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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the Impac Mortgage Holdings Inc Fourth Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to Joe Joffrion, General Counsel. Please go ahead, sir.

Joseph O. Joffrion - *Impac Mortgage Holdings, Inc. - Senior VP & General Counsel*

Good morning, everyone, and thank you for joining Impac Mortgage Holdings Year-end 2021 Earnings Conference Call. During this call, we will make projections and other forward-looking statements in regards to, but not limited to, GAAP and taxable earnings, cash flows, interest rate 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 and Form 10-Qs filed in 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 any outlook and guidance is effective as of the date given, and we firstly disclaim any duty to update the information herein.

I would like to get started by introducing George Mangiaracina, Chairman and CEO of Impac Mortgage Holdings. George?

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Thank you, Joe. Tiffany Entsminger, our COO; Jon Gloeckner, our Treasurer; Obi Nwokorie our CIO, will join me for the prepared remarks, and Justin Moisio, our CAO, will be available for the question-and-answer segment of today's call.

For the fourth quarter of 2021, the company reported GAAP net income of $3.6 million or $0.15 per diluted common share and a core loss of approximately $5 million or $0.23 per diluted common share. For the year ended December 31, 2021, the company reported a GAAP net loss of $3.9 million or $0.22 per diluted common share and a core loss of approximately $12.4 million or $0.58 per diluted common share. The delta between GAAP and core results is primarily attributable to the increase in the fair value of our residual portfolio, which Jon Gloeckner will discuss in his prepared remarks later in this call.

As we've outlined in prior earnings calls, the company broadly classifies its origination activities, irrespective of channel as either rate or credit. Our rate business is centered around our GSE product while our credit business is focused on our NonQM products. In the fourth quarter of 2021, with respect to our rate business, the company was not immune from the reduced origination volumes and margin compression typically experienced by the industry at the latest stack stages of refinance waves that were driven by low rates and accommodative monetary policy. This was reflected in our GSE origination volumes in the fourth quarter.

We anticipate that market conditions will continue to be challenging for the foreseeable future in our rates business and have adjusted our capacity models, marketing spend and headcount accordingly. With respect to our credit business, the fourth quarter of 2021 further evidenced the resilience of our NonQM franchise, NonQM originations totaled close to $400 million in the fourth quarter of 2021, double that of the third quarter and positioned the company for an annualized run rate of approximately $1.5 billion.

For the full year 2021, the company posted close to $700 million in NonQM, 2.5x out of 2020. Further context, the company originated less than $15 million in NonQM in the 4 quarters post-COVID in the second quarter of 2020 through the first quarter of 2021. The NonQM segment of the mortgage market experienced significant market pressure beginning in the fourth quarter of 2021, with conditions further deteriorating into the first quarter of 2022. Expectations related to rising short-term interest rates, as expressed in the 2- and 3-year swap rates, have resulted in concerns over extension risk and more expensive structured financing terms. In addition to a disciplined approach to hedging activities, NonQM note rates require to be recalibrated with the consumer from a low 4% range prevalence in 2021 and to a target in the mid-5% to 6% levels, not coincidentally, present in the market prior to the COVID induced emergency monetary policy measures of March 2020.

The average note rate of the company's current locked pipeline reflects this arduous climb of the rate ladder. The company continues to believe that the addressable market for NonQM will expand once markets normalize. The first quarter of 2020 introduced increased market volatility and heightened market awareness of non-transitory inflation and credit and liquidity risk brought on by geopolitical events. Some of us were cutting our teeth in the business back in October of 1998 at the advent of the Russian debt crisis, which triggered a flight to safety rally in U.S. treasuries and a concurrent sell-off in credit-based assets.

Especially finance companies at that time experienced losses and liquidity calls on their treasury short hedge positions and also faced warehouse margin calls and market value declines in their subprime and [old] day mortgage loan portfolios. Layered risks are difficult to effectively hedge in times of acute market dislocation. The company has deployed a wide range of capital markets hedge strategies and delivery mechanisms over the last several years with increased utilization over the last 6 months on futures, on treasury swaps, forward sale agreements and best effort deliveries in lieu of aggregating NonQM for bulk sale.

We will continue to remain disciplined in our origination and capital markets activities, and remain undeterred in our belief that the addressable market for NonQM will expand to our benefit once markets normalize with respect to volume and margin.

