

loanDepot, Inc. NYSE:LDI

FQ2 2023 Earnings Call Transcripts

Tuesday, August 08, 2023 9:00 PM GMT

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Call Participants

EXECUTIVES

David R. Hayes
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Frank D. Martell
CEO, President & Director

Gerhard Erdelji
Senior Vice President of Investor Relations

Jeff Alexander Walsh
President of LDI Mortgage

Jeffrey Michael DerGurahian
Chief Investment Officer & Head Economist

ANALYSTS

Douglas Michael Harter
Crédit Suisse AG, Research Division

Kevin James Barker
Piper Sandler & Co., Research Division

Kyle Joseph
Jefferies LLC, Research Division

Presentation

Operator

Good afternoon, and welcome to loanDepot's Second Quarter 2023 Earnings Call. [Operator Instructions] Thank you.

I would like now to turn the call over to Gerhard Erdelji, Senior Vice President, Investor Relations. Please go ahead.

Gerhard Erdelji

Senior Vice President of Investor Relations

Good afternoon, everyone, and thank you for joining loanDepot's Second Quarter 2023 Earnings Call. Before we begin, I would like to remind everyone that this conference call may include forward-looking statements regarding the company's operating and financial performance in future periods. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including, but not limited to, guidance to our pull-through weighted rate lock volume, origination volume, pull-through weighted gain on sale margin and expense trends. These statements are based on the company's current expectations and available information.

Actual results for future periods may differ materially from these forward-looking statements due to risks or other factors that are described in the Risk Factors section of our filings with the SEC. A webcast and a transcript of this call will be posted on the company's Investor Relations website at investors.loandepot.com under the Events & Presentations tab.

On today's call, we have loanDepot President and Chief Executive Officer, Frank Martell; and Chief Financial Officer, David Hayes, to provide an overview of our quarter as well as our financial and operational results, outlook and to answer your question. We are also joined by our Chief Investment Officer, Jeff DerGurahian; and LDI Mortgage President, Jeff Walsh, to help address any questions you might have after our prepared remarks.

And with that, I'll turn things over to Frank to get us started. Frank?

Frank D. Martell

CEO, President & Director

Thank you, Gerhard, and thank you all for joining us today. I look forward to sharing my perspective on market conditions and our results. Before I begin, I'd like to welcome David Hayes to the call. David brings a strong track record of financial and business leadership as well as deep mortgage industry knowledge to loanDepot. I know David well and look forward to partnering with him as we continue to execute our Vision 2025 plan.

I also want to take this opportunity to express my gratitude to Pat Flanagan for his leadership and commitment to loanDepot. Pat helped shepherd the company from private to public ownership, and most recently, he helped the company address the critical challenges arising from the dramatic market downturn last year. We wish Pat the very best in his future endeavors.

Despite the historic downturn in the housing market, I believe that our second quarter and first half results represent an objective marker of our progress on the strategic imperatives we laid out in our Vision 2025 plan.

As you may recall, Vision 2025, which was announced in July of 2022, has 4 pillars:

- Pillar 1 focuses on transforming our originations business to drive purchase money transactions with an expanded emphasis on purpose-driven lending;

- Pillar 2 calls for aggressively rightsizing our cost structure in line with current and anticipated market conditions as well as internally set targets to achieve first quartile operating performance;
- Pillar 3 covers investing in profitable growth-generating initiatives and critical business operating platforms and processes to support operating leverage and best-in-class quality and delivery; and finally,
- Pillar 4 relates to optimizing our organization structure.

The second quarter was our second consecutive quarter of strong sequential top line growth and margin expansion. At the same time, we continue to aggressively drive cost productivity and operating leverage. Our second quarter 2023 revenues were up \$64 million or 31% sequentially from the first quarter, due primarily by higher purchase transaction volumes and gain on sale margins.

Purchase transactions accounted for approximately 73% of all originations in Q2. During the second quarter, our costs increased by \$16 million or 5%. This growth was primarily driven by variable expenses associated with higher origination volumes.

In a moment, Dave will go through our operating results, including our volume-related expenses, Vision 2025 program costs and legal accruals attributable to the settlement of certain legacy litigation. If these expenses were to be excluded due to their nonrecurring nature, this would result in a 4% quarter-over-quarter reduction in our core operating expenses.

Profitable growth, together with our laser focus on productivity and operating leverage, accounted for a \$42 million or 46% sequential reduction in our Q2 net loss. This follows a \$66 million reduction in our sequential quarterly net loss in the first quarter.

