



# PennyMac Financial Services, Inc.

First Quarter 2022 Earnings Transcript

May 5, 2022

## **Introduction:**

Good afternoon, and welcome to the first quarter earnings discussion for PennyMac Financial Services, Inc. The slides that accompany this discussion are available on PennyMac Financial's website at [ir.pennymacfinancial.com](http://ir.pennymacfinancial.com). Before we begin, let me remind you that our discussion contains forward-looking statements that are subject to risks identified on Slide 2 that could cause our actual results to differ materially, as well as non-GAAP measures that have been reconciled to their GAAP equivalent in our earnings presentation.

Now I'd like to begin by introducing David Spector, PennyMac Financial's Chairman and Chief Executive Officer who will review the Company's first quarter 2022 results.

## **Speaker:**

*David Spector – Chairman and Chief Executive Officer*

Thank you Isaac.

PennyMac Financial's first quarter results demonstrate the earnings power of our comprehensive mortgage banking platform against the backdrop of a rising interest rate environment and significant competition among industry participants with excess capacity in the smaller origination market. Increased income from our servicing business more than offset the decline in production income caused by the current transition in the origination market. As a result, PFSI produced net income of 174 million dollars or

diluted earnings per share of 2 dollars and 94 cents, representing an annualized return on equity of 20 percent.

With regard to our capital usage, we continued to repurchase shares, and in the first quarter we repurchased 2.3 million shares of PFSI common stock for an approximate cost of 141 million dollars; and in April we repurchased an additional 905 thousand shares, for an approximate cost of 44 million dollars. The pace of share repurchases was down from last quarter as we believe it is prudent to retain capital during periods of greater volatility.

PFSI's Board of Directors also declared a first quarter cash dividend of 20 cents per share.

In total, this strong financial performance drove continued growth in book value per share, which was up 3 percent from December 31<sup>st</sup> to 62 dollars and 19 cents at March 31<sup>st</sup>.

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

In total, loan acquisition and origination volumes were 33 billion dollars in the first quarter. These production volumes more than offset prepayment activity in Pennymac's servicing portfolio, which totaled nearly 520 billion dollars in unpaid principal balance at March 31<sup>st</sup>, up 2 percent from the end of the prior quarter and up 16 percent from the same time last year.

In PFSI's Investment Management segment, net assets under management were 2.2 billion dollars at quarter end, down from the prior quarter as PMT

reported a net loss primarily driven by the impact of wider credit spreads on the fair value of its CRT investments.

This rapid and significant increase in mortgage 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 these forecasts to decrease further as the unprecedented increase in rates continues to be absorbed by the markets, we will remain nimble and proactive in our approach, supported by our position as one of the largest producers of purchase-money loans in the country.

As a public company for nearly nine years, PennyMac Financial has a long history of demonstrating success while managing through varying interest rate environments. In 2014 when originations totaled 1.3 trillion dollars, 75 percent of our production was purchase loans and we achieved a 19 percent return on equity. Similarly, in an extremely difficult 2018, with a higher 10-year treasury yield and an origination market of 1.6 trillion dollars, 80 percent of our production was purchase loans and we achieved a return on equity of 13 percent. PFSI's strong record across various market environments is well-documented and unique among mortgage banks.

Successfully navigating a challenging mortgage environment requires a strong balance sheet, expertise in the capital markets and strong operational and capital planning disciplines – things we have been emphasizing for years.

Our balanced business model with leadership positions in both production and servicing, along with our long-time commitment to risk management, drives profitability across different market environments. This dynamic has led to the growth in PFSI's equity base and book value per share, which has nearly tripled since the end of 2018. We have achieved this tremendous growth while simultaneously maintaining low levels of leverage and strong liquidity relative to our peers.

These values and commitments are engrained within our company culture and have been since our founding in 2008. With our long-term strategic goals in mind, our first course of action is ensuring that our future expense levels are aligned with the lower projected activity in the market. While these are always tough decisions to make, our expense management initiatives began in the summer of 2021 with certain hiring freezes and strategic plans to accommodate a changing market. Though mortgage rates increased faster than predicted, we have already taken necessary steps to better align our expense base with expected lower levels of activity, while continuing to drive greater efficiencies. These expense management initiatives are expected to take a few months to be fully reflected in our results. We will be diligent in our operational and financial management disciplines in order to return our production channel expenses to more appropriate levels. Due to these impacts, PFSI's ROE is projected to trend lower before returning to its pre-COVID range over time.

Before turning it over to Doug Jones, our President and Chief Mortgage Banking Officer, 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.

As I mentioned earlier, PFSI has a long track record of strong financial performance, robust liquidity and capital planning disciplines, and has historically operated with low levels of leverage. If the standards were implemented today, PennyMac Financial is well-positioned to meet each of these requirements given its long-standing commitment to capital and enterprise risk management, with these disciplines fully integrated throughout the organization.

Now I'll turn it over to Doug, who will discuss the benefits of our large and growing servicing business and review PFSI's first quarter mortgage banking results.