Turning now to our long-standing preferred deal litigation. As we disclosed in our 8-K filing on July 19, 2021, the Maryland (inaudible) an order, which affirmed the lower court's ruling, specifically that the proposed 2009 amendment to the Preferred B Articles did not receive the required votes, and that, therefore, the original Preferred B Articles remained in place. I will now turn the call over to our General Counsel, Joe Joffrion, for a more detailed update on this matter. Joe?

Joseph O. Joffrion - *Impac Mortgage Holdings, Inc. - Senior VP & General Counsel*

Thanks, George. As previously discussed, as a result of the court's order, the company will be required to pay approximately $1.2 million in unpaid dividends to certain Preferred B stockholders, which amount was previously accrued by the company back in 2018. The payees of the unpaid dividends will be determined once the Circuit Court determines the basis for an appropriate record date. In addition, the court's order required a special meeting of Preferred B stockholders for the election of two additional directors of the company.

The special meeting of the Preferred B stockholders was originally convened on October 13, 2021, however, it was adjourned to November 23, 2021, due to lack of quorum sufficient for an election of directors. Similarly, on November 23, 2021, the meeting was further adjourned until January 6, 2022, due to the lack of quorum. And finally, also due to lack of quorum at the January 6, 2022 meeting, the special meeting was concluded without the election of any new directors.

The company (inaudible) would have been achieved at one of the special meeting dates, as we are looking forward to welcome the new Board members and their input, especially in aligning the company's stakeholders to create a sustainable capital structure and strategic vision for the future. With respect to payment of the future dividends on Preferred B stock, such dividends are cumulative. However, they are not payable unless declared by the Board. The Preferred B stock is perpetual with respect to both its liquidation preference and payment of dividends. At this time, there is no intent to declare any dividends on the Preferred B stock especially in line with the $82 million insured and long-term debt that has seniority in the company's capital structure. Additional information on the company's capital structure, the court's order and the special meeting of Preferred B stockholders can be found in our 10-Ks, 10-Qs and 8-K filings. Jon Gloeckner will now discuss the operating results for the fourth quarter of 2021.

Jon Gloeckner - *Impac Mortgage Holdings, Inc. - Senior VP of Treasury & Financial Reporting, Principal Financial and Accounting Officer*

Thank you, Joe. For the fourth quarter, the company reported GAAP earnings of $3.6 million as compared to $2.1 million for the third quarter and a loss of $2.2 million in the fourth quarter of 2020.

Our 2021 year-to-date GAAP net loss was $3.9 million as compared to a loss of $88.2 million in 2020. For the fourth quarter, core loss was $5 million as compared to earnings of $810,000 in the third quarter and earnings of $3.3 million in the fourth quarter of 2020. Our 2021 year-to-date core loss was $12.4 million as compared to a core loss of $58.7 million in 2020. The financial results of the quarter reflected increased loan production, net of the effect of market margin compression.

Gain on sales loans decreased to $14.9 million during the fourth quarter as compared to $19.6 million during the third quarter. During the fourth quarter of 2021, our originations were $759 million with margins of 196 basis points as compared to originations of $683 million with margins of 287 basis points in the third quarter of 2021. The increase in production quarter-over-quarter was due to our ability to grow our NonQM production to $382 million, which increased 105% as compared to $186 million in production during the third quarter. During the fourth quarter, $129 million or 34% came from our retail channel as compared to $54 million or 29% during the third quarter of 2021.

The shift in our production focus and subsequent increase in NonQM production through both our TPO and retail channels, has helped to offset the decline in conventional originations we all knew was coming. With the fourth quarter conventional originations decreasing by 25% to $351 million as compared to $467 million during the third quarter. During the fourth quarter of 2021, other income increased $7.3 million in mark-to-market fair value gains on our net trust assets as a result of a decrease in residual discount rates a decrease in loss assumptions on certain trust and an increase in prepayment assumptions as well as a $1.5 million increase in fair value gains on our long-term debt. As George had previously indicated, changes in fair value of the net trust assets and long-term debt are excluded from core earnings.

Operating expenses increased to $20.5 million in the fourth quarter as compared to $19.8 million in the third quarter primarily due to personnel costs, which increased to $13.2 million from $12.7 million in the third quarter. The increase in personnel costs during the fourth quarter was primarily the result of an increase in variable compensation as a result of the increase in origination volume as well as personnel costs, which continue to remain elevated across the industry due to the competition for talent.

