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# EDITED TRANSCRIPT

IMH - Q1 2017 Impac Mortgage Holdings Inc Earnings Call

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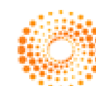

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## CORPORATE PARTICIPANTS

**Justin Moisio** *National Investor Relations Institute - Director of Orange County*

**William S. Ashmore** *Impac Mortgage Holdings, Inc. - President and Director*

## CONFERENCE CALL PARTICIPANTS

**Doyle Flaherty**

**Henry Joseph Coffey** *Wedbush Securities Inc., Research Division - MD for Specialty Finance*

**Trevor John Cranston** *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Impac Mortgage Holdings First Quarter 2017 Earnings Conference Call. (Operator Instructions)

I would now like to introduce your host for today's conference, Justin Moisio, VP, Investor Relations for Impac. Sir, you may begin.

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**Justin Moisio** - *National Investor Relations Institute - Director of Orange County*

Thank you. Good morning, everyone. Thank you for joining Impac Mortgage Holdings First Quarter 2017 Earnings Call. During this call, we will make projections or other forward-looking statements in regards to, but not limited to, GAAP and taxable earnings, cash flows, interest rate risk and market risk exposure, mortgage production and general market conditions. I would like to refer you to the business risk factors in our most recently filed Form 10-K under the Securities and Exchange Act of 1934. These documents contain and identify important factors that could cause the actual results to differ materially from those contained in our projections or forward-looking statements. This presentation, including outlook and any guidance, is effective as of the date given, and we expressly disclaim any duty to update the information herein.

I would like to get started by introducing Bill Ashmore, President of Impac Mortgage Holdings.

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Thanks, Justin. Good morning, everyone. Welcome and thank you for joining Impac's First Quarter 2017 Earnings Call. I have on the line with me, Joe Tomkinson, our CEO; Todd Taylor, our Chief Financial Officer; and Ron Morrison, our General Counsel.

I will begin with a brief review of the results for the first quarter of 2017. Consistent with our previous earnings releases, and in order to get a better understanding of the company's operating results, management believes it is more useful to discuss adjusted operating income as opposed to GAAP net earnings. Adjusted operating income is operating income excluding changes in the contingent consideration. Please see the company's earnings release for a reconciliation between GAAP net earnings and adjusted operating income.

For the first quarter of 2017, adjusted operating income decreased to $2.2 million or $0.12 per diluted common share for the first quarter of 2017 as compared to $7 million or $0.60 per diluted common share in the first quarter of 2016. The main drivers of the drop in operating income were higher interest rates subsequent to the November presidential election and the usual seasonal slowdown, which caused lower refinance origination volumes during the first quarter 2017.

During the first quarter of 2017, total originations decreased 33% to $1.6 billion as compared to $2.3 billion in the first quarter of 2016. However, as a result of higher volume of non-agency, also known as Non-QM, and government loans, gain on sale margins increased by 7 basis points to 236 basis points in the first quarter of 2017 as compared to the first quarter of 2016. This is a good trend in light of the fact that in a declining





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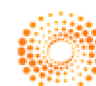

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origination market, margins typically will compress. Despite the decline in total origination volume, our non-agency originations have dramatically increased, along with substantial inquiries from our business-to-business customers, to start originating these loans. Typically, these loans, along with government loans, take longer to move through the origination process, plus there is more training involved because the loan programs are more complex. As a result, the time to ramp up production on non-agency loans take longer. Therefore, we expect to see greater volumes on these products as our clients and our call center loan officers become more familiar in originating these types of loans.

