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Finance of America Companies, Inc

Third Quarter 2022 Earnings Call

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CORPORATE PARTICIPANTS

Michael Fant, *Senior Vice President, Finance*

Graham Fleming, *President and Interim Chief Executive Officer*

Johan Gericke, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Stephen Laws, *Raymond James*

Douglas Harter, *Credit Suisse*

James Forsyth, *Morgan Stanley*

PRESENTATION

Operator

Hello and welcome to the Finance of America Third Quarter 2022 Earnings Call.

I'll now hand you over to Michael Fant, Senior Vice President, Finance to begin. Michael, please go ahead.

Michael Fant

Thank you and good morning everyone. Welcome to Finance of America's third quarter 2022 earnings call. With me today are Graham Fleming, President and Interim Chief Executive Officer and Johan Gericke, Chief Financial Officer.

As a reminder, this call is being recorded and you can find the earnings release and presentation on our Investor Relations website at www.financeofamerica.com.

In addition, we will refer to certain non-GAAP financial metrics on this call. You can find reconciliations of non-GAAP to GAAP financial metrics to the extent available without unreasonable effort discussed on today's call in our earnings press release and presentation on the Investor Relations page of our website.

Also, I would like to remind everyone that comments on this conference call may be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding the Company's expected operating and financial performance for future periods. These statements are based on the Company's current expectations and are subject to the Safe Harbor statement for forward-looking statements that you'll find in today's earnings release.

Actual results for future periods may differ materially from those expressed or implied by these forward-looking statements due to a number of risks or other factors, including those that are described in the Risk Factor section of Finance of America's annual report on Form 10-K for the year ended December 31, 2021, originally filed with the SEC on March 15, 2022. As such risk factors may be amended and updated in our subsequent periodic filings with the SEC.

We are not undertaking any commitment to update these statements if conditions change. Please note these are interim period financials and are unaudited.

Now, I would like to turn the call over to Finance of America's President and Interim Chief Executive Officer, Graham Fleming. Graham?

Graham Fleming

Yes, thank you Michael.

Good morning everyone and thank you for joining us on our third quarter 2022 earnings conference call.

On today's call, I would like to briefly touch on our recent announcement before discussing our SF&S businesses and go forward strategy. Johan will then jump in with a review of our financials before we open the call for questions.

The decision to discontinue our Forward Mortgage business was the outcome of a thorough review of our business and the broader economic outlook. Ultimately, we determined that market conditions have fundamentally changed, and we need to change with them. We expect to materially complete the wind down across both Retail and Wholesale mortgage channels by the end of this year.

As a Company, we took this decision very seriously and understand the impact it will have on our employees who are highly valued members of our team. In response, we are providing support to assist departing employees in their search for new employment opportunities and are committed to facilitating the transition as they move to other mortgage lenders. I would like to thank everyone for the partnership and continued dedication to supporting our customers and our Company.

The exit from Forward Mortgage will allow FOA to optimize our resources and prioritize high growth businesses where we already hold distinct competitive advantages and leading positions in markets with positive macro tailwinds.

In the near term, we believe home equity will be a crucial asset for retirees to supplement their income. Moreover, we believe that in the future, many consumers will seek to broaden discussions with their financial advisors to include home equity as they reassess retirement planning and their long-term financial needs.

Against this backdrop, and with FOA's leading position offering Reverse Mortgage products that lever home equity, we will better serve our customers in their financial journey. Our Company has a history of product innovation, and our Reverse business has tremendous opportunity to continue this legacy during these changing market conditions.
We will also look to expand our partnership model with large mortgage lenders and other financial services companies to offer our products on their platforms. Where we previously were focused on leveraging our own Mortgage Retail platform to offer these products, we will now pursue the opportunity to expand this program throughout the mortgage industry. We intend to have several large retail lenders and other financial services companies offer our Reverse products.

Additionally, we recently debuted a collaboration with Morningstar to educate financial advisors about Reverse Mortgages and other home equity solutions available to their clients. We continue to believe that education is key to the growth of the Reverse industry, and the collaboration will make education about Reverse Mortgages, including the Finance of America's suite of products available to around 150,000 advisors. By teaming with Morningstar, we can ensure that mortgage advisors are educated about home equity as they create diverse and long-term financial strategies for their clients.