Our business promotion expense was relatively flat at $2.2 million quarter-over-quarter. This reflects our previous push to target NonQM production in our retail channel, expand production outside of California and maintain lead volume. While the company previously experienced a substantial amount of organic lead flow, the increase in competition has prompted an increase in marketing spend to maintain a consistent level of lead volume.

We currently have warehouse lines with a combined borrowing capacity of $600 million, and we'll continue to balance capacity needs to meet funding demands of our NonQM production goals. We continue to carefully manage our liquidity and balance the demands of an aggregation model. Based on our current cash position, turn times and borrowing resources, we feel we have the liquidity necessary to meet our near-term production goals. Obi Nwokorie will provide specific commentary around our NonQM capital markets philosophy. Obi?

Obi Nwokorie - *Impac Mortgage Holdings, Inc. - Executive VP of Alternative Credit Products, CIO & Director*

Thank you, Jon. As [George] has mentioned, the industry saw a significant pressure on margins in the fourth quarter. During the quarter, we saw a flattening of the yield curve with 2-year and 3-year swap rates increasing by over 50 basis points each. The rise in short-term rates was driven by inflationary pressures in the economy and the market's expectations to the Fed's reaction to that pressure.

In addition to the selloff (inaudible), we saw a widening of credit spreads across the capital stack with spreads on new issuing NonQM AAA rated tranches moving from 65 basis points over interpolated swaps at the beginning of the quarter to 90 basis points over by the end of the quarter. Credit spreads have continued to widen and AAA NonQM spreads are currently around 160 basis points over benchmark rates. The rise in credit spreads occurred as we saw increased volatility in the [volume] markets, but this widening was also a reflection of a supply demand imbalance in the NonQM sector with supply outstripping demand during the fourth quarter.

Investors also began to focus on extension risk for lower coupon mortgages. Originators were generally slow to react to these changes in investor appetite. As a result of these pressures, the company began to take steps during the quarter to protect its margins by raising rates across all NonQM products. We also began raising the minimum rates allowed on our rate sheets from 3.125% at the start of the quarter to 4.625% today. The effect of these changes to the rate sheet is that the weighted average coupon on many originated NonQM loans has gone from the low 4% in the fourth quarter to mid to high 5% today.

We also introduced some new tools as George previously mentioned and expanded others to more closely manage the interest rate and credit exposure on our NonQM mortgage pipeline. We entered into interest rate swap features to manage the interest rate risk and increased our forward loan sales to manage the pipeline risk. With that, I'll now turn it over to Tiffany to discuss production activity during the quarter.

Tiffany Entsminger - *Impac Mortgage Holdings, Inc. - COO*

Thank you, Obi. As we discussed during the second half of 2021, the landscape of the GSE lending space continue to present challenges to conventional lending growth. Decreased loan application volume industry-wide is suggestive of the noticeable stagnation and GSE origination volume for many lenders competing for market share. A rising rate environment combined with ongoing competitive pressure, with further constricted margins as well as the opportunity for growth around GSE production. Impac's primary driver of GSE originations is our retail consumer direct call center. And while the volume in our retail channel remained relatively flat in the fourth quarter as compared to the third quarter, it did experience a decrease in GSE originations of 23%. We will continue to originate in the GSE space through our retail channel with minimal marketing spend, but we'll remain diligent around market conditions with an eye towards protecting margin and credit quality.

Previously, we discussed the important pivot within our consumer direct retail call center, allowing it to navigate shrinking GSE margins and offsetting this volume with NonQM origination volume and revenue. We are pleased with how quickly we've been able to shift focus and increase NonQM production in the call center. By leveraging the sales and marketing expertise that was so successful in ramping up this product previously, we've compressed the time line significantly and shifting product composition within the retail channel.

Our NonQM funding volume in the retail call center increased to $129 million in the fourth quarter 2021, more than doubling the $54 million of NonQM funding volume in the third quarter. While that NonQM growth trajectory and the call center will level off, we do expect our NonQM run rate to remain relatively flat into the first quarter of 2022. As Jon touched on, our business promotion expense attributed almost entirely to our retail channel increased slightly in the fourth quarter as compared to the third quarter.