In the first quarter of 2017, non-agency and government originations now represent almost 40% of total originations, as compared to just 20% of total originations in the first quarter of 2016. During the first quarter of 2017, origination volume of non-agency loans increased to $184.3 million as compared to just $289.6 million of non-agency production for all of 2016 and $86 million in the fourth quarter of 2016. We saw an increase in non-agency origination volume across all channels in the first quarter of 2017, and it should be noted that this increase in volume has been more evenly distributed across all channels. In the first quarter, 40% of the volume was originated from our retail channel and 60% from wholesale and [correspondent] channels. As compared to the fourth quarter of 2016, in which the retail channel only accounted for 12% of non-agency production, while wholesale and correspondent originations accounted for nearly 88% of the non-agency production. We believe it's a very positive sign that our retail channel has successfully pivoted its origination strategy to meet the growing consumer demand for non-agency products.

Additionally, in the first quarter of 2017, the company's government loan production increased to $428.4 million as opposed to $394 million in the first quarter of 2016. As we continue to increase existing non-agency production, the company is planning on releasing a new prime non-agency home equity product during the second quarter, which has been in the works for quite a while. And we believe this will create additional non-agency production by tapping into many additional underserved, high-credit quality borrowers.

Now I'd like to discuss how our strategy in retaining MSRs is progressing. As a result of management strategic decision to retain its mortgage servicing rights beginning in the fourth quarter of 2015, our retained mortgage servicing rights increased in value to $141.6 million at the end of the first quarter as compared to $131.5 million at the end of the year, a $10 million pickup. As of March 31, 2017, we had increased the size of our servicing portfolio by 7% from year-end, bringing our total servicing portfolio to $13.2 billion. The increase in the size of our servicing portfolio also resulted in a 45% increase in servicing income during the first quarter of 2017 as compared to the fourth quarter of 2016, while the portfolio's delinquencies remained very low. Through strong retention capabilities, we were able to take advantage of low interest rate environment throughout 2016 and generate stronger origination volume while mitigating higher prepayments. As a result, we created a low weighted average coupon portfolio, which, as previously mentioned, increased in value during the recent rising interest rate environment.

As of March 31, 2017, this high-credit quality servicing portfolio had a weighted average coupon of just 3.73%, a weighted average [LTV] of 66% and a weighted average FICO of almost 740. Once again, the company wants to highlight that the decision to retain MSRs in late 2015 was the right decision as the numbers and the performance bears out.

To further maximize the return on the MSR portfolio, in February, the company paid off its $30 million working line of credit and replaced it with a mortgage servicing rights financing facility, which, on an annualized basis, provided $1.35 million in interest expense savings. It also gives us the flexibility to increase or decrease the financing as we see fit.

In addition, another significant trend continued in the first quarter of 2017. The company was able to further increase its book value per common share in the first quarter. Since the beginning of 2016, the company has increased its book value per share by 33% from $11.09 per share to $14.74 per share at March 31, 2017, creating tremendous shareholder value. Also, given our significant tax loss carry-forwards, we continue to be very tax efficient, allowing us to retain more of our net earnings, which ultimately helps in increasing book value.

Additionally, this week, we successfully exchanged 8.5 million shares of trust preferred debt at a discount to par by issuing 412,264 shares of common stock with an annualized savings interest expense of approximately $400,000.

Now let's focus on what is happening currently at Impac. In the first quarter, our total pipeline was $553 million, which remained relatively flat in comparison to year-end. However, as of March 31, 2017, our non-agency pipeline had increased to approximately $202 million as compared to $148 million at December 31, 2016, a 36% increase. Additionally, as of yesterday, the non-agency pipeline has now increased to $232 million, a 15% increase since the end of the first quarter. As mentioned earlier, historically, the non-agency originations take longer to process through the



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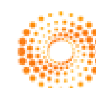

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pipeline. Therefore, the company has been diligently working on a proprietary technology solution that will reduce the time to originate non-agency and government loans, along with greater data accuracy. In fact, in the quarter, we have increased our underwriter daily work output by over 50% and have had significant improvement in our data accuracy, along with reducing turn times from process to close on non-agency loans in our business-to-business channels by over 25%. In addition, we believe we can continue to improve our efficiencies even more as our training, process improvements and proprietary technologies advance.

