

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

May 09, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended March 31, 2016

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from to

Commission file number: 001-35916

PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware	80-0882793
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6101 Condor Drive, Moorpark, California 93021
(Address of principal executive offices) (Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes
No

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date.

Class	Outstanding at May 6, 2016
Class A Common Stock, \$0.0001 par value	22,047,491
Class B Common Stock, \$0.0001 par value	50

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

March 31, 2016

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (“Report”) contains certain forward looking statements that are subject to various risks and uncertainties. Forward looking statements are generally identifiable by use of forward looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “seek,” “anticipate,” “estimate,” “approximately,” “believe,” “predict,” “continue,” “plan” or other similar words or expressions.

Forward looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain financial and operating projections or state other forward looking information. Examples of forward looking statements include the following:

- projections of our revenues, income, earnings per share, capital structure or other financial items;
- descriptions of our plans or objectives for future operations, products or services;
- forecasts of our future economic performance, interest rates, profit margins and our share of future markets; and
- descriptions of assumptions underlying or relating to any of the foregoing expectations regarding the timing of generating any revenues.

Our ability to predict results or the actual effect of future events, actions, plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward looking statements. There are a number of factors, many of which are beyond our control that could cause actual results to differ significantly from management’s expectations. Some of these factors are discussed below.

You should not place undue reliance on any forward looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 10, 2016.

Factors that could cause actual results to differ materially from historical results or those anticipated include, but are not limited to:

- the continually changing federal, state and local laws and regulations applicable to the highly regulated industry in which we operate;
- lawsuits or governmental actions if we do not comply with the laws and regulations applicable to our businesses;
- the mortgage lending and servicing-related regulations promulgated by the Consumer Financial Protection Bureau (“CFPB”) and its enforcement of these regulations;
- our dependence on U.S. government sponsored entities and changes in their current roles or their guarantees or guidelines;
- changes to government mortgage modification programs;

- the licensing and operational requirements of states and other jurisdictions applicable to our businesses, to which our bank competitors are not subject;
- foreclosure delays and changes in foreclosure practices;
- certain banking regulations that may limit our business activities;
- our dependence on the multi-family and commercial real estate sectors for future originations and investments in commercial mortgage loans and other commercial real estate related loans;
- changes in macroeconomic and U.S. real estate market conditions;
- difficulties inherent in growing loan production volume;
- difficulties inherent in adjusting the size of our operations to reflect changes in business levels;
- purchase opportunities for mortgage servicing rights (“MSRs”) and our success in winning bids;
- changes in prevailing interest rates;

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- increases in loan delinquencies and defaults;
- our reliance on PennyMac Mortgage Investment Trust (“PMT”) as a significant source of financing for, and revenue related to, our mortgage banking business;
- any required additional capital and liquidity to support business growth that may not be available on acceptable terms, if at all;
- our obligation to indemnify third party purchasers or repurchase loans if loans that we originate, acquire, service or assist in the fulfillment of, fail to meet certain criteria or characteristics or under other circumstances;
- our obligation to indemnify PMT and certain investment funds if our services fail to meet certain criteria or characteristics or under other circumstances;
- decreases in the historical returns on the assets that we select and manage for our clients, and our resulting management and incentive fees;
- the extensive amount of regulation applicable to our investment management segment;
- conflicts of interest in allocating our services and investment opportunities among ourselves and certain advised entities;
- the effect of public opinion on our reputation;
- our recent growth;
- our ability to effectively identify, manage, monitor and mitigate financial risks;
- our initiation of new business activities or expansion of existing business activities;
 - our ability to detect misconduct and fraud; and
- our ability to mitigate cybersecurity risks and cyber incidents.

Other factors that could also cause results to differ from our expectations may not be described in this Report or any other document. Each of these factors could by itself, or together with one or more other factors, adversely affect our business, results of operations and/or financial condition.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 31, 2016	December 31, 2015
	(in thousands, except share amounts)	
ASSETS		
Cash (includes \$95,826 and \$93,757 pledged to creditors)	\$ 116,560	\$ 105,472
Short-term investments at fair value	28,264	46,319
Mortgage loans held for sale at fair value (includes \$1,632,074 and \$1,079,489 pledged to creditors)	1,653,963	1,101,204
Derivative assets	90,054	50,280
Servicing advances, net (includes \$40,770 and \$33,458 valuation allowance)	284,140	299,354
Carried Interest due from Investment Funds pledged to creditors	70,519	69,926
Investment in PennyMac Mortgage Investment Trust at fair value	1,023	1,145
Mortgage servicing rights (includes \$594,403 and \$660,247 at fair value; \$1,332,775 and \$803,560 pledged to creditors)	1,337,082	1,411,935
Real estate acquired in settlement of loans	2,320	—
Furniture, fixtures, equipment and building improvements, net (includes \$11,356 and \$14,034 pledged to creditors)	23,855	16,311
Capitalized software, net (includes \$541 and \$783 pledged to creditors)	4,323	3,025
Note receivable from PennyMac Mortgage Investment Trust	150,000	150,000
Receivable from PennyMac Mortgage Investment Trust	17,647	18,965
Receivable from Investment Funds	1,119	1,316
Deferred tax asset	14,637	18,378
Mortgage loans eligible for repurchase	139,009	166,070
Other	46,748	45,594
Total assets	\$ 3,981,263	\$ 3,505,294
LIABILITIES		
Assets sold under agreements to repurchase	\$ 1,658,578	\$ 1,166,731
Mortgage loan participation and sale agreements	246,636	234,872
Notes payable	127,693	61,136
Obligations under capital lease	12,070	13,579
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	321,976	412,425
Derivative liabilities	9,915	9,083
Accounts payable and accrued expenses	87,005	89,915
Mortgage servicing liabilities at fair value	6,747	1,399
Payable to Investment Funds	28,843	30,429