While we continue to work on resetting our cost structure to align with generally low unit volumes, we are also focused on the other pillars of Vision 2025, including our strategy to expand purpose-driven lending that supports first-time homebuyers and diverse communities.

During 2022, loanDepot ranked as the country's third largest mortgage lender for all minorities. In addition to ranking third overall for all minorities, loanDepot is also the #3 lender serving Hispanics, the #4 lender serving African Americans, the #4 lender serving Native Americans and the #6 lender serving Asian Americans. As we all know, homeownership is the bedrock of the American Dream and plays a vital role in helping to build strong and stable communities. Further deepening our support for a diverse and first-time homebuyers is a critical component of our Vision 2025. As a purpose-driven lender, our team is passionate on making homeownership accessible and achievable for more families. Through our products, our people and our digital tools, we are working hard every day to create a more inclusive and sustainable path to homeownership.

Our HELOC product, which provides our customers with a powerful option for achieving their financial goals, also demonstrated consistent growth with strong customer adoption during the quarter.

Finally, as outlined in Pillar 4 of our Vision 2025 plan, we continue to make significant strides towards optimizing our organization structure. During Q2, we promoted Darren Graeler as our Chief Accounting Officer, and Alec Hanson as our Chief Marketing Officer. We also recruited talented executives, including David as our Chief Financial Officer and Melanie Graper as our Chief Human Resources Officer. Finally, we consolidated our LDI digital division under our LDI Mortgage President, Jeff Walsh. Our entire leadership team is energized and committed to continuing to deliver improved financial performance and superior value for our customers and our shareholders.

I want to conclude my prepared remarks today by thanking Team loanDepot and our other key stakeholders for their support. Our markets remain challenging, no doubt, but I believe this is also a very important period of positive change and forward momentum for the company. I believe we are seeing the positive and tangible results for our continued focus on the 4 pillars of our Vision 2025 strategic plan.

With over \$700 million in cash on hand, ongoing operating efficiency initiatives and consistently growing revenues exiting the first half, we believe we are increasingly well positioned to navigate through the present market downturn and emerge as a stronger and more valuable company.

With that, I will now turn the call over to David who will take us through the financial results in more detail.

David R. Hayes
Chief Financial Officer

Thanks, Frank, and good afternoon, everyone. It's a pleasure to join this very talented team at loanDepot.

During the second quarter, loan origination volume was \$6.3 billion, an increase of 27% from the first quarter of 2023. This was at the high end of the guidance we issued last quarter, which was between \$4.5 billion and \$6.5 billion. Second quarter volume consisted of \$4.6 billion in purchase loan originations and \$1.7 billion in refinance loan originations, primarily cash-out refinances.

Our pull-through weighted rate lock volume of \$6.1 billion for the second quarter contributed to total revenue of \$272 million, which represented a 31% increase from the first quarter. Rate lock volume also came in within guidance we issued last quarter of \$5.5 billion to \$7.5 billion.

The increase in revenue is primarily a result of higher loan origination income from an increase in pull-through weighted rate lock volume and higher gain on sale margins. Our pull-through weighted gain on sale margin for the second quarter came in at 285 basis points, above the guidance we provided of 240 to 280 basis points. Our higher gain on sale margin was primarily due to wider profit margins on our production, a shift in mix favoring more profitable FHA loans and a lower provision for loan losses.

Turning now to our servicing portfolio. The unpaid principal balance of our servicing portfolio remained relatively consistent at \$142 billion quarter-over-quarter. Servicing fee income decreased slightly from \$119 million in the first quarter of 2023 to \$118 million in the second quarter of 2023. During the quarter, we sold excess agency servicing rights related to unpaid principal balances totaling \$14 billion, resulting in a gain of \$7.7 million. This transaction allowed us to monetize a portion of the asset while maintaining our direct servicing relationship with those customers.

We hedge our servicing portfolio so we do not record the full impact of the changes in fair value and the results of our operations. We believe this strategy protects against volatility in our earnings and liquidity. Our strategy for hedging the servicing portfolio is dynamic. We adjust our hedge positions in reaction to changing interest rate environments.

We believe our servicing portfolio is well protected against potential rising defaults. As of June 30, the weighted average FICO was 736, the weighted average coupon was 3.3% and the weighted average LTV at origination was 71%. These characteristics contributed to a low delinquency rate, with only 70 basis points of the portfolio more than 90 days past due at quarter-end and should generate reliable ongoing revenue during these uncertain economic times.