Lastly, in April, the company completed a successful $56 million common stock registered direct offering. The net proceeds for the company from the sale of the shares of common stock in the registered direct offering were approximately $55.4 million. This offering is yet another positive sign that the company is headed in the right direction even as the overall residential mortgage market saw its volumes decline in the first quarter of 2017. We intend to use the net proceeds to continue to expand our servicing portfolio and assist with our anticipated return to the securitization market with our rapidly growing non-agency production. Additionally, the net proceeds give us the ability to continue to expand into diversified income platforms and take advantage of strategic opportunities as they arise. At this point, we are well capitalized with strong cash position and will be more responsive to take advantage of opportunities as they arise.

Now I'll close my prepared remarks and open up the call for questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Trevor Cranston with JMP Securities.

**Trevor John Cranston** - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

A couple questions to start on the growth in the non-agency originations. You mentioned the new product you're planning to roll out in the second quarter, the prime home equity product. I think last quarter, you commented on a couple of key products that were sort of your main ones in the non-agency space, one being a loan for self-employed borrowers and another for investors. Can you comment on the -- in terms of your first quarter originations, what the makeup of the different product types were that you were able to originate in the quarter?

**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Sure, Trevor. Thanks. This is Bill. Yes. Basically our self-employed program is using bank statements and/or assets to qualify the borrower. That is our largest origination product in the non-agency space. It's representing currently about 40% of originations. And again, that is for the bank statement and/or asset depletion used for the -- deriving the ability to repay. The next one is the investor, which is viewed as a commercial loan. It is outside of Dodd-Frank, so it is not a Non-QM. But it has also been very, very successful because there's been a lot of people venturing into owning non-owner properties, and that represents about another 20%, 25%. And then the balance is in what we would call agency or Fannie Mae, Freddie Mac fallout. These would be traditionally documented loans that would either be using W-2 and/or tax returns, but the loan might have an interest-only, might have a higher debt-to-income ratio than the agencies allow. It might have multiple finance properties which agencies do not allow. It might be non-ownable condos. There's a number of other items that may cause it to not be available. In addition, it might be a larger loan balance. And so basically, that's the breakdown of our non-agency production in the first quarter.

**Trevor John Cranston** - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

And then you talked a little bit about the proprietary technology you guys are developing, helping the efficiency and the process, particularly in the business-to-business channel. And it sounds like, hopefully, that will kind of continue to improve things going forwards. When you think about the growth strategy for non-agency lending, particularly on the retail side, is that strategy primarily focused on -- more on the ad campaigns,



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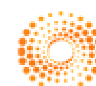

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product availability and just having the employees in CashCall more and more used to originating the product? Or is there anything like technology related that goes into the retail growth strategy for non-agency?

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Well, specifically on retail, we have changed our strategy effective at the beginning of the year. We had teams originating in the call center, and each team was specific to a product, so it might have been a conventional product for several teams, depending on what the volume is. And then there was a government team for FHA/VA, and then there was a third team for Non-QM. What we did at the first of the year was we had an extensive training of our loan officers. We collapsed our teams down to a lesser amount of teams, and everyone on the team was given (inaudible) all of the products that we offer. It was a little bit bumpy during the first month or so, but it's been gaining traction ever since as they become more fluent and able to move quite quickly relative to -- as a borrower calls in, they may be eligible for an FHA loan. They may be needing a refinance or cash-out conventional loan, or in fact, they may be somebody that needs to rely on more of the non-agency. But the strategy there has more been one of how we are taking the calls in. We are in the midst of changing some -- on the front end at the point of sale because we are noticing that, because of our advertising, we're getting a lot of people. Even though we advertise a lot on radio and TV, we get a lot of people that will go directly to the website as opposed to, let's say, call in. We subsequently will get in contact with them, so we're attempting to do a significant update relative to our point of sale where the retail bar would come in the front. But the -- on the B2B and on the -- and subsequently on the retail, we are one of the main portion to technology that we're still in the stages of getting it refined is our -- we call it an IUS, and it's Impac or the Intelligent Underwriting System. So that it's a completely different viewpoint than we've had in prior years, and we are having a very substantial positive reaction from our underwriters. Now we have all the underwriters over at a B2B that are on the system, and we've noticed that their time to originate a loan has significantly diminished. In fact, the other day, one of the lead underwriters had e-mailed me, said that she was completing an underwriting and a loan in 38 minutes, which is very quick. Whether it's Non-QM or not, it's very, very rapid underwriting. So we think that as we further refine and roll out specifically that automated system on a very complex loan program, it's going to be a big lift, not only to B2B, but also to the retail.

