

PennyMac Mortgage Investment Trust

Third Quarter 2022 Earnings Transcript

October 27, 2022

Introduction

Good afternoon, and welcome to the third 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 third quarter 2022 results.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Isaac.

In what was a challenging market for most mortgage REITs in the third quarter, PMT reported net income of 1.5 million dollars, or 1 cent per common share. Strong performance from PMT's interest rate sensitive strategies and overall income excluding market-driven fair value changes was sufficient to offset the impact of continued credit spread widening and an increased provision for tax expense.

PMT paid a common dividend of 47 cents per share. Book value per share decreased to 16 dollars and 18 cents from 16 dollars and 59 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.

During the quarter, we repurchased 1 million shares of PMT's common stock for 13 million dollars at an average price of 13 dollars and 66 cents, significantly below current book value per share; and through October 26th we repurchased an additional 1.1 million shares, for an approximate cost of 13 million dollars at 11 dollars and 74 cents per share. PMT's Board of Trustees also recently approved an increase to its share repurchase authorization from 400 million dollars to 500 million dollars.

One of PMT's greatest strengths is its ability to organically generate investments through our high-quality loan production sourced from correspondent sellers across the country. This quarter, 10 billion dollars in UPB of conventional correspondent production led to the creation of 178 million dollars in high-quality mortgage servicing rights.

With mortgage interest rates currently around 7 percent, the most recent third-party forecasts for originations have decreased meaningfully, indicating an annualized run rate of 1.7 to 1.9 trillion dollars in upcoming quarters.

We believe mortgage REITs with diversified investment portfolios, efficient cost structures and strong risk management practices such as PMT are best-positioned to manage through the volatility presented by the current market; and with strong fundamentals underlying PMT's investment portfolio, we remain optimistic for PMT's long-term return potential.

Although returns in PMT's credit sensitive strategies have been impacted in recent periods by wider market credit spreads, our lender risk share investments consist of seasoned loans with a weighted average current loan to value of 62 percent, benefiting from the strong home price appreciation we have seen in recent years. With delinquency rates at pre-COVID levels and strong current unemployment data, recent realized losses on our CRT investments have been limited.

In our interest rate sensitive strategies, the volatility of MSR values has declined as prepayment speeds have fallen significantly; and with higher short-term rates, we expect an increased contribution from earnings on custodial balances and deposits in the coming quarters. Over the long-term, we believe the underlying performance of PMT's MSR portfolio will be strong, supported by PFSI's industry-leading servicing capabilities, workflows and proprietary technology.

Turning to correspondent production, though we expect volumes to decline in future quarters given the reduced forecasts for originations, our customers are increasingly selling loans servicing-released to stable capital partners like Pennymac as they seek to manage profitability and enhance liquidity. With a strong capital base and consistent commitment to the

channel, we believe PMT is well-positioned to continue leading as we provide our partners the stability and support they need to successfully navigate the current challenging mortgage market.

Now I'd like to turn the call over to Vandy Fartaj, Senior Managing Director and Chief Investment Officer, who will talk about the outlook for PMT and its third quarter investment performance.

Speaker:

Vandy Fartaj – Senior Managing Director and Chief Investment Officer

Thank you, David.

Let's begin by talking about the outlook for capital deployment at PMT.

In recent periods, equity allocated to PMT's credit sensitive strategies has decreased meaningfully due to runoff of our lender risk share investments and the fair value declines that have resulted from market credit spread widening. Though the future of new lender risk share transactions remains uncertain, wider credit spreads have created investment opportunities in GSE-issued CRT with attractive expected returns. Year-to-date, PMT has invested approximately 185 million dollars in floating-rate CRT bonds recently issued by Fannie Mae and Freddie Mac, and we will continue to deploy capital into the asset class opportunistically.

At the same time, equity allocated to the interest rate sensitive strategies has increased meaningfully given new investments in MSR and the fair value gains that have resulted from significantly higher interest rates. While

PMT will continue investing in MSR, we will do so at a more measured pace as market volumes decline and as we look to more effectively manage capital allocation between interest rate sensitive and credit sensitive assets. To that effect, for the fourth quarter PMT will sell certain of its conventional loans to PFSI for a sourcing fee, similar to the government loans it acquires through its correspondent production business.

As David mentioned, PMT's Board of Trustees recently approved an increase to its share repurchase authorization from 400 million dollars to 500 million dollars, and we expect to remain active deploying capital to buy back shares as long as PMT's share price is well below book value per share.

Let's now take a look at our potential returns across the investment portfolio. On slide 7 of our third 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 41 cents per share or a 10 percent annualized return on common equity.

This run-rate potential reflects performance expectations in the current 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 continued to widen.

