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PHH Corporation Q2 2008 Earnings Call Transcript

Question-and-Answer Session

Operator

Certainly. (Operator instructions) And our first question comes from Bose George with KBW Investments.

Bose George – KBW Investments

Guys good morning.

Terry Edwards

Good morning Bose.

Bose George – KBW Investments

I had a couple of questions on the mortgage production business. First your fee-based closings are up pretty well. And can you just discuss the drivers of that and the economics of the fee-based business versus originating loans for sale and also given that your total production is up quarter-over-quarter and \$20 billion, why you are revisiting the \$39 billion guidance number?

Terry Edwards

Okay, fees, the fee-based services that is up because one of the things that we had to halt was doing jumbo loans for sale in the secondary market. From the first quarter to the second quarter that mark-to-market has basically dried up and is limited – and almost is still dry at this point. If you reverse engineer where AAA prime securities, obviously AAA and prime they go together – securities we trade in the marketplace if you reverse engineer the execution you would get that would mean a coupon rate to a new originating customer of about 8% and that is just not going to fly in the mortgage market today. So as a result our large clients are portfolio [ph] jumbo loans and because of the increased portfolio activity for this business that drives the fee-based business up. The fee based business is good business in that we don't take the risk but because you don't take the risk the return isn't as great as it would be if we sold the loan on a gain on sale basis in the secondary market. That said we don't have any appetite for the risk of taking on jumbo loans and holding onto them and hoping that we can get execution in the market place. With regard to the overall \$39 billion target, you are right Bose, we were at the \$20 billion through the first half. So everything was on track but as I indicated our June results were hurt by the fact that new application volume started to come down in June as rates were up basically 50 basis points from where they were in the first quarter. Rates have continued higher and while I don't want to make a trend out of a week and a

half of August activity, volume is very, very slow and it is slow for every single business source we have. So isn't a function of one particular business source or a couple of business sources slowing down. So it is our expectation that the \$4 gas, the fact that every month everyone gets to read how much housing prices are dropping, the amount of credit card debt has now increased with that data that is out there. Consumers are tightening their belt and, you know, one of the things that is going to slow down is obviously new home acquisition. People think that houses are going to be cheaper you know further out from here. So as a result volume is very slow. Now I don't want to call August a trend. Typically August slows down anyway but it has slowed down dramatically. So as we move towards September – so just based on that August slowdown we're not going to do \$20 billion almost \$20 billion in the second half of the year. So we are as I said rebalancing what our expectations are. Hopefully, getting those additional three clients that I talked about plus others over the goal line with that information we will assess how much additional costs we have to take out of the business, recognize that market-wise the world is going our way. More and more are going to outsource. So we have to balance cutting our platform cost and making sure we don't cut into muscle. We want to have the muscle available for new client signings and to the extent that if there is any lift in the housing market we want to be there for it. Now I would expect that the lift in the housing market would have to come from some kind of drop in interest rates, a compounding factor associated with rates is the fact that spreads of Fannie and Freddie agency securities are close to their lives of all time as we speak. So that in itself those spreads trading the swaps at a number like 135 basis points relative to our traditional spread of 75 or 80 that in itself has added 50 basis points to the cost that the consumer pays.

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