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**Trevor John Cranston** - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Got it. That's great color. And then to follow up on the comment you made about the new capital you guys raised, potentially partially being used to help your return to the securitization market. Can you just clarify that statement a little bit to -- as to whether or not you're planning to start retaining loans for potential securitization in the near term or if you're still kind of, near term, seeing better execution through loan sales to the investors you have?

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Ultimately, it's going to be the total execution that we're looking at. We currently have a couple of investors that we are selling the product away on a -- several times per month, and we're -- we will evaluate that. And at a point to where we see that it makes more sense to retain the loans for securitization, we will do that. However, we are in the midst of going through a rating agency evaluation as a originator and as a master servicer. We've engaged this as of couple of weeks ago. That's going to take a month or 2. So we feel we're going to be prepared if and when we move ahead to go ahead and do that since we have a lot of expertise there. But for right now, for the near term or more, we're going to be looking to sell loans away.

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**Trevor John Cranston** - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Okay. That makes sense. And last thing for me, can you just give an update on where the total current pipeline is for the company currently and how it's trended versus where it was at March 31?

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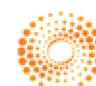

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

So we are up slightly. The interesting thing is that with higher amounts of Non-QM, you may have less numbers of loans, but you will have higher balances on average. I'll give you an example. In business to business, average balance over there is in the $400,000 plus, where if you look for more of the agency and the government, it's in the $200,000s. So you have a 25% higher loan balance. And I guess good news, bad news is that we can have a bigger pipeline but actually do it with lesser loans. It's not quite as dramatic over in the retail, but you're still seeing higher loan balances over there. In fact, we would be actually originating closer to $600,000 in average loan balances, however we do originate loans from $100,000 to $200,000, and that kind of brings that average down, so maybe it's a little bit misleading. Because that -- and this is consistent with what we saw prior to 2007 when you're looking at these non-agency products that they are, on average, they will be higher loan balances. I think back then, it was similar in terms of size. There was anywhere from 20-plus-percent higher than the average originations, and I think we're consistent with that 20%, 25% is what we're seeing right now.

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**Operator**

Our next question comes from Henry Coffey with Wedbush.

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**Henry Joseph Coffey** - *Wedbush Securities Inc., Research Division - MD for Specialty Finance*

Yes. What is it costing to get a customer to either pick up the phone or sign up on the website? And what is your conversion rate on those inquiries?

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

You know what, I don't have that. I can get back to you on the cost, but the conversion rate -- I'll give you an idea in terms of how we handle the business over in our call center. When a borrower comes in that is prequaled on the phone, if he's put into process, basically what we're attempting to do is get him into a position where he is withdrawing documents within 5 to 7 days because the traditional rate lock, even though it's slightly longer for non-agency, is like 15 days. We have a slightly longer time for rate lock. So the idea here is you need to very quickly bring a borrower in and qualify him. And if he does get into the process, we have extremely high close ratio once he gets into process at 80-plus-percent. But the amount at the front end that gets through under a prequalification, actually gets through a loan officer is also very, very high. But again, we want to get him in the door and prequalified in process and have that borrower committing basically to close a loan within 5 days to 7 days.