In the third quarter, our SF&S businesses continue to be profitable and generated $7 million in adjusted net income in line with our previous guidance. Of note, our Reverse business earned $34 million in pre-tax income during the quarter.

Looking a little closer at each business line, our Reverse business has been the leading wholesale origination platform in the industry for more than a decade. The industry has not been immune to the impacts of the market, and we are seeing attractive opportunities to strengthen our platform and expand this cornerstone line of business. This should allow FOA to exit this downturn in a position of strength to capitalize on structural long-term market opportunities resulting from baby boomers significant home equity.

While we expect to see a further decline in Refinance volumes, we continue to see year-over-year growth in new to Reverse customers, including seven straight quarters of growth in our home safe, new to Reverse loans.

A strong complement to our Reverse business is our Home Improvement vertical. As one of our most efficient customer acquisition channels, Home Improvement compliments our Reverse products, given the overlapping customer characteristics. The average age of a Home Improvement customer is 52 years old. As these customers look to update their home for retirement, a Home Improvement loan offers an effective solution for homeowners seeking to leverage their equity and is an attractive option for those who have already locked in low interest rates on their mortgages.

The competitive dynamic has improved, and as a result, volume has increased, and margins are expected to expand. This business continues to grow and volumes in Q3 '22 were 8% higher than volumes in Q3 last year.

In our Commercial business, we continue to focus on a return to profitability. We have raised coupons on new volume and pipeline multiple times as rates continue to rise at a rapid rate. In addition, we remain focused on our cost structure to match capacity with demand.

Our Lender Services business continues to introduce new products to better serve our partners in the Mortgage industry. With access to our appraisal management, title, insurance, and other in-house services, we are well placed to sell a bundle of products to our existing customers and deepen the relationship. Over time, we expect these value-added products and services to replace the revenue lost due to the rapid decrease in the refinance market.

In addition, we remain focused on costs to ensure we optimize the platform based on current demand. Looking forward, we believe that the combination of our SF&S platform, along with continued investments in technology, will enhance our customer experience.

With that, I will pass the call to Johan to discuss the financials.

Johan Gericke

Thank you, Graham, and good morning everyone.

For today's discussion, I want to spend a moment discussing our Q3 results for the Company and then for our SF&S business segment. From there, I will dig into the additional costs resulting from the discontinuation of our Forward Mortgage business.

Turning to the operating results, the overall company recognized an adjusted net loss of $20 million and fully diluted adjusted loss per share of $0.10, as our Forward Mortgage Origination segment continued to be pressured by current market conditions. During the third quarter Mortgage generated an adjusted net loss of $27 million, and our SF&S businesses generated adjusted net income of $7 million in line with prior guidance.

I will discuss revenue and other financial impacts in more detail when I cover the individual segments.

From a balance sheet perspective, cash in Q3 decreased by $50 million predominantly due to the repayment of secured debt. Year-to-date, we have paid down over $150 million of secured lines of credit. In addition, we are focused on preserving liquidity in this volatile environment.

Mortgage MSR balances decreased as we completed strategic sales of these assets during the quarter, but have increased HECM MSR, and in Q4 closed a new financing facility secured by this asset to further enhance liquidity.

Book value as of September 30 stands at $575 million of which tangible net worth was $137 million.

Turning to our individual reporting segments, and as mentioned earlier, Mortgage Originations recorded a $27 million adjusted net loss. Beginning in Q4, these results will be recorded as discontinued operations in accordance with GAAP.

Our Reverse segment originated funded volumes of $1.1 billion, generated revenue of $72 million with improved margins, and generated pre-tax income of $34 million.

Our Commercial segment originated funded volumes of $355 million, and revenue of $12 million as margins return to more normalized levels.

Lender Services revenue for the quarter was $44 million, and the segment generated an $11 million pre-tax loss inclusive of corporate allocations and other non-cash expenses.

Finally, looking at our Portfolio Management segment, pre-tax income was negatively impacted by non-cash fair value marks on our assets. As of September 30, the residual value of assets subject to non-recourse debt totaled $61 million down from $390 million as of December 31, 2021.