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Payable to PennyMac Mortgage Investment Trust	153,094	162,379
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	74,275	74,315
Liability for mortgage loans eligible for repurchase	139,009	166,070
Liability for losses under representations and warranties	22,209	20,611
Total liabilities	2,888,050	2,442,944

Commitments and contingencies

STOCKHOLDERS' EQUITY

Class A common stock—authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 22,047,491 and 21,990,831 shares, respectively	2	2
Class B common stock—authorized 1,000 shares of \$0.0001 par value; issued and outstanding, 50 and 51 shares, respectively	—	—
Additional paid-in capital	174,005	172,354
Retained earnings	103,645	98,470
Total stockholders' equity attributable to PennyMac Financial Services, Inc. common stockholders	277,652	270,826
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	815,561	791,524
Total stockholders' equity	1,093,213	1,062,350
Total liabilities and stockholders' equity	\$ 3,981,263	\$ 3,505,294

The accompanying notes are an integral part of these financial statements.

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended March 31,	
	2016	2015
	(in thousands, except earnings per share)	
Revenues		
Net gains on mortgage loans held for sale at fair value:		
From non-affiliates	\$ 93,476	\$ 76,667
Recapture payable to PennyMac Mortgage Investment Trust	(1,952)	(1,289)
	91,524	75,378
Mortgage loan origination fees	22,434	16,682
Fulfillment fees from PennyMac Mortgage Investment Trust	12,935	12,866
Net mortgage loan servicing fees:		
Mortgage loan servicing fees		
From non-affiliates	91,327	50,101
From PennyMac Mortgage Investment Trust	11,453	10,670
From Investment Funds	701	968
Ancillary and other fees	11,452	11,185
	114,933	72,924
Amortization, impairment and change in fair value of mortgage servicing rights	(116,863)	(53,684)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	19,449	7,536
	(97,414)	(46,148)
Net mortgage loan servicing fees	17,519	26,776
Management fees:		
From PennyMac Mortgage Investment Trust	5,352	7,003
From Investment Funds	560	1,486
	5,912	8,489
Carried Interest from Investment Funds	593	1,233
Net interest expense:		
Interest income:		
From non-affiliates	11,927	8,933
From PennyMac Mortgage Investment Trust	1,602	—
	13,529	8,933
Interest expense:		
To non-affiliates	13,972	8,077
To PennyMac Mortgage Investment Trust	7,015	3,752
	20,987	11,829
Net interest expense	(7,458)	(2,896)
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	(86)	107
Result of real estate acquired in settlement of loans	(435)	—
Other	463	1,679

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Total net revenue	143,401	140,314
Expenses		
Compensation	68,298	58,144
Servicing	20,887	9,735
Technology	6,847	4,938
Loan origination	4,186	4,351
Professional services	3,733	2,833
Other	9,311	7,075
Total expenses	113,262	87,076
Income before provision for income taxes	30,139	53,238
Provision for income taxes	3,596	6,114
Net income	26,543	47,124
Less: Net income attributable to noncontrolling interest	21,368	38,096
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 5,175	\$ 9,028
Earnings per share		
Basic	\$ 0.24	\$ 0.42
Diluted	\$ 0.23	\$ 0.42
Weighted average common shares outstanding		
Basic	22,006	21,593
Diluted	76,194	76,050

The accompanying notes are an integral part of these financial statements.

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

	Class A Common Stock			Retained earnings	Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	
	Number of shares (in thousands)	Par value	Additional paid-in capital		Private National Mortgage Acceptance Company, LLC	Total equity
Balance at December 31, 2014	21,578	\$ 2	\$ 162,720	\$ 51,242	\$ 593,302	\$ 807,212
Income	—	—	—	9,028	38,096	47,124
and unit-based compensation	31	—	1,124	—	2,824	3,948
Contributions	—	—	—	—	(5,522)	(5,522)
Repayment of common stock in lieu of directors' fees	4	—	74	—	—	74
Exchange of Class A units of National Mortgage Acceptance Company, LLC to Class A common stock of PennyMac Financial Services, Inc.	44	—	792	—	(792)	—
Effect of exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A common stock of PennyMac Financial Services, Inc.	—	—	(54)	—	—	(54)
Balance at March 31, 2015	21,657	\$ 2	\$ 164,656	\$ 60,270	\$ 627,908	\$ 852,884
Balance at December 31, 2015	21,991	\$ 2	\$ 172,354	\$ 98,470	\$ 791,524	\$ 1,062,348
Income	—	—	—	5,175	21,368	26,543
and unit-based compensation	47	—	1,107	—	3,270	4,377
Repayment of common stock in lieu of directors' fees	6	—	74	—	—	74
Exchange of Class A units of National Mortgage Acceptance Company, LLC to Class A common stock of PennyMac Financial Services, Inc.	3	—	601	—	(601)	—
Effect of exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A common stock of PennyMac Financial Services, Inc.	—	—	(131)	—	—	(131)

ge Acceptance
ny, LLC to
a common stock of
Mac Financial Services,

e at March 31, 2016

22,047

\$ 2

\$ 174,005

\$ 103,645

\$ 815,561

\$ 1,093

The accompanying notes are an integral part of these financial statements.

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)