**Speaker:**

*Doug Jones – President and Chief Mortgage Banking Officer*

Thanks, David.

A large servicing business is essential for the success of a mortgage bank in a rising rate environment. Our de novo servicing platform was built from scratch, void of any legacy issues that arose from the Great Financial Crisis, and we have invested significantly throughout our history to ensure

that we are able to efficiently and effectively serve our customers at the highest standards. Our leading production business has driven the strong organic growth of our servicing portfolio and today, I am extremely proud of the more than half a trillion dollars in UPB of servicing that we manage and more than 2.2 million customers we serve.

As a key part of our balanced business model, our large servicing portfolio provides significant value to the company. Servicing and sub-servicing fees generate over 1 billion dollars in revenue annually, and PFSI is expected to benefit further in the near-term as higher short-term interest rates are expected to drive increased interest income on our custodial deposit balances.

In 2019 we launched our own, proprietary, cloud-based servicing system designed specifically for Pennymac's unique workflows. SSE, as we call it, not only provides us with cost efficiencies by reducing third party vendor expenses, but increases our flexibility, enabling us to adapt quickly to current market conditions or forthcoming regulation. Additionally, SSE provides invaluable insight to our servicing team members dedicated to assisting customers with hardships and mitigating losses. Going even further, SSE provides the data we use to better understand our customers' needs so loan officers in our consumer direct channel can assist borrowers with products that can benefit them.

Finally, given the scale we have achieved, we have begun work with Hippo to offer homeowners insurance to our servicing portfolio customers and

are currently evaluating other potential partnerships to explore ways to better serve our customers with additional product offerings.

All of these benefits demonstrate the strength of a large servicing business such as ours, especially one supported by an industry leading production business delivering new loans and additional customers on a daily basis.

Now let's turn to PFSI's multi-channel production business. Pennymac maintained its leadership position in the correspondent channel and we estimate that over the past twelve months we have represented approximately 15.8 percent of the channel overall.

Total correspondent loan acquisition volume was 22.5 billion dollars in the first quarter. 57 percent, or 12.7 billion dollars were government loans and 43 percent, or 9.8 billion dollars were conventional loans, for which PFSI earns a fulfillment fee from PMT.

Government acquisition volumes were down consistent with industry volumes, while conventional correspondent acquisitions were 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.

Government correspondent lock volume was 12.5 billion dollars, down 20 percent from the prior quarter.

Revenue per fallout-adjusted government lock in the first quarter was 23 basis points, down one basis point from the prior quarter. The scale we have achieved in our correspondent business, combined with our low cost structure and operational excellence in the channel allow us to operate efficiently through volatile market environments. In this environment, some smaller market participants have pulled back significantly or exited the channel entirely, potentially creating some opportunities as the market transitions.

In April, correspondent acquisitions were 6.5 billion dollars and locks were 7.5 billion dollars.

Turning to consumer direct, our market share has approximately doubled since 2020 and we accounted for approximately 1.7 percent of total originations in the channel over the last twelve months.

Origination volumes for the first quarter were 8.2 billion dollars and interest rate lock commitments were 9.1 billion dollars. While down from the previous quarter, the pace of decline is less than that of the overall market as we continue to build out our capabilities in the channel.

The ongoing success we see in our consumer direct channel can be attributed to the increased application of data analytics and investments we have made in our loan fulfillment and sales processes. I remain excited for the future potential for market share growth in this channel as we leverage our servicing portfolio, new technology and advanced data analytics capabilities.

We also continue to see success in our purchase and new customer acquisition channels, despite the smaller origination market. Purchase lock volume in the first quarter was 791 million dollars, up slightly from the prior quarter and new customer acquisition lock volume was 1.3 billion dollars, down from 1.9 billion dollars last quarter.

Margins in this channel continue to tighten, with revenue per fallout adjusted lock of 297 basis points in the quarter.

In April, originations for our consumer direct channel totaled 1.8 billion dollars, and locks totaled 1.6 billion dollars. The committed pipeline at April 30<sup>th</sup> was 1.9 billion dollars.

Originations in our broker direct channel totaled 2.5 billion dollars and locks totaled 3.5 billion dollars. Pricing margins in the channel continue to reflect significant levels of competition and revenue per fallout-adjusted lock was 62 basis points, down from 68 basis points in the prior quarter.

We estimate that in the last 12 months we represented approximately 2.2 percent of the origination volume in the channel, with over 2,200 brokers approved to offer our products, or approximately 15 percent of the total population of brokers.

Despite elevated levels of competition currently, we continue to see opportunity in the channel over the long-term and remain committed to providing our broker partners and the customers they serve new products and a superior mortgage experience. While we remain committed to the

broker direct channel, we will remain disciplined in the current market environment.

Broker originations in April totaled 800 million dollars and locks totaled 700 million dollars. The committed pipeline at April 30<sup>th</sup> was 900 million dollars.

