate sensitive strategies.

During the quarter, we repurchased 2 million shares of PMT's common stock for 32 million dollars; and in April we repurchased an additional 990 thousand shares, for an approximate cost of 15 million dollars.

PMT paid a common dividend of 47 cents per share. Book value per share decreased to 17 dollars and 87 cents from 19 dollars and 5 cents at the end of the prior quarter.

Dan Perotti, Senior Managing Director and Chief Financial Officer, will review additional details of PMT's financial performance later on in this discussion.

A strength of PMT's is its ability to organically generate investments through our high-quality loan production sourced from correspondent sellers across the country. This quarter, 9.8 billion dollars in UPB of conventional correspondent production led to the creation of 195 million dollars in new mortgage servicing rights.

We continue to create new credit investments in the form of subordinate bonds from non-Agency investor loan securitizations, also sourced from PMT's loan production volumes. This quarter, PMT successfully completed a securitization with an aggregate UPB of 420 million dollars. In total, the fair value of PMT's investments in investor loan securitizations was approximately 103 million dollars at March 31, 2022.

The rapid and significant increase in mortgage interest rates has impacted the origination market considerably. Current economic forecasts for 2022 total originations range from 2.6 to 3.1 trillion dollars. While there is potential for forecasted loan volumes to decrease further as the unprecedented increase in rates continues to be absorbed by the markets, Pennymac remains well-positioned as the largest correspondent

aggregator and one of the largest producers of purchase-money loans in the country.

The higher interest rate environment and wider credit spreads have also created opportunities for PMT to deploy capital into investments with attractive, long-term risk-adjusted returns, which Vandy Fartaj, PMT's Senior Managing Director and Chief Investment Officer, will discuss later.

Successfully navigating a challenging mortgage environment requires a strong balance sheet, expertise in the capital markets and strong investment management and capital planning disciplines – things we have been emphasizing for years. Before turning it over to Vandy, I would like to briefly address the FHFA's recent re-proposal of eligibility standards for non-bank Agency seller/servicers. While the FHFA is currently considering comments on its proposal, the proposed standards call for tightened liquidity, net worth and leverage requirements. For large non-banks, additional proposed standards include an added liquidity buffer, capital and liquidity plans, and third party ratings requirements.

If the standards were implemented today, PMT is well-positioned to meet each of these requirements given its relatively low levels of leverage, strong liquidity, and long-standing commitment to capital and enterprise risk management.

Now I'd like to turn the call over to Vandy who will talk about the drivers of PMT's outlook and first quarter investment performance.

Speaker:

Vandy Fartaj – Senior Managing Director and Chief Investment Officer

Thank you, David.

The rapid shift in market interest rates and credit spreads created opportunities for PMT to make investments in addition to those normally created from its correspondent production activities. Although our ability to organically produce investments distinguishes PMT from most other public mortgage REITs, we also have the strong balance sheet and risk management capabilities necessary to deploy capital in investments from third parties when attractive opportunities arise.

In our credit sensitive strategies, we invested 86 million dollars in floating-rate CRT bonds recently issued by Freddie Mac and Fannie Mae in three separate transactions during the quarter. After quarter end, we invested an additional 31 million dollars in floating-rate CRT bonds recently issued by Freddie Mac and Fannie Mae in two separate transactions.

And in our interest rate sensitive strategies, during the quarter we invested 27 million dollars in fixed-rate bonds from a senior tranche of a recently completed jumbo securitization.

On slide 7 of our first quarter earnings presentation, we illustrate the run-rate return potential from PMT's investment strategies, which represents the average annualized return and quarterly earnings potential that PMT expects over the next four quarters. In total, we expect the quarterly run-rate return for PMT's strategies to average 39 cents per share or an 8.7 percent annualized return on equity.

This run-rate potential reflects performance expectations in the highly-competitive, transitioning mortgage market. In our credit sensitive strategies, the potential return from PMT's organically created CRT investments increased from last quarter, reflecting credit spreads that widened. In addition, we expect to continue investing in the subordinate tranches of bonds that result from private label securitizations of Agency-eligible investor loans, albeit at a slower pace than the last several quarters due to the decline in market origination volumes.

In the interest rate sensitive strategies, we expect more consistent returns as prepayment speeds have declined meaningfully.

In correspondent production, the expected returns reflect the continuation of the declining size of the origination market and the intense competitive dynamic in the conventional correspondent channel, which is expected to continue.

This analysis excludes potential contributions from additional opportunistic investments and opportunities under exploration, such as new investments in PMT's organically-created GSE CRT or the introduction of new products other than investor loans.

Our forecast for PMT's taxable income and liquidity continues to support the common dividend at its current level of 47 cents per share through the remainder of 2022.

Now let's discuss the drivers of first quarter results in our Correspondent Production segment.

Total correspondent loan acquisition volume was 22.5 billion dollars in the first quarter. 43 percent, or 9.8 billion dollars were conventional loans and 57 percent, or 12.7 billion dollars were government loans.

Conventional lock volume in the quarter was 10.2 billion dollars, down significantly as increased competition for conventional loans, including from the GSEs, was heightened during the quarter. Margin compression in the conventional correspondent space created a return profile lower than our threshold and so volume declined as we maintained our discipline, though we have started to see some return to more normalized margins in April.