Turning to the effect of winding down the Mortgage business as identified in our recent 8-K filing, we are expecting costs related to the mortgage shutdown to total between $145 million and $164 million. This includes $130 million to $138 million in non-cash expenses such as the impairment of intangibles and other assets of which $129 million was incurred in Q3.

Total cash expenses comprising predominantly of severance costs as well as anticipated lease and vendor contract termination buyouts are expected to be between $15 million and $26 million with most of these anticipated to occur in Q4 2022.

With that, let me now hand it back to Graham for closing remarks.

Graham Fleming

Yes, thank you Johan.

In the near term we're going to focus on successfully managing the shutdown of our Mortgage Origination's business, we're looking ahead to '23 and beyond. We are bullish on the earnings power of the organization. With respect to 2023, we project adjusted fully diluted earnings per share of $0.45 to $0.55 per year, driven predominantly by our Reverse Origination segment where we see powerful macro tailwinds continuing to exist.

In closing, streamlining of the Organization will allow us to focus all of our resources on those businesses that drive growth and which in turn will drive long-term shareholder value.

With that we'll open the call up for any questions, Operator?

Operator

Thank you. Our first question is from the line of Stephen Laws from Raymond James. Please go ahead.

Stephen Laws

All right, thank you. Graham, good morning. Can you talk about the MSR sales and if there have been any additional MSR sales quarter-to-date?

Graham Fleming

Go ahead.

Johan Gericke

Hi, Stephen, it's Johan. Yes, good morning. We will have a number of MSR sales in Q4, but as you saw from our sales in Q3, most of the sales happened in that quarter. If you think about the dynamics there Forward MSRs were priced relatively attractive during the course of that quarter, and so we capitalized on that trend. Whereas HECM MSRs were, we felt there was actually some value in that. We've been investing in HECM MSRs, obviously, and as I mentioned secure the new funding facility on the back of HECM MSR.

Stephen Laws

Great, thanks, Johan. When I think about the charges—went through a bunch of numbers. I've got the 8-K from a couple weeks ago pulled up, but did you say $129 million of charges related to the Forward business were incurred in Q3, and is that kind of comparison to the number from the 8-K of a midpoint of $140 million of total charges that will be incurred in 2022? Does that mean most of it hit and there's very little left or how do we think about expenses and items that are going to hit in Q4?

Johan Gericke

Yes, so the $129 was predominantly the impairment of intangibles, and other assets. It's almost entirely a non-cash expense. If you think of the Q4 expenses really to be those expenses that will incur in cash. That would be things like claim severance, buying out of any leases we may have to buy out. As well as, buying out of vendor contracts, and that's the roughly $15 million to $26 million that we estimate. I'd say the bulk of that's going to happen in Q4 and maybe a little bit that holds over into the early part of next year.

Stephen Laws

Okay and any holdovers reflected in the guidance provided at the end of the call?

Johan Gericke

Yes, we anticipate that those will obviously be disclosed as discontinued operations and will be materially wrapped up by the end of the year.

Stephen Laws

Great. Then on the Reverse business, volume declined a little more than I was expecting. Can you talk about what's going on there, how the rate volatility is impacting that market and how quickly you're, or lack thereof you're able to reset pricing in the Reverse business given the current environment?

Johan Gericke

Yes, so Stephen, we are seeing reductions in Refinance volumes as rates have gone up and as we've reset rates based upon current securitization economics on the deals that we're issuing. As I mentioned, we're continuing to see growth in new Reverse and given current economic climate, we are working on some new products that will assist seniors accessing equity, such as a second product or other opportunities that we can create.

I will say that we did back off our correspondent acquisitions in Q3. The volumes wear down as a result of not (phon) acquiring, I think on an equivalent basis in Q2 is about $150 million to $200 million of correspondent, right? We think as that market normalizes we'll be able to increase the volume through new to Reverse a second lean product and increasing our correspondent acquisitions.

Stephen Laws

Great. I appreciate the comments, Graham and Johan. Thank you.

Johan Gericke

Thank you, Stephen.

Operator

Our next question is from the line of Doug Harter of Credit Suisse. Doug, please go ahead.

Douglas Harter

Thanks. Can you talk about your expectations for kind of cash flow, cash earnings, both in 4Q and as we head into '23 given kind of further shut down costs and also just out of the remaining businesses?

