Velocity Financial, Inc.

Financial Second Quarter 2025 Conference Call

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CORPORATE PARTICIPANTS

Chris Farrar - *President, Chief Executive Officer*

Mark Szczepaniak - *Chief Financial Officer*

Chris Oltmann - *Treasurer*

PRESENTATION

Operator
Good day, and welcome to the Velocity Financial Second Quarter 2025 Conference Call. All participants will be in a listen-only mode. Should you need any assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note this event is being recorded.

I would now like to turn the conference over to Chris Oltmann, Director of Investor Relations. Please go ahead.

Chris Oltmann
Thanks, Danielle. Hello, everyone, and thank you for joining us today for the discussion of Velocity's Second Quarter 2025 Results. Joining me today are Chris Farrar, Velocity's President and Chief Executive Officer; and Mark Szczepaniak, Velocity's Chief Financial Officer. Earlier this afternoon, we released the press release with our second quarter results, and you can find that press release and accompanying presentation that we will refer to during this call on our Investor Relations website at www.velfinance.com.

I'd like to remind everyone that today's call may include forward-looking statements, which are uncertain and outside of the company's control, and actual results may differ materially. For a discussion of some of the risks and other factors that could affect results, please see the risk factors and other cautionary statements made in our communications with shareholders, including the risk factors disclosed in our filings with the Securities and Exchange Commission.

Please also note that the content of this conference call contains time-sensitive information that is accurate only as of today, and we do not undertake any duty to update forward-looking statements. We may also refer to certain non-GAAP measures on this call. For reconciliations of these non-GAAP measures, you should refer to the earnings materials in our Investor Relations website. And finally, today's call is being recorded and will be available on the company's website later today.

And with that, I will now turn the call over to Chris Farrar.

Chris Farrar
Thanks, Chris, and welcome, everyone to our second quarter earnings call. After the close today, we reported record quarterly results with net income increasing 76% and new loan production up 72% versus Q2 '24. Obviously, our business is performing exceptionally well across the board. I believe our people are our most important asset, and they deserve the credit for delivering this outstanding performance. We grew revenue by $31 million, managed expenses carefully, and saw our pre-tax income increase by $14 million, as operating leverage boosted our core pre-tax return on equity to 24%.

With respect to our end markets, we saw a pickup in transactions during Q2, and investors are quite active, especially within our niche. Year-over-year, we increased the portfolio by just under $1.4 billion, with commercial properties representing approximately $770 million of the increase, and residential properties the other $600 million. Our ability to finance a broad range of property types is a unique strength that differentiates us from other mortgage lenders. We expect strong growth from each of these categories going forward.

In terms of the portfolio, our asset management team did a fantastic job of curing delinquent loans, which drove our NIM expansion and resolved NPAs with significant gains. This team knows our asset class well, and they continue to drive exceptional performance.

From a capital markets perspective, this is our busiest quarter ever, completing four securitizations, issuing just under $1 billion in securities. The strong support for our program and robust market conditions are important tailwinds which fuel our growth. As we look forward, the pipeline for new loans is very strong, and we expect continued growth in originations as we take market share. Our team is very proud of the earnings growth and the predictability of our unique business model, and we know that the value proposition for our investors is outstanding.

That concludes my prepared remarks, and we'll turn to the presentation starting with page three. In terms of earnings, as I mentioned, core net income $27.5 million or $0.73 a share, a new all-time record for the company. And NIM for the quarter was up to 3.82%, up 47 bps from just last quarter. And a large driver of that was really, as I mentioned earlier, the recapture of delinquent interest on non-performing loans. So, our team did a great job on those recoveries.

In terms of the portfolio, I mentioned the record production and saw the portfolio grow by 30.8% on a year-over-year basis. In terms of the non-performing loans, those ticked down slightly to 10.3% as we continued to work hard to resolve delinquent borrowers. Most importantly, probably from the portfolio perspective, continued to see very positive gains of $3.6 million on just over $100 million of UPB that was resolved.