PMT's correspondent production segment pretax income as a percentage of interest rate lock commitments was 4 basis points, up from 3 basis points in the prior quarter and the weighted average fulfillment fee rate in the first quarter was 17 basis points, up from 12 basis points in the prior quarter.

Acquisition volumes in April were 6.5 billion dollars, and locks were 7.5 billion dollars.

PMT's Interest Rate Sensitive strategies consist of our investments in MSRs sourced from our correspondent production, and investments in Agency MBS, non-Agency senior MBS and interest rate derivatives with offsetting interest rate exposure.

The fair value of PMT's MSR investments at the end of the first quarter was 3.4 billion dollars, up from 2.9 billion dollars at the end of the prior quarter.

The increase reflects both newly originated MSRs resulting from conventional production volumes and fair value gains. The UPB of loans underlying PMT's MSR investments also continued to grow as new production more than offset runoff from prepayments.

Now I would like to discuss PMT's Credit Sensitive Strategies, which primarily consist of seasoned investments in organically-created CRT from PMT's production, investments in non-Agency subordinate bonds from private-label securitizations of PMT's production, and opportunistic investments in GSE CRT.

The total UPB of loans underlying PMT's organically-created CRT investments as of March 31st was 28.2 billion dollars, down 8 percent quarter-over-quarter. The fair value of our organically-created CRT investments at the end of the quarter was 1.4 billion dollars, down from 1.7 billion dollars at December 31st due to fair value declines and the decline in balance that resulted from prepayments.

The outlook for our current investments in organically-created CRT remains favorable, with a current weighted average loan-to-value ratio of approximately 63 percent at March 31st, benefiting from the home price appreciation experienced in recent years. The 60-plus day delinquency rate underlying these investments continued to improve and declined to 1.85 percent from 3.06 percent at December 31st.

We continue to hold discussions with the GSEs regarding the potential resumption of our lender-based CRT transactions. We are encouraged by

the progress we are making, but do not currently have any further definitive developments to share on this topic.

As David mentioned earlier, we continued to invest in securitizations collateralized by investor loans and during the quarter, we added 23 million dollars in fair value of new investor loan securitization investments. We ended the quarter with 103 million dollars in fair value of such investments.

Now I would like to turn the call over to Dan who will review our quarterly financial results.

Speaker:

Daniel Perotti – Senior Managing Director and Chief Financial Officer

Thank you Vandy.

PMT reports results through four segments: Credit Sensitive Strategies, which contributed 56 million dollars in pretax loss; Interest Rate Sensitive Strategies, which contributed 84.2 million dollars in pretax income; Correspondent Production, which contributed 4.6 million dollars in pretax income; and the Corporate segment, which had a pretax loss of 14.8 million dollars.

The losses on PMT's organically-created CRT investments this quarter totaled 47.8 million dollars. This amount included 74.9 million dollars in market-driven fair value losses, reflecting the impact of wider credit spreads. Losses on PMT's organically-created CRT investments also included 23.3 million dollars in realized gains and carry, 16 million dollars in

net recoveries of previously-realized losses, primarily related to L Street Securities 2017-PM1, 200 thousand dollars in interest income on cash deposits, 10 million dollars of financing expenses, and 2.5 million dollars of expenses to assist certain borrowers in mitigating loan delinquencies they incurred as a result of dislocations arising from the COVID-19 pandemic.

PMT's interest rate sensitive strategies contributed income of 84.2 million dollars in the quarter. MSR fair value increased 393 million dollars during the quarter driven by higher mortgage rates, resulting in expectations for lower prepayment activity in the future. These fair values gains held in PMT's taxable REIT subsidiary resulted in a provision for tax expense of 37 million dollars.

The fair value on Agency MBS and interest rate hedges declined by 351 million dollars primarily driven by higher interest rates.

PMT's Correspondent Production segment contributed 4.6 million dollars of pretax income for the quarter.

PMT's Corporate segment includes interest income from cash and short-term investments, management fees and corporate expenses. The segment's contribution for the quarter was a pretax loss of 14.8 million dollars.

As David mentioned, book value decreased to 17 dollars and 87 cents from 19 dollars and 5 cents at the end of the prior quarter. The decline in book value per share is outsized relative to PMT's performance this quarter, as a recent accounting change beginning in 2022 required us to reclassify the

portion of PMT's senior notes that are exchangeable for PMT common shares originally allocated to additional paid-in capital to the carrying value of the exchangeable senior notes. Pro forma for this change, book value at December 31st was 18 dollars and 60 cents.

And with that, I'll turn the discussion back over to David for some closing remarks.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Dan.

While fair value impacts drove a net loss for PMT this quarter, changes in the current market environment have provided additional opportunities for new investments with attractive, long-term risk-adjusted returns. Though the current market environment remains challenging, I am confident in this management team's ability to deliver strong performance to PMT's shareholders over the longer term.

We encourage investors with any questions to reach out to our Investor Relations team by email or phone. Thank you.

Operator:

This concludes PennyMac Mortgage Investment Trust's first quarter earnings discussion. For any questions, please visit our website at

www.PennyMac-REIT.com, or call our Investor Relations department at 818-224-7028. Thank you.