We increased business promotion to both maintain our lead volume in the call center and augment targeted marketing to attract NonQM focused consumers. With the aforementioned increase in business promotion related to NonQM marketing in the consumer direct channel, we continue to see a corresponding shift in pipeline composition. Currently, NonQM originations represent approximately 52% of our locked consumer direct pipeline as compared to approximately 35% at the time of our last earnings call in November. Additional marketing allocations will continue to be deployed as needed to leverage the expertise in the call center and educate consumers around the NonQM product offering to further promote growth in the channel.

The primary focal point in ramping up our NonQM production remains within our third-party wholesale origination channel. Wholesale has traditionally been a driving channel around NonQM originations industry-wide as well as a successful vehicle for increasing volume over the last several years. Measuring from the first quarter of this year, the momentum around NonQM origination volume has steadily increased. As George mentioned, the company originated over $380 million of NonQM production in the fourth quarter 2021 as compared to $185 million in the third quarter, doubling our NonQM production from the third to fourth quarter. Roughly 66% of our NonQM production volume was generated through our TPO channel, with the overall composition of the TPO pipeline, almost entirely NonQM product.

Over the course of the second half of 2021, the progress we've made in our TPO channel is indicative of the clear focus the business has on rebuilding a successful alternative credit platform. In December, our wholesale channel funded $95 million in NonQM production, equaling the largest wholesale NonQM funding month as compared to historical volume numbers since 2015, a very impressive milestone for our NonQM team.

While the dramatic growth of our wholesale channel following its relaunch in the third quarter of 2020 has produced positive results, the TPO channel has still not fully relaunched the correspondent division. There's additional opportunity to capture market share and drive volume through delegated and non-delegated correspondent business relationships in the future. As Obi mentioned, we've taken steps to protect margins by raising rates across all NonQM products. This has been an adjustment for our borrower and broker partners, as they recalibrate to pricing changes in a rising rate environment. Despite these changes, our NonQM run rate across all channels has remained at over $100 million per month during the first quarter.

We will continue to build our NonQM teams with both channels to offer alternative credit products and in the same thoughtful and responsible way we have since 2015. That concludes the financial results and our prepared remarks. And I'll now turn the call over to Justin Moisio for the question-and-answer session.

QUESTIONS AND ANSWERS

Justin R. Moisio - *Impac Mortgage Holdings, Inc. - Chief Administration Officer & Corporate Secretary*

Thanks Tiffany. So we received a list of questions from Trevor Cranston ahead of the call. And so what I'll do right now is I'll go through those questions and have the team answer them directly. So the first item that Trevor had mentioned was, it's his understanding that the impact of the NonQM valuation at the end of the fourth quarter, had to do with spreads widening within NonQM securitizations. So with that said, given what has happened in the first quarter with the recent rate movement, do we see margins tightening even further. So Obi, maybe you can touch on that briefly?

Obi Nwokorie - *Impac Mortgage Holdings, Inc. - Executive VP of Alternative Credit Products, CIO & Director*

Yes, sure, Justin. So yes, I mean we've continued to see margin compression into the first quarter of this year. As mentioned in the prepared remarks, AAA NonQM spread ended the fourth quarter at roughly 90 basis points over the interpolated swaps. Today with a few deals in the market, we're seeing those spreads at somewhere between 155 to 160 basis points over. So another, call it, 65 to 70 basis points increase in credit spreads at the AAA level. And that, obviously, has continued to impact margins. We've also seen rates, I mentioned earlier that rates had increased around 50 basis points during the fourth quarter. We've probably seen another 80 to 90 basis points sell-off in rates since that time. So again, the combination of these two things have continued to put pressure on margins. I do think that originators, ourselves included, have responded and we begin to see increased rates offering on the rate sheets. And I think that, given where did weighted average coupon is probably 150 basis points higher than it was back then, and all of this is in an attempt to arrest some of that margin compression.

Justin R. Moisio - *Impac Mortgage Holdings, Inc. - Chief Administration Officer & Corporate Secretary*

The next item is kind of a follow-up there. So within the NonQM space, has the market, specifically the brokers and our consumers, adjusted to the increase in higher NonQM rates? And do we expect there to be a dip in volume? Then after that, do we expect that to stabilize?

So I can just take that one. So as we touched on in a couple of different places in the prepared remarks, the geopolitical events, combined with what was already a very volatile market, put significant pressure on us and the rest of the industry. And obviously, that was pushed forward to consumers and brokers, and they had to recalibrate to the significant pricing changes, which we outlined previously.