In terms of financing and capital, I mentioned the four securitizations. The most significant securitization we did was our MC25-1, and that transaction freed up about $53.5 million of cash to continue to grow the portfolio. So that was really an important transaction for us, and Jeff and team did a great job from a capital markets perspective of getting great execution on that transaction. That increase in cash obviously drove strong results in our liquidity up to $139 million, so we've got lots of liquidity to continue to fund our growth and plenty of warehouse capacity.

Now, turning to page four, this is a new slide that we're presenting, something that we haven't presented before, but we really wanted to highlight the unique business structure being a C-Corp that retains our earnings, which allows us to grow book value, and our earnings as we reinvest those earnings back into new assets. We really feel like we're unique and unlike a lot of other mortgage lenders that are out there.

You can see that there's tremendous performance here in all categories with earnings growing, equity growing, and ROE increasing, which is obviously pretty impressive to grow that ROE as much as we did with the equity base continuing to increase. So, we're very pleased with those results, and based on all these things, we really feel like there's a tremendous value in the shares, that we trade, in our view, at a very low PE-based on our growth profile and our ability to continue growing not only earnings but the portfolio as well.

Turning to the next slide on page five, we've seen this one before. Again, continuing to highlight how our strategy builds book value as we retain those earnings and put them back into the business for future growth. All the way to the far right is our adjusted book value, which represents the total value we think of our assets if we were allowed to mark everything to fair value. And I think from our perspective, from management's perspective, we view this $17.60 a share really as a floor in terms of valuation.

We feel like that's the minimum that our company should ever trade for because that's really the NPV of what's on the balance sheet as of today and doesn't take into account the value of the platform and any future earnings or growth in the business. So, as we grow this book value, we expect to reward shareholders but really feel like this puts a nice floor in terms of valuation.

With that, I'll turn it back over to Mark to continue.

Mark Szczepaniak
Thanks, Chris. Good afternoon and evening, everyone. In the second quarter, then we saw record production and continued strong earnings growth. If we take a look at the slide on page six, Q2 had record loan production of just over $725 million in UPB. That was a 13.3% increase from Q1, which was our previous record production was Q1 of $640.4 million. So, we've had two record productions in a row from two quarters.

In Q2, there were over 1,600 loans funded. The strong production growth in Q2 included the weighted average coupon on new held for investment originations continuing to come in strong at 10.5%. The weighted average coupon on our HFI originations, if you just look back over the last five-quarter average, has been at 10.7%. And the growth in originations in Q2 continued at tight credit levels, as you can see in the table. The weighted average loan to value for the quarter was at 62.7%, and on a five-quarter average trend, 63.2%. So very tight credit levels and good coupons. So, the record growth at the healthy WAC and the low LTV continues to demonstrate a consistent trend of borrower demand for Velocity's product, even in the recent current volatile market.

On page seven, as a result of the continued growth in production, we see a growth in Q2 for our overall loan portfolio. Our total portfolio as of June 30th was at $5.9 billion in UPB and a 7.5% increase from last quarter, from Q1, and an increase of 31% year-over-year. The weighted average coupon on our total portfolio as of June 30th was 9.67%, and that's eight basis points higher from where it was at the end of Q1. It's 42 basis points higher on a weighted average coupon basis compared to the second quarter of 24, so year-over-year. And the total portfolio weighted average loan-to-value remained consistently low at 65.8% as of June 30th.

Page eight, our Q2 NIM was at 3.82%. That's a 47 basis points increase over Q1. The NIM, if you look at the components of NIM, our portfolio yields increased by 54 basis points quarter-over-quarter due, as Chris mentioned, mainly because of higher cash interest received as a result of the special servicing efforts on our non-performing loans. And also, to a secondary degree, we just mentioned that our portfolio WAC at the end of Q2 was eight basis points higher than it was at the end of Q1, so you're getting some pick up from a slightly increased total weighted average coupon on the portfolio. On the cost of funds side, our cost of funds increased by only one basis point, quarter-over-quarter, which also contributed to a widening NIM.

On page nine, our non-performing loan rate at the end of Q3 was 10.3%. That's down half a point from Q1. Our non-performing loan rate has remained consistent. If you look at the last five-quarter ends, it's been at 10.6%. We continue to see the strong collection efforts by special servicing that have resulted in favorable gain resolutions of all of our non-performing assets, which are comprised of both non-performing loans and REOs

And if you look at the table on page 10, it shows these positive results of our in-house special servicing NPA resolution efforts. For Q2, our non-performing asset resolution gains were $3.6 million or 3.5% of about $104 million of NPA UPB resolved. And on a trend basis, we've continued to average 3.5% quarterly NPA resolution gains over the last five quarters.

