



PennyMac Mortgage Investment Trust

Second Quarter 2023 Earnings Transcript

July 27, 2023

Introduction

Good afternoon, and welcome to the second quarter discussion for PennyMac Mortgage Investment Trust. The slides that accompany this discussion are available on our website at pmt.pennymac.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 turn the call over to David Spector, PMT's Chairman and Chief Executive Officer, who will discuss the Company's second quarter 2023 results.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Isaac.

PMT had a solid second quarter in 2023, as strong performance from its credit sensitive strategies and income excluding the impacts of market-driven fair value changes were partially offset by fair value declines in its interest rate sensitive strategies and related tax impacts. Net income to common shareholders was 14 million dollars, or 16 cents per common share, with an annualized return on equity of 4 percent. Book value per share, net of the 40-cent dividend, decreased slightly to 15 dollars and 81 cents. PMT spent 19 million dollars on share repurchase during the second

quarter, and it remains an attractive use of capital when PMT's share price is well below book value per share.

Dan will provide additional details on PMT's financial performance later on in this discussion.

With mortgage rates currently near 7 percent, the most recent third-party forecasts for 2023 originations range from 1.6 to 1.8 trillion dollars, still well below normalized levels. While industry origination volume in the second quarter was meaningfully higher than the first quarter, higher mortgage rates are driving borrowers to remain in their homes, leading to low inventory levels and continued home price appreciation. Unit originations in 2023 are projected to total just 5 million, the lowest level since 1990, indicating the potential for industry consolidation if market conditions persist. While 2024 originations are expected to approach 2 trillion dollars, we expect the competitive environment to continue given unit origination volume will likely remain constrained.

Given the current market environment, we believe that mortgage REITs like PMT, with diversified investment portfolios, efficient cost structures and strong risk management practices, are best positioned to manage through the volatility presented by the current market environment.

Throughout 2023, credit spreads have tightened and we have observed improvements in the structured product markets, which has driven additional capital deployment into opportunistic investments. This quarter, PMT invested 94 million dollars into such opportunistic investments.

Additionally, we continue to monitor opportunities to purchase bulk MSR packages with lower note rates and projected prepayment speeds that align with PMT's investment objectives. After quarter end PMT entered into an agreement to acquire a bulk MSR portfolio totaling 1.4 billion dollars in UPB.

Our lender risk share investments remain strong, consisting of seasoned loans with low loan-to-value ratios that have benefitted from recent home price appreciation. Delinquency rates are at pre-COVID levels, and combined with low unemployment, realized losses on our CRT investments are expected to remain limited. Looking forward, the return potential of PMT's organically created investments in GSE CRT decreased slightly from the prior quarter due to tighter credit spreads.

In the interest rate sensitive strategies, we believe the Federal Reserve is approaching the end of its tightening cycle and interest rate volatility has declined meaningfully from peak levels earlier this year. As a result, hedge costs declined significantly throughout the quarter. Absent a meaningful increase in volatility, hedge costs are expected to remain low in future periods, which should lead to more consistent performance for the interest rate sensitive strategies.

Additionally, higher short-term rates and custodial deposit balances from seasonal lows in the first quarter have resulted in increased placement fee income, and we anticipate these strong contributions to continue throughout 2023. With the support of PFSI's industry-leading servicing capabilities and proprietary technology, we are confident in the long-term

performance of PMT's MSR portfolio. Our expectations for potential returns from the interest rate sensitive strategies over the near term has decreased, however, due to the expectation that short term rates remain higher for longer, driving projected financing costs closer to our expected asset returns over the next few quarters.

Turning to correspondent production, Pennymac has many strong relationships with purchase-focused mortgage companies. Throughout the quarter, we increased the number of approved correspondent seller relationships to 800, driven by a strategic effort to add sellers who previously maintained a relationship with commercial banks that have pulled back from or recently exited the channel. Over the past twelve months, we estimate that we represented approximately 19 percent of the correspondent channel overall, maintaining our leadership position with more than double the share of the next largest channel participant.

As noted last quarter, the proportion of conventional loans acquired by PMT and subsequently sold to PFSI increased meaningfully, as we continue to leverage the synergistic relationship between the two companies. This enables PMT to maintain its leadership position in the correspondent channel while actively managing its equity allocation across credit and interest rate sensitive strategies. We expect these loan sales to continue in the third quarter.

Projected returns for correspondent production are higher than levels achieved in recent periods as GSE pricing changes without pipeline protection negatively impacted recent results.

Slide 7 of our second quarter earnings presentation illustrates the run-rate return potential from PMT's investment strategies, representing the average annualized return and quarterly earnings potential that PMT expects over the next four quarters. Driven by current sentiment for rates to stay higher for longer, we expect the quarterly run-rate return for PMT's strategies to average 30 cents per share or an 8 percent annualized return on common equity.

Now I'd like to turn the call over to Dan who will review the drivers of PMT's second quarter financial results.

Speaker:

Daniel Perotti – Senior Managing Director and Chief Financial Officer

Thank you, David.

PMT reports results through four segments: Credit Sensitive Strategies, which contributed 71.1 million dollars in pretax income; Interest Rate Sensitive Strategies, which contributed 13.2 million dollars in pretax loss; Correspondent Production, which contributed 1.4 million dollars in pretax income; and the Corporate segment, which had a pretax loss of 12.5 million dollars. PMT also recorded an income tax expense of 22.2 million dollars.