So for that reason, within specifically just the unlocked pipeline, so those folks that have not yet locked their loans yet, we did see some fall out there, which was to be expected when they felt that the rates that they were going to get were going to be considerably lower, and then there was that large move. So there was some fallout there. So depending on how March [shakes] out, NonQM for Q1 will most likely be down as compared to Q4. However, and Tiffany just mentioned this, we're still remaining at $100 million a month of NonQM production. And as the market gets comfortable with where rates are currently, we do expect that to stabilize and then increase our locks and subs going forward.

The next question that Trevor had asked was, do we ever expect NonQM gain on sale margins to return to the levels that we got to enjoy in the third quarter? Or is there a more realistic target gross margin with these higher coupon levels?

That's a difficult one from a crystal ball perspective. But Obi, do you want to maybe give your thoughts on that?

Obi Nwokorie - *Impac Mortgage Holdings, Inc. - Executive VP of Alternative Credit Products, CIO & Director*

Yes, sure. Yes, really, really difficult question to answer, given the volatility in the market and some of the changing dynamics we're seeing. But we do think that the market will normalize at some point. And once it does the originators will find a rate level that returns margins to, (inaudible) if not the same levels you saw in Q3 of '21 (inaudible) that allows us to run the business in a profitable manner. The one thing I would say, it's, obviously, a pipeline business, with a lag between when rates are locked by the borrower and when the loans are shown to investors or purchase by investors. There's some continued progression there, but I do think that at some point, we stabilize here and originators come to [rate] that allow us to get back to those (inaudible) type margin. .

Justin R. Moisio - *Impac Mortgage Holdings, Inc. - Chief Administration Officer & Corporate Secretary*

Okay. Next question. Do we expect competition to remain as intense as it has been the last 3 or 4 months within the NonQM space? Do we believe that some new entrants could fall out due to all the volatility that's going on. So I mean that -- the question is around the staying power of some of our competitors.

So I'll take that one as well. So since really late third quarter, there's been a lot of new faces step into the NonQM space, which I think can be expected. We've seen this before to help offset the anticipated loss of the GSE production. It's really outside of purchase money, the one pivot that a lot of folks will move to. So while it's still too early to tell, I would say, some of these new entrants to the extent that they hadn't built out their proper alternative credit, NonQM infrastructure, similar to ourselves and some other, the larger NonQM lenders out there.

Yes, they could conceivably back away from the table at this point to the extent that the volatility was too much for them to stomach. However, we do believe that the larger names are self included that have been tied to NonQM since really its inception. We'll continue to aggressively compete on margin, market share. So from a big picture standpoint, I don't think that the competition in the space will fall off at all, but you could see some of the newer entrants back away from it.

And the last question that Trevor had focused on the kind of the call center in the GSE space. So regarding GSE production. The assumption is that our call center has experienced the same pain as some other GSE shops. Have we adjusted appropriately? Where do we see NonQM in the call center? And I'll just hold on to this one as well. So we talked about this last couple of calls on this call a bit, and George even mentioned it in his prepared remarks in terms of -- with respect to the rate business. We are certainly not immune from the reduced origination volumes and margin progression around GSE production.

So while our total volume in the retail call center remained relatively flat in the fourth quarter as compared to the third, we did experience a decrease of about 23% in GSE originations. We do expect that decrease to continue going further. Not a surprise there, especially when you take into account and Jon mentioned this in terms of marketing spend, we're not chasing that production currently with increased marketing spend. We've pivoted almost all of our business promotion within the call center to NonQM. And so the GSE that's coming in right now is purely organic, and we'll continue to capture as much of that, that we can get that comes in, but we're not going to chase that volume at these margin levels.

And Tiffany touched on it in her prepared remarks. We doubled our NonQM production within the call center in the fourth quarter compared to the third. So clearly, we've made that a point of emphasis, and we're finding great success doing so. And then a topic that continues to come up in terms of trade publications that you read all the time is reduction of head count at some of the larger institutions out there. And that's not something that we're immune from either, but the difference here is that our folks know how to originate alternative credit and GSE products from years of being cross-trained on that. So that makes that much easier. But we'll continue to staff thoughtfully and respond appropriately as the market changes, rightsizing our capacity to current market conditions as we always do.

So that concludes what we have in terms of questions today. So with that, thank you all for joining us, and we'll speak to the market in a few months here for the results of the first quarter. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect. Everyone, have a wonderful day.