Turning to page 11, we see our CECL loan loss reserve and also our net loan charge-off and gain loss on REO activity. On the CECL reserve, as of June 30th, our CECL reserve was $4.9 million or 22 basis points of our outstanding amortized cost held for investment portfolio. And our CECL reserve has been consistent with our last five-quarter average running right around 20 basis points.

Keep in mind the CECL loan loss reserve does not include loans carried at fair value. It's only the loans carried at amortized cost. And also, for Q2, our net gain/loss from loan charge-offs netted with REO-related activities recognized a net gain of $2 million. And that's consistent, if we look at the second quarter of 2024, it's consistent year-over-year with a $2 million net gain recognized in Q2 of last year.

Page 12 shows our durable funding and liquidity position at the end of Q2. Our total liquidity at the end of June was $139.2 million and comprised of about $80 million in actual cash-and-cash equivalents and another $59 million in available immediate liquidity on unfinanced loan collateral. As of June 30th, our warehouse line capacity was $476 million, almost $477 million on a maximum line capacity of $810 million, so again, plenty of capacity on our warehouse line and plenty of liquidity at the end of the quarter.

As Chris mentioned earlier, in Q2, we did issue four securitizations, including our second securitization ever collateralized by our short-term loan product, which leveraged new short-term collateral and re-leveraged existing short-term collateral from collapsing our 2023 short-term securitization.

And as Chris mentioned, we also collapsed and refinanced our 2022 mixed collateral securitization with a new 2025 mixed collateral securitization that generated over $50 million in additional liquidity.

That concludes my 2025 Q2 financial recap of a very, very strong quarter for the company. I'd now like to turn the presentation back to Chris for his overview of Velocity's 2025 outlook on our key business drivers. Chris…

Chris Farrar
Thanks, Mark. You can see from the points here on the slide that we feel really good about the future and about our growth prospects. Markets are healthy, both on the end-user side and the capital market side. So, we're very bullish on the momentum that we have and expect it to continue in the next year or two.

So, with that, that concludes all of our prepared remarks and we will open it up for questions, please.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press "*" "2."

The first question comes from Don Fandetti from Wells Fargo. Please go ahead.

Don Fandetti
Hi, good evening. I was wondering if you could talk a little bit about NIM going into Q3? If you think you can maintain this level or if there's some pull forward in Q2, and then if you can talk a little bit about the long growth expectations for H2?

Chris Farrar
Sure. Hi, Don, so yes, our target NIM is 3.5%. I think Q1 was a little light, Q2 was obviously very strong. We're trying to target 3.5% on a consistent basis. As Mark mentioned resolving delinquent assets, because they do go on a non-accrual status, they tend to be very lumpy. So, timing when that asset will cure is a little tricky. So, there's some volatility around NIM depending on when we actually collect. We do ultimately believe we're going to collect it almost all the time. It's just a question of timing and when. So, if you average out the first two quarters, you're like 3.6, I think, on NIM. And we think that's very sustainable going forward.

Don Fandetti
Got it. In terms of the pace of loan growth in the next quarter or two?

Chris Farrar
Yes, I think we still expect to grow. What we've seen historically is to kind of go in a step function. It doesn't go up continuously every month. You sort of get to a new level, digest that level, and then take another step up. So, I don't have a forecast for you on the actual rate of growth, but we do expect to grow going forward.

Don Fandetti
Thank you.

Chris Farrar
Sure.

Operator
The next question comes from Steve DeLaney from Citizens JMP Securities. Please go ahead.

Steve DeLaney
Good afternoon. Thanks. Good afternoon, everyone. Congrats on a great quarter. Really remarkable with the numbers, the NIM and the ROE. I guess, Chris, for our, you know, when you look at where you are, pretty darn good, where are the opportunities, are there opportunities for improvement or is this sort of the range at which you would consider to be optimal and optimal high performance or are there any things that you lay awake at night thinking, gosh, if I could just get this number a little bit better.