Johan Gericke

Yes, good morning Doug. Obviously liquidity is something that's at the front of what we're focused on. I think if you look at what we've been doing, you'll notice that we have been de-risking and de-leveraging the balance sheet, both reducing our inventory of loans and obviously having haircuts locked up in that as well as paying off secure debt. As I mentioned, we sold our Forward MSR assets because pricing was pretty attractive there for a while and to monetize that.

Then obviously we've invested in HECM MSR, which we think is attractively priced for investment at the moment and secured some financing on that. As we look forward to Q4, one thing I would say is our securitization activity in Q3 of proprietary HomeSafe assets of Reverse assets was pretty light. We expect that activity to pick up and then obviously generate some cash with that. Then as we wind down the Forward Mortgage business, obviously, all the haircut and the other cash that we have invested in that business will be freed up and obviously firstly used to pay down the expenses in Forward Mortgage. But then whatever is left we will obviously have access to for the rest of the business, so kind of the macro on liquidity.

Douglas Harter

I guess, kind of as you free up cash from the Forward business, I guess how are you thinking about priority of usage, and then kind of along that, you said you've paid down some secured debt this year. I guess how are you thinking about paying down secured debt versus maybe trying to repurchase some of your unsecured debt, which would trade at discounts and just kind of how you're thinking about future cash flow usage?

Johan Gericke

Yes, no, that's a great question. Look, I would say it shouldn't come as a surprise that there's some opportunity in the market here for us to strengthen our businesses where we have a dominant share. We are actively looking at pretty much everything that we can, that is a sensible way to spend our cash for all stakeholders quite honestly. We are going to deploy the cash in a manner that's going to get us the best return, strengthen our platforms, capitalize on some potential opportunities that are out there so that when, as Graham mentioned, we accept this downturn, we're in a very strong position. That's going to be the broad kind of framework for looking at our liquidity at the moment and building cash and using that to strengthen the franchise.

Douglas Harter

All right. Thank you.

Operator

Our next question is from the line of James Faucette of Morgan Stanley. James, please go ahead.

James Faucette

Thank you, and thanks for the details this morning. Just quickly, are there any business lines or segments that may be impacted by the discontinuation of the Forward Mortgage business? Just wondering where a cross-sell was particularly important to, and how that may impact some of these other remaining segment's trajectories.

Johan Gericke

Yes, so as I said in my remarks, we're assisting a lot of our branches to go to other mortgage lenders during the shutdown wind down. With that, we're also working with the lenders that they're going too, to help them introduce these products. We actually believe that not in the short-term, but over the course of '23, we think there's a bigger opportunity to cross-sell. As I also said in my remarks, we're working with a couple of large retail lenders to embed our Reverse products in their offering, they'll distribute it through their franchise.

We do think that we can enhance the cross-sell opportunity but yes, we don't see a negative impact. If anything we see an opportunity as we get our products introduced to more lenders as our branches go work with other mortgage banks.

James Faucette

Got it. Got it. Then obviously in these periods there's a lot in flux operationally, but anything else that we should be aware of, particularly as it relates to the cost cutting initiatives and how you plan to manage those costs and what are the things that you'll be looking at to determine if you need to be more aggressive or maybe less than planned in terms of managing those costs?

Johan Gericke

I think that's segment by segment, right? We'll be substantially complete with the wind down of Mortgage by the end of November. There's going to be some trailing operational folks to wind down the remaining pipeline, deliver that pipeline into the secondary market early '23, so we're substantially complete with that.

As a result a knock-on effect of that is it allows us to become more streamlined in our corporate functions, and we're actively working on streamlining those functions. Then, as I said, with Commercial and Lender services, we are managing those expenses on a monthly basis, and it's a function of the volume and the volume is somewhat a function of the rates that are in the market and the desire of borrowers to take products at those rates.

While we've seen a small reduction in volume in Commercial, we've been adjusting the operating expenses monthly as a result of that. I think it's an ongoing effort and one that we probably will be continuing all the way through Q1 of next year.

James Faucette

That's great. Thank you very much.

Operator

Thank you everyone. That concludes the question-and-answer session for today, and this also concludes the Finance of America's third quarter 2022 earnings call. Thank you for joining and you may now disconnect your lines.