As we discussed earlier, these acquisition and origination volumes continue to drive the organic growth of our servicing portfolio. This quarter, approximately 24 billion dollars of portfolio runoff was more than offset by the addition of 33 billion dollars in total production, and we ended the quarter with a servicing portfolio of 519 billion dollars, or approximately 4.1 percent of all residential mortgage debt in the U.S.

Prepayment speeds have slowed meaningfully given the rapid increase in mortgage rates David mentioned earlier. PennyMac Financial's owned portfolio reported a prepayment speed of 17.1 percent in the first quarter, down from 23.4 percent in the prior quarter. Similarly, prepayment speeds in PennyMac Financial's sub-serviced portfolio – which includes mostly Fannie Mae and Freddie Mac mortgage servicing rights owned by PMT – was 13 percent, down from 19.8 percent in the prior quarter.

PFSI's owned servicing portfolio, which consists primarily of Ginnie Mae MSRMs, had a 60 day plus delinquency rate of 3.9 percent, down from 4.7 percent at the end of the prior quarter, while our subserviced portfolio, consisting primarily of conventional loans, reported a 60 day plus delinquency rate of 0.7 percent, down from 0.9 percent at December 31<sup>st</sup>.

The UPB of completed modifications was 5.1 billion dollars and the UPB of EBO loan volume totaled 2.1 billion dollars, both down from the prior quarter as opportunities have declined due to lower delinquency levels and higher mortgage rates.

I'll now turn it over to Dan who will speak to the financial results for the quarter.

**Speaker:**

*Dan Perotti – Senior Managing Director and Chief Financial Officer*

Thanks, Doug.

As David mentioned earlier PFSI's net income was 174 million dollars, or diluted earnings per share of 2 dollars and 94 cents.

Production segment pretax income was 9.3 million dollars. As you will see on slide 10, we provide a breakdown of the revenue contribution from each of PFSI's loan production channels, net of loan origination expenses, including the fulfillment fees received from PMT for conventional correspondent loans.

Production revenue margins in consumer direct continued to decline from the prior quarter. Broker direct margins also declined from the prior quarter and remain below their normalized levels. Government correspondent margins were also down slightly. Revenue per fallout-adjusted lock for PFSI's own account was 102 basis points in the first quarter, down from

113 basis points in the prior quarter. This includes 19.5 million dollars in losses realized related to timing of revenue and loan origination expense recognition, hedging, pricing & execution changes, and other items.

We recognize that expenses in our production segment remain elevated given the rapid decline in the size of the overall origination market and are actively working to adjust these expenses to better align with lower expected volumes.

The Servicing segment recorded pretax income of 225.2 million dollars, up from pretax income of 126.1 million dollars in the prior quarter and 141.7 million dollars in the first quarter of 2021.

Pretax income excluding valuation-related items for the servicing segment was 86 million dollars, down from the prior quarter primarily as a result of lower EBO related income.

Operating revenue was essentially unchanged from the prior quarter.

Operating expenses as a percentage of average servicing portfolio UPB increased, primarily due to seasonal collection trends, but were down from the first quarter of last year.

Payoff-related expenses, which include interest shortfall and recording and release fees related to prepayments, decreased by 6.2 million dollars.

Realization of MSR cash flows increased 14 million dollars driven by higher average MSR values during the quarter.

In order to protect the value of our MSR asset we utilize a comprehensive hedging strategy. This strategy is designed to moderate the impact of interest rate changes on the fair value of our MSR asset and also considers production-related income.

On slide 14, you can see the fair value of our MSR increased by 324 million dollars in the first quarter, driven by higher mortgage rates which resulted in expectations for lower prepayment activity in the future. Hedging losses totaled 218 million dollars, primarily driven by higher interest rates.

Finally, our Investment Management segment delivered pretax income of 97 thousand dollars, down from 1.5 million dollars in the prior quarter.

Net assets under management totaled 2.2 billion dollars as of March 31<sup>st</sup>, down 6 percent from December 31<sup>st</sup> and March 31<sup>st</sup>, 2021. Segment revenue was 10.1 million dollars, down 3 percent from the prior quarter and up 6 percent from the first quarter of 2021.

And with that, I would like to turn it back to David for some closing remarks.

**Speaker:**

*David Spector – Chairman and Chief Executive Officer*

Thank you, Dan.

And thank you to our current shareholders and potential investors listening to the call. While the current mortgage market is going through rapid changes and transitioning to a more purchase-oriented focus, we feel PFSI

is well-positioned due to the strength of our balanced business model, our position as a leading producer of purchase mortgages, and our risk management capabilities. We have successfully navigated many mortgage cycles throughout our history and I firmly believe there is not a better management team than Pennymac's to navigate this one.

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

Thank you.

**Operator:**

This concludes PennyMac Financial Services, Inc.'s first quarter earnings discussion. For any questions, please visit our website at [ir.pennymacfinancial.com](http://ir.pennymacfinancial.com), or call our Investor Relations department at 818-264-4907. Thank you.