During the quarter, PMT repurchased 1.6 million shares of common stock for 19 million dollars at an average price of 11 dollars and 87 cents, significantly below current book value per share.

Let's discuss PMT's credit sensitive strategies, which primarily consist of investments in organically-created CRT, non-Agency subordinate bonds from private-label securitizations of PMT's production, and opportunistic investments in GSE CRT.

Income from PMT's organically-created CRT investments this quarter totaled 57.8 million dollars. This amount includes 43 million dollars in market-driven fair value gains, reflecting the impact of tighter credit spreads. Gains on PMT's organically-created CRT investments also included 17.9 million dollars in realized gains and carry, 500 thousand dollars in realized losses, 15.8 million dollars in interest income on cash deposits, and 18.4 million dollars of financing expenses. The fair value of these investments increased slightly from the prior quarter to 1.2 billion dollars, as increases from fair value gains more than offset declines from prepayments.

As David mentioned, the outlook for our current investments in organically-created CRT remains favorable, with an underlying current weighted average loan-to-value ratio of 52 percent. The 60-plus day delinquency rate for these investments decreased slightly to 1.12 percent at June 30th from 1.18 percent at March 31st.

As David mentioned earlier, we invested 94 million dollars into additional opportunistic investments throughout the second quarter. This included 52 million dollars into GSE CRT bonds in the credit sensitive strategies, and an additional 42 million dollars into fixed-rate bonds from recently completed jumbo securitizations in the interest rate sensitive strategies. We will

continue closely evaluating potential opportunities like these across the mortgage landscape.

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 interest rate sensitive strategies contributed a pretax loss of 13.2 million dollars in the quarter. As you can see on slide 12 of our second quarter earnings presentation, MSR fair values, before recognition of realization of cash flows, increased by 15 million dollars. Net fair value losses on Agency MBS, interest rate hedges and the related tax impacts were 65 million dollars. PMT reported an income tax expense of 22 million dollars primarily due to fair value increases on MSRs and interest rate hedges, which are held in PMT's taxable subsidiary.

The fair value of PMT's MSR investments at the end of the second quarter was 4 billion dollars, essentially unchanged from the end of the prior quarter, as new investments and fair value gains were offset by runoff from prepayments. The UPB of loans underlying PMT's MSR investments was also essentially unchanged as new production volumes were offset by payoffs.

Delinquency rates for borrowers underlying PMT's MSR portfolio remain low, consistent with our expectations for a conventional loan portfolio in a normalized environment. Servicing advances outstanding for PMT's MSR

portfolio decreased to 94 million dollars at June 30th from 121 million dollars at March 31st. No principal and interest advances are currently outstanding, as prepayment activity continues to sufficiently cover remittance obligations.

PMT's Correspondent Production segment contributed 1.4 million dollars of pretax income for the quarter. These results include a negative impact of 4.5 million dollars, caused by changes in GSE pricing that did not come with pipeline protection as they historically have.

Segment pretax income as a percentage of interest rate lock commitments was 4 basis points, up from last quarter, and the weighted average fulfillment fee rate was 18 basis points, unchanged from the prior quarter.

Total correspondent loan acquisition volume was 21 billion dollars in the second quarter, up 5 percent from the prior quarter. 53 percent were government loans and 47 percent were conventional loans. Purchase volume was 93 percent of total acquisitions.

Conventional loans acquired for PMT's account totaled 3 billion dollars, down 54 percent from the prior quarter due to the increased sale of conventional loans to PFSI. Total correspondent fundings for the month of July for both PMT and PFSI are estimated to be 5.9 billion dollars and locks are estimated to be 6.4 billion dollars.

PMT's Corporate segment includes interest income from cash and short-term investments, management fees and corporate expenses. The segment incurred a pretax loss of 12.5 million dollars for the quarter.

PMT reported 25 million dollars of net income across its strategies, excluding market-driven value changes and the related tax impacts.

A key driver of PMT's long-term success and solid performance relative to peers has been the innovative financing structures we have in place to finance MSR and CRT assets. In the interest rate sensitive strategies, this quarter we issued a new 5-year, 155 million dollar term loan secured by Fannie Mae MSRs.

In the credit sensitive strategies, we issued 235 million dollars of new 2-year CRT term notes to finance the CRT investments previously financed with securities repurchase agreements; and we also extended the CRT term note originally due in May 2023 for 2 years. As a reminder, these CRT term notes do not contain margin call provisions, mitigating cash exposure risks associated with fluctuation in market values.

With that, I'll return the discussion to David for some closing remarks.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thanks, Dan. We continue to believe PMT's strong balance sheet and seasoned investment portfolio with strong underlying fundamentals will drive improved performance over the long term.

We encourage investors to join us today at 5:45 PM Eastern Time for our live question and answer session. The webcast will be available at

pmt.pennymac.com. For any additional questions, please contact our Investor Relations team by email or phone. Thank you.

Operator:

This concludes PennyMac Mortgage Investment Trust's second quarter earnings discussion. For any questions, please visit our website at pmt.pennymac.com, or call our Investor Relations department at 818.224.7028. Thank you.