Chris Farrar
Yes, sure.

Steve DeLaney
You look at the results and the future.

Chris Farrar
Yes, thanks, I appreciate it. Yes, it's funny, I remember a long time ago going to an AYSO (Ph) game and this soccer coach told all the parents, the worst thing you can do is watch your kid's best game and then go out every week and expect your kid to perform at that level. So, I get your point. But I do think this is a…I don't think it's a high point for us. We're doing exceptionally well, that's true. And we did see kind of that big pickup in the NIM and some of those things, so some of those things are timing issues. But I still feel like we have room to improve. And the biggest areas that we're working on in just staying focused in our knitting this technology. We're undertaking a program right now over the next call it 12 to 18 months where we're breaking down our entire process and looking where we can apply technology to improve processes and make our team more productive.

So, I don't think we're at peak performance. I think we're at very strong performance. But I think it's sustainable going forward. And I do think we could improve on the efficiency side of the business, as a very small example, we just recently rolled out some technology in our post-closing department with it, makes our people probably five times more productive than they were with the old process. So, those won't be massive gains every quarter, but over the next year and a half, we think we can drive some more performance and some more efficiency out of the business.

Steve Delaney
Got it. Yes, I think everyone likes to have better technology or at least keep up. Geography, you guys are out on the West Coast and it's a big country. Do you in your current markets you're operating in, maybe describe concentration, West Coast, how broad is your origination platform? How far can you reach? And I'm just curious if you can touch the Southeast or possibly touch the Florida market with your existing setup and structure?

Chris Farrar
Yes. Good question. So, we like to concentrate on the major MSAs. We have loans in 48 states. So, we have deep reach across the country, and we like the diversity in the portfolio.

You mentioned Florida. We do have an office in Miami, and they're one of our highest producing offices per capita. So, they do a fantastic job for us. And you tend to see the portfolio kind of bar-belled between the coasts and then some of the Southern states, so kind of a smile, if you will. So, I think we'll stay with that footprint largely, and we think there's plenty of runway to expand there.

Steve Delaney
Thanks for the comments, Chris, and great quarter.

Chris Farrar
Thank you, Steve.

Operator
As a reminder, if you have a question, please press "*" "1." The next question comes from Tim Chiang from BTIG. Please go ahead.

Eric Hagen
Hey, this is Eric Hagen, BTIG. You guys have historically leaned into securitization as basically the only source of longer term financing. But with all this private capital that's being raised right now in the market, I mean, you think there could be an opportunity to incorporate loan sales into the routine? And would alternative financing sources maybe allow you guys to grow more quickly?

Chris Farrar
Yes. Hi, Eric. Good question. We are getting reverse inquiries from some of these private credit sources. And I do think there's some opportunities for us to put financing in place to grow the portfolio. We have looked at whole loans in the past. I don't expect that will be a big source for us, but I do think that maybe there's some private structures that might work that could help us expand another leg of the stool, if you will.

Eric Hagen
Okay. That's interesting. Thank you. We're looking at the prepayment rate and how it increased quarter over quarter, and I realize these are longer duration assets to begin with and prepayment rate kind of…is less applicable maybe to the strategy, but what's driving that? I imagine it's not really an interest rate incentive because the coupons don't really move around a lot. So, what's the context behind prepayment activity?

Chris Farrar
Yes, good question. So, we've studied that in the past, and we found roughly about half the time folks are selling the property and about half the time they're refinancing somewhere else. So, we've always kind of positioned the firm as a medium term lender that the borrower has some immediate need for capital and they utilize our capital for, call it, one to five years depending on their situation. And then they tend to move on. So, it's pretty typical for our business. As you know, we collect prepayment penalty fees in those cases to maintain our yields. So, we're indifferent if they do choose to leave. It's largely driven by their unique circumstance and their situation and whether or not they're refinancing or selling the property.

Eric Hagen
Got it. That's helpful. Thank you, guys.

Chris Farrar
Sure.

CONCLUSION

Operator
This concludes our question and answer session. And the conference has now been concluded. Thank you for attending today's presentation. You may now disconnect.