

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

August 07, 2015

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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 June 30, 2015

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 August 5, 2015
Class A Common Stock, \$0.0001 par value	21,792,701
Class B Common Stock, \$0.0001 par value	52

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PENNYMAC FINANCIAL SERVICES, INC.

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June 30, 2015

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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, 2014, filed with the SEC on March 13, 2015.

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)

	June 30, 2015	December 31, 2014
	(in thousands, except share data)	
ASSETS		
Cash	\$ 74,728	\$ 76,256
Short-term investments at fair value	23,577	21,687
Mortgage loans held for sale at fair value (includes \$1,369,324 and \$976,772 pledged to secure mortgage loans sold under agreements to repurchase; and \$202,076 and \$148,133 pledged to secure mortgage loan participation and sale agreement)	1,594,262	1,147,884
Derivative assets	43,568	38,457
Servicing advances, net (includes \$21,589 and \$18,686 valuation allowance)	244,806	228,630
Carried Interest due from Investment Funds	68,713	67,298
Investment in PennyMac Mortgage Investment Trust at fair value	1,307	1,582
Mortgage servicing rights (includes \$581,269 and \$325,383 at fair value; \$536,172 and \$392,254 pledged to secure note payable; and \$359,102 and \$191,166 subject to excess servicing spread financing)	1,135,510	730,828
Furniture, fixtures, equipment and building improvements, net	11,773	11,339
Capitalized software, net	1,250	567
Note receivable from PennyMac Mortgage Investment Trust—secured	52,526	—
Receivable from PennyMac Mortgage Investment Trust	16,245	23,871
Receivable from Investment Funds	2,148	2,291
Deferred tax asset	34,165	46,038
Loans eligible for repurchase	77,529	72,539
Other	48,498	37,419
Total assets	\$ 3,430,605	\$ 2,506,686
LIABILITIES		
Mortgage loans sold under agreements to repurchase	\$ 1,263,248	\$ 822,182
Mortgage loan participation and sale agreement	195,959	143,638
Note payable	246,456	146,855
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	359,102	191,166
Derivative liabilities	13,584	6,513
Accounts payable and accrued expenses	84,357	62,715
Mortgage servicing liabilities at fair value	11,791	6,306
Payable to Investment Funds	31,255	35,908

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Payable to PennyMac Mortgage Investment Trust	139,699	123,315
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	71,895	75,024
Liability for loans eligible for repurchase	77,529	72,539
Liability for losses under representations and warranties	16,257	13,259
Total liabilities	2,511,132	1,699,420
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Class A common stock—authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 21,790,666 and 21,577,686 shares, respectively	2	2
Class B common stock—authorized 1,000 shares of \$0.0001 par value; issued and outstanding, 52 and 54 shares, respectively	—	—
Additional paid-in capital	167,536	162,720
Retained earnings	73,019	51,242
Total stockholders' equity attributable to PennyMac Financial Services, Inc. common stockholders	240,557	213,964
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	678,916	593,302
Total stockholders' equity	919,473	807,266
Total liabilities and stockholders' equity	\$ 3,430,605	\$ 2,506,686

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 June 30,		Six months ended	
	2015	2014	June 30, 2015	2014
	(in thousands, except earnings per share)			
Revenues				
Net gains on mortgage loans held for sale at fair value:				
From non-affiliates	\$ 85,411	\$ 42,230	\$ 162,078	\$ 78,666
Recapture payable to PennyMac Mortgage Investment Trust	(1,456)	(2,526)	(2,745)	(4,424)
Loan origination fees	83,955	39,704	159,333	74,242
Fulfillment fees from PennyMac Mortgage Investment Trust	15,333	12,433	28,199	21,335
Net loan servicing fees:				
Loan servicing fees				
From non-affiliates	66,867	43,314	116,968	79,414
From PennyMac Mortgage Investment Trust	12,136	14,180	22,806	28,771
From Investment Funds	153	4,161	1,121	5,638
Ancillary and other fees	11,850	4,838	23,035	9,989
	91,006	66,493	163,930	123,812
Amortization, impairment and change in fair value of mortgage servicing rights	(15,324)	(19,586)	(69,008)	(37,933)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	(7,133)	10,062	403	14,854
	(22,457)	(9,524)	(68,605)	(23,079)
Net loan servicing fees	68,549	56,969	95,325	100,733
Management fees:				
From PennyMac Mortgage Investment Trust	5,779	8,912	12,782	16,986
From Investment Funds	1,184	2,086	2,670	4,121
	6,963	10,998	15,452	21,107
Carried Interest from Investment Funds	182	1,834	1,415	3,991
Net interest expense:				
Interest income:				
To non-affiliates	12,651	6,252	21,584	10,362
To PennyMac Mortgage Investment Trust	533	—	533	—
	13,184	6,252	22,117	10,362
Interest expense:				
To non-affiliates	10,531	5,593	18,608	9,117
To PennyMac Mortgage Investment Trust	5,818	3,139	9,570	6,001
	16,349	8,732	28,178	15,118
Net interest expense	(3,165)	(2,480)	(6,061)	(4,756)
	(244)	(103)	(137)	12

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Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust				
Other	357	735	2,036	2,038
Total net revenue	196,351	130,435	336,665	235,927
Expenses				
Compensation	70,422	46,971	128,566	89,857
Servicing	28,603	11,694	38,338	14,784
Technology	6,490	3,741	11,428	6,564
Loan origination	4,148	1,998	8,499	3,415
Professional services	4,074	2,661	6,907	4,860
Other	7,815	5,323	14,890	9,339
Total expenses	121,552	72,388	208,628	128,819
Income before provision for income taxes	74,799	58,047	128,037	107,108
Provision for income taxes	8,619	6,630	14,733	12,153
Net income	66,180	51,417	113,304	94,955
Less: Net income attributable to noncontrolling interest	53,431	41,799	91,527	77,365
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,749	\$ 9,618	\$ 21,777	\$ 17,590
Earnings per share				
Basic	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.84
Diluted	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.83
Weighted average common shares outstanding				
Basic	21,700	21,142	21,647	21,005
Diluted	76,105	75,915	76,063	75,895

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)

PennyMac Financial Services, Inc. Stockholders

	Number of shares		Common stock		Additional paid-in capital	Retained earnings
	Class A (in thousands)	Class B	Class A	Class B		
2013	20,813	—	\$ 2	\$ —	\$ 153,000	\$ 14,400