A major component of our Vision 2025 plan is to align our expense base with our expectations for a 2023 market size of \$1.5 trillion and create efficiencies to improve operating leverage and financial performance over time. Our total expenses for the second quarter of 2023 increased by \$16 million or 5% from the prior quarter. This was driven primarily by higher volume-based commissions, Vision 2025-related expenses and legal expenses.

Our volume-related expenses, consisting of commissions and direct origination expenses, increased by \$13 million, reflecting higher originations. Vision 2025-related charges totaled \$7 million, including \$5 million of personnel-related expenses and \$2 million of lease and other asset impairment charges. Vision 2025 expenses incurred in the first quarter of 2023 totaled \$3 million.

During the second quarter, we accrued \$8 million of legal expenses related to the settlement of legacy litigation.

Excluding volume-related expenses, Vision 2025-related charges and the litigation settlement accrual, our adjusted operating expenses decreased by \$10 million compared to the first quarter, reflecting the ongoing benefits of our efficiency improvements.

Looking ahead to the third quarter volumes and margins, we expect origination volume of between \$5 billion and \$7 billion. We expect pull-through weighted rate lock volume of between \$5.5 billion and \$7.5 billion, and we expect our third quarter pull-through weighted gain on sale margin to be between 245 and 285 basis points. The reduction in our gain on sale margin guidance for the third quarter primarily reflects increased interest rates subsequent to the end of the second quarter, which adversely will impact loan margins.

Going forward, we expect to continue to reduce expenses and narrow our losses, reflecting decreasing personnel-related costs due to lower head count, G&A and other corporate expenses. As we move forward in the second half of 2023, we plan to continue maintaining a strong liquidity position and aggressively reduce our costs. Importantly, we're also investing in critical operating platforms, which we expect to deliver higher levels of automation and operating leverage and position us for additional growth and margin expansion in 2024.

With that, we're ready to turn it back to the operator for Q&A. Operator?

Question and Answer

Operator

[Operator Instructions] Your first question comes from Doug Harter from Credit Suisse.

Douglas Michael Harter

Crédit Suisse AG, Research Division

I think -- I believe you guys extended or refinanced one of your MSR lines during the second quarter. Can you talk about kind of the updated terms on that and what your MSR line maturities look like now?

David R. Hayes

Chief Financial Officer

Yes. This is David Hayes. We did renew one of our MSR lines, but we don't disclose the specifics of that on the call. Those are proprietary negotiated deals.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Okay. I guess do you have a sense of what any near-term maturities are, or just in general, kind of -- was there any change in advance rates kind of in that extension?

David R. Hayes

Chief Financial Officer

Yes. Well, those will be issued in our 10-Q, the more specifics on that, but we did renew the line. We did expand some capacity. We renewed all lines that were in the quarter, and we don't see any concerns about upcoming renewals through the third quarter.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Okay. And then I guess, at this point, how are you thinking about kind of additional MSR sales versus kind of retaining and growing that portfolio, kind of what is the outlook for that?

Frank D. Martell

CEO, President & Director

Yes, this is Frank. We look at the servicing portfolio as an important asset for the company and an important base of earnings for the company. And so we have not been in the market selling a lot of assets of the portfolio. And if we do, contemplating that, it will be more targeted and opportunistic. But in general, we would -- we've held the servicing book quite steady. And we would like to do that and grow that portfolio as we go forward as part of the company's strategy.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Okay. And then last one for me. What would be kind of the target level of cash that you would look to hold to feel

comfortable running the business?

David R. Hayes
Chief Financial Officer

Yes. This is David again. We continue to be focused on maintaining a very strong liquidity position. As you know, we drew down some balances and put on the balance sheet. We had a fortress balance sheet last year to navigate through these challenging markets. We do have target liquidity goals of maintaining at least 5% of our assets in liquidity. But for the time being, we're expecting to keep excess liquidity in the balance sheet.

Operator

Our next question comes from the line of Kyle Joseph from Jefferies.

Kyle Joseph
Jefferies LLC, Research Division

Okay. Just looking at your guidance, it looks like you expect similar volumes in 3Q '22, but as you mentioned on a lower head count. Can you give us a sense for where the productivity gains are coming from?

David R. Hayes
Chief Financial Officer

Yes. I don't know if we've talked about specific on head count, but we do look at the market kind of being in line in the third quarter as it was in the second quarter. I think we're continuing to invest in productivity and operating leverage gains. A lot has gone into our -- into the technology area as well as process redesign, which is part of Vision 2025. So we'll continue to see that type of a gain in terms of our ability to be more productive per loan generated.