In the interest rate sensitive strategies, we expect slightly lower returns due to higher financing costs and diminished recapture benefits.

In correspondent production, the projected returns have increased due to an expected increase in the proportion of higher margin delivery methods.

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.

Going forward, the dividend level will be driven primarily by projections of PMT's earnings potential and taxable income, with a bias toward dividend stability.

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

Total correspondent loan acquisition volume was 22.4 billion dollars in the third quarter. 46 percent, or 10.2 billion dollars were conventional loans and 54 percent, or 12.2 billion dollars were government loans.

Purchase volume was 90 percent of total acquisitions, up from 82 percent last quarter.

Conventional lock volume in the third quarter was 10.6 billion dollars, down slightly from the prior quarter.

PMT's correspondent production segment pretax income as a percentage of interest rate lock commitments was 6 basis points, down from 9 basis

points in the prior quarter and the weighted average fulfillment fee rate was 18 basis points, down from 20 basis points in the prior quarter.

Acquisition volumes in October are estimated to be 7.5 billion dollars, and locks are estimated to be 8 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 third quarter was 3.9 billion dollars, up from 3.7 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 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 September 30th was 25.3 billion dollars, down 4 percent from June 30th. The fair value of our organically-created CRT investments at the end of the quarter was 1.2 billion dollars, down from 1.3 billion

dollars at June 30th due to fair value decreases that resulted from market credit spread widening and prepayments.

The outlook for our current investments in organically-created CRT remains favorable as David mentioned, with a current weighted average loan-to-value ratio of 62 percent. The 60-plus day delinquency rate underlying these organically-created GSE CRT investments continued to improve and declined to 1.14 percent at September 30th from 1.31 percent at June 30th.

PMT also purchased 59 million dollars in floating-rate CRT bonds recently issued by Fannie Mae and Freddie Mac during the quarter.

We will continue to evaluate investments across the mortgage landscape and be prudent in the deployment of capital given current market conditions.

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 3.7 million dollars in pretax loss; Interest Rate Sensitive Strategies, which contributed 103.5 million dollars in pretax income; Correspondent Production, which contributed 6.1 million dollars in pretax

income; and the Corporate segment, which had a pretax loss of 15.5 million dollars.

The losses on PMT's organically-created CRT investments this quarter totaled 1.4 million dollars. This amount included 14.2 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 18.8 million dollars in realized gains and carry, 0.2 million dollars of net losses recognized during the period, 7 million dollars in interest income on cash deposits, and 12.7 million dollars of financing expenses.

PMT's interest rate sensitive strategies contributed income of 103.5 million dollars in the quarter. MSR fair value increased 163 million dollars during the quarter driven by higher mortgage rates, resulting in expectations for lower prepayment activity in the future. These fair value gains combined with similar performance from the interest rate hedges held in PMT's taxable REIT subsidiary resulted in a provision for tax expense of 78 million dollars.

The net fair value of Agency MBS and interest rate hedges declined by 100 million dollars primarily driven by higher interest rates.

PMT's Correspondent Production segment contributed 6.1 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 15.5 million dollars.

Excluding market-driven value changes, and the related tax impact, PMT reported 46.5 million dollars of net income across its strategies.

We have maintained strong financing structures related to our CRT investments. Our first three CRT transactions, representing 7 percent of the total fair value, are currently financed by securities repurchase agreements, while the remainder, or 93 percent of the total fair value, is currently financed by secured term notes. Importantly, these term notes collateralized by our CRT transactions do not contain mark-to-market, or margin call provisions. This has served us extraordinarily well, as we are not obligated to post collateral for the majority of our CRT investments if fair values decline. The maturity of our CRT term notes originally due this month were extended by two years to October 2024. All other CRT term notes contain the option to extend the maturity for 2 years at PMT's discretion, except 233 million dollars of notes due in December of this year. Consistent with our long-standing risk and liquidity management disciplines, we have ample reserves to settle these term notes, and it is currently our expectation to finance the underlying investments utilizing securities repurchase agreements while maintaining reserves for potential margin calls.

Finally, though not implemented until September of 2023, I'd like to briefly speak about the new eligibility standards recently introduced by the FHFA. Eligibility requirements are assessed at PennyMac Corp, or PMC, a wholly-

owned subsidiary of PennyMac Mortgage Investment Trust. As you can see on slide 14 of our presentation, on a pro-forma basis, PMC is in excess of all prospective capital, liquidity and leverage requirements recently introduced.

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. PMT delivered net income in what was a challenging environment in the third quarter. I remain confident in the ability of this seasoned and experienced management team to navigate successfully through this evolving mortgage environment and that PMT will provide attractive risk-adjusted returns for its shareholders over the long 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 third 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.