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**Henry Joseph Coffey** - *Wedbush Securities Inc., Research Division - MD for Specialty Finance*

So once you get the application started, it's an 80% close rate?

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Or better.

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**Henry Joseph Coffey** - *Wedbush Securities Inc., Research Division - MD for Specialty Finance*

And then is that -- how is this process working, now that, obviously, you're going to start touching more purchase money business?

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

It's got a long date. So the -- for cash flow, last year was predominantly in the retail channel, which is predominantly refinance conventional. The average close was inside of 20 days, like 15 to 18 days. You're going to see that -- those are expanded out if it's -- if there's more Non-QM and more purchase money, that will be expanding out and be more in the 20- to 30-day range.



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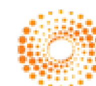

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**Henry Joseph Coffey** - *Wedbush Securities Inc., Research Division - MD for Specialty Finance*

So outside of your securitizations, who's buying the loans on the other side? Is it regional banks, community banks, credit unions, investor funds? Who's on the other side with the Non-QM product and some of the other nonconventional products that you originate?

**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

There are a handful of regional banks that directly originated that, in some cases, might be our competition. That is a smaller portion of it. The actual investors on this, there are several out there, and they're not that many. But there are several out there that would be more hedge-fund-oriented and/or have term commitments relative to financing that's in there that they can hold for term as opposed to maybe a hedge fund type of a shorter term. But there still is not that many. There's a handful. So it's not like there's dozens and dozens out there that are ready and able. But I can tell you right now, if at the -- we're at $100-plus-million and we'll probably be substantially higher than that by the end of December on a monthly run rate, if I was originating 5x or maybe 10x more than that, there's enough demand that, that could be sold.

**Operator**

Our next question comes from Doyle Flaherty with CQS.

**Doyle Flaherty**

Yes. I was wondering if you could provide some more detail on gain-on-sale margins, and in particular how they break down between QM, Non-QM across channels, how they have evolved over the past year and where you project them going forward? And after that, do you expect Non-QM loans to basically be originated via the retail channel?

**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Sure. Let me try and answer that. Margins for the Non-QM in retail are relatively consistent with agency originations in terms of gain on sale. However, in the business-to-business TPO channels, which include correspondent and wholesale, the margins are significantly wider than agency originations, upwards of 2x to 3x greater on a revenue per loan. Remember, Non-QM loans are usually significantly larger loan balances, and the borrower is paying fees, and in some cases, points where agency originations in today or over the last 10 or more years, agency originations were usually no points and sometimes no fees. So it's a different strategy in terms of how you originate these loans since the borrowers are paying fees, but you're coming to a similar instance relative to retail where they're consistent with agency. But it's a combination of borrower paying it and getting it through a premium on the back end from a sale. And the same thing goes on, on business-to-business channel. Almost everybody that I see is charging some sort of a fee, a point or so, plus fees.

**Doyle Flaherty**

Okay. Could you put some firmer numbers on that? I -- if agency originations have a 2-handle in gain on sale and B2B, where roughly would a Non-QM have -- would that be a 4-handle 5-handle or 6-handle?

**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

Yes. I think I've tried to answer as best I could there without giving specifics on it, so I feel comfortable with my answer.





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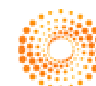

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**Operator**

(Operator Instructions) I'm not seeing any additional questions in queue.

I'd now like to turn the call back over for closing remarks.

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**William S. Ashmore** - *Impac Mortgage Holdings, Inc. - President and Director*

I have no further remarks. I appreciate everybody for being on the line, and we'll talk to you in the near term. Thank you.

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**Operator**

Thank you. And ladies and gentlemen, that does conclude today's conference. Thank you very much for your participation. You may now disconnect. Have a wonderful day.

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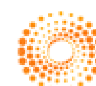

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