In addition, obviously, we are -- we have been reducing head count. We expect that to continue given the market uncertainty and -- but we expect that to be funded largely through productivity gains through the -- through both process and technology platforms. As you may recall, we had a couple of pretty large investments that we're making despite the chopiness of the market in our LOS platform and in our underwriting areas as well that we think will add significant productivity gains when they come online in 2024.

Kyle Joseph
Jefferies LLC, Research Division

Yes. Got it. And then with kind of the better origination outlook, just -- and obviously, that factors into your expense outlook. But are there any more -- is there any more wood to chop in terms of expenses? And which kind of line items would those be in specifically?

Frank D. Martell
CEO, President & Director

Yes. I think Dave talked about in his prepared remarks, I think we look at corporate overhead, obviously some of the G&A areas, marketing, and really in both -- in the operational part of the company as well as sales as we get more productive and we improve our tools and our base platform. So I think it's pretty broad-based.

Obviously, we have to react to a very uncertain market, but we have to react to that and address challenges as they come along. But I think, by and large, we have most of those reduction programs in flight. And our -- I would expect that the trends you're seeing in the second quarter versus the first quarter to continue into the third quarter and beyond.

Operator

Your next question comes from Kevin Barker from Piper Sandler.

Kevin James Barker

Piper Sandler & Co., Research Division

Right. I just want to follow up on some of the questions from Doug regarding the MSR. I noticed it's -- as a percent of your overall equity, it's roughly 2.5x, which is about twice as high as it was pre-2022. Is there any target that you have regarding the size of the MSR relative to your equity base? Or -- and another way to think about it is, is there -- do you think about your MSR relative to your origination channel or manage it to a certain size relative to how much do you think you can produce within the origination channel?

Frank D. Martell

CEO, President & Director

Yes, I'll let DerGurahian to answer, but obviously one of our advantages, we believe, is we have a very effective recapture mechanism off of our servicing portfolio, which is very meaningful for the economics of the company. As it relates to target sizes, et cetera, as I mentioned earlier, we want to build the servicing book intelligently as we go forward. And so we're kind of managing to that overall strategy. The pace in which we do that is kind of varies depending on the quarterly conditions we're faced with in the market.

But in general, we've been able to hold the portfolio steady. And as I said, I think that's something that we want to actually expanded a bit as we go forward. But again, we have to pace it with the market conditions, which are, needless to say, pretty fluid right now with the rate environment we're dealing with and trying to figure out where that's all going for the balance of this year, certainly.

So Jeff, I don't know if you want to add anything to this -- to answer this -- to my answer.

Jeffrey Michael DerGurahian

Chief Investment Officer & Head Economist

Yes. Frank, I think you covered it well. I mean you can see the portfolio has been pretty steady at this level, and that's by design. And we continue to refine the composition of the portfolio so that works well with the origination platform and what we're trying to achieve overall with -- touching our customers and providing incremental products or refinance opportunities to them.

Kevin James Barker

Piper Sandler & Co., Research Division

Okay. Great. And then in addition to the efficiency strategies, have you done anything structurally to drive maybe better margins particularly around how you compensate loan officers or how you think about the structural impact or the structural compensation you look at for loan officers, particularly on the direct-to-consumer or even the call center operations in order to like really drive higher margins within the direct-to-consumer channel?

Jeff Alexander Walsh

President of LDI Mortgage

Yes, this is Jeff Walsh. I mean we're always evaluating the compensation as a percentage of the total revenue and try to maintain kind of a responsible percentage there. We also shift our business focus away from unprofitable markets and

products, shifted more into the government space and some other type of products that yield more and a higher percentage of revenue against commission. But commissions are largely industry driven and influenced by the industry as a whole. But I think we do a pretty good job of managing, like I say, a responsible percentage of compensation to overall revenue.

Operator

[Operator Instructions] There are no more questions. I'll turn the call back over to Frank Martell for closing remarks.

Frank D. Martell

CEO, President & Director

Yes. Thanks, everybody, for joining us today and some really good questions. I think that the company delivered in a very tough market in the second quarter. And I really appreciate the efforts of the entire team to do that. I also want to just thank our stakeholders for their support. I couldn't do without you guys. And we look forward to continuing to progress and deliver more value for our customers, our team members, partners and our shareholders as we go forward. So with that, thanks, everybody.

Operator

Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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