

FINAL TRANSCRIPT

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PHH - Q1 2005 PHH CORP Earnings Conference Call

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PRESENTATION

Operator

Please stand by. Good morning, ladies and gentlemen. Welcome to the PHH Corporation First Quarter 2005 Earnings conference call.

[Operator Instructions]

At this time, Nancy Kyle, VP of Investor Relations, will proceed with the introduction. Please go ahead, Nancy.

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Nancy Kyle - PHH Corporation - VP, Investor Relations

Good morning, everyone, and thank you for joining us. On the call with me today are Terry Edwards, President and CEO, and Neil Cashen, Executive VP and CFO.

If you did not receive a copy of our earnings release, please call our investor hotline at 856-917-7405 for a faxed copy, or you may access it on our web site at www.phh.com.

We will be making statements about future results during our call today. Such statements constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and the current economic environment. Forward-looking statements and projections that we discuss are inherently subject to significant economic and competitive uncertainties and contingencies, which are beyond the control of management and are no guarantee of future performance.

Actual results may differ materially from those expressed or implied in the forward-looking statements. For a more detailed discussion of assumptions and risk factors that could cause our results to differ materially from those in the forward-looking statements, please see our recent SEC filings, specifically 10-K for the year ended December 2004, the 8-K information statement filed on January 19th, 2005, and the press release associated with this conference call, which was also filed this morning as an 8-K.

If you need copies of these documents, please call our investor hotline at 856-917-7405 or you may access them at the SEC's website, www.sec.gov.

And finally, during the call, we may be discussing certain non-GAAP financial measures as defined by the SEC. Where required, we have provided a reconciliation of those measures to the most directly comparable measures in the tables in the press release.

And with that, I'd like to turn it over to Terry.

Terry Edwards - PHH Corporation - President and CEO

Thanks, Nancy. That's riveting stuff; I hope everyone's still awake.

Good morning, and thank you all for joining us on our First Quarter Earnings Conference Call. Here's the plan. I'm going to do some brief opening remarks that will link our last the last time we were together with regard to the road show presentation. I'm going to turn it over to Neil. Neil will take you through the quarter. And then Neil's going to bring it back to me, I'll take you through how we see the remainder of the year.

As you can imagine, becoming a public company is a significant undertaking. Some of the things that have kept us busy included multiple meetings with our board and committees, setting up corporate governance public policies and other public company procedures, hiring a small but high quality corporate staff, and switching our reporting structure to a financial institutions format. We expect to file the Q by Monday.

And later this month, we'll be also filing an 8-K, amending our 10-K for 2004, which will reformat our financial information on a basis consistent with the Q.

We've also been communicating with external stakeholder lists such as bankers, potential clients, existing clients, and of course, the rating agencies. And of course, we have been running the business.

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Now back to the road show. As you will recall, the key topics we discussed during the road show were the investment highlights. Those investment highlights were our focused outsource business model, the complementary segments of the mortgage and the fleet business, the growth opportunities, again those were going to come primarily from mortgage business, the proven credit and asset quality associated with both businesses and the experienced and motivated management team that both businesses have.

We also discussed our capital structure of 1.4 billion in equity and the resulting projected ROE of 7%. That ROE was driven by three assumptions. 2005 origination business was expected to be break-even. The servicing business was projected to earn between a 100 million and a 110 million pre-tax. And the fleet business was expected to earn between 70 million and 80 million pre-tax.

Many of you asked us a question, why such a low ROE? And as we said, there were two reasons for that. The first reason is, because we're under-leveraged. However the existing level of equity was required to achieve the investment grade ratings from the rating agencies. Because the rating agencies were concerned about the competitive environment they anticipated PHH was going to face in 2005, and because they wanted to see a new company operate in a highly regulated environment, which many of us know as the SOX world.

Assuming we are able to deal with these two hurdles, we would expect to be able to increase our leverage in 12 to 18 months freeing up approximately 200 million to 300 million of our capital. With this capital our options include buying back stock, which would help drive us towards a double-digit ROE.

The second reason, as we explained for the low ROE is the extra costs we are carrying in the originations business in anticipation of growing market share with existing clients and growing share by signing new clients. We expect the originations earnings to improve over time as we balance the platform with more loan closings.

At this time, I'm going to turn it over to Neil who will take you through the quarter. And then, as I said, at the top, I'll finish our prepared remarks expectations for the remainder of the year.

Neil Cashen - PHH Corporation - EVP and CFO

Thanks, Terry. My remarks today will cover three major points. First will be a general review of the first quarter results including our spin-off related write-offs and tax provisions. Second, a review of the mortgage and fleet segment results. And third, I'll cover the balance sheet and our shareholder's equity at the end of the first quarter.

PHH Corporation has had a solid first quarter. However in reviewing these results, please keep in mind the following.

The historical 2004 results are presented with both Cendant Mobility and Wright Express as discontinued operations. Accounting regulations require us to include STARS, the appraisal business contributing to PHH Corporation in January 2005 in our historical results. And finally in accordance with GAAP, no pro forma adjustments are included in the financial statements.

Keep in mind these pro forma adjustments were included in the 2004 pro forma financial results presented in our January 2005 8-K, and in the road show.

With that as a background, here are some of the highlights of the quarter.

As Terry just mentioned, we have enhanced our financial reporting relative to our GAAP presentation, and we will continue to work to provide meaningful and timely information. We have provided a more detailed breakdown of our revenue components, and you will see more detail by business segment when the 10-Q is filed.

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Now for the financial results. Total revenues for PHH Corporation increased \$59 million or 27% to \$279 million for the quarter. We have enhanced our reporting to present the revenues on a net basis as a substantial portion of the previously disclosed revenues represented the gross billings of operating leases. A large portion of these billings were depreciation and interest components which represent a direct pass through to clients on their bills. And hence we concluded that the presentation of net revenues more clearly represents the performance of the business as opposed to pass through items which are not available to generate profits for the company. We do show the Gross Fleet Lease Income for those of you who want some comparison to past revenue levels.

In terms of the current results, the net revenue growth was centered in Net Loan Servicing Income and we will discuss this in detail in our mortgage segment discussion.

Expenses are broken down between ongoing expenses and one-time items related to the spin-off. The ongoing expenses total \$203 million, a 5% decrease from the first quarter of 2004 levels with all of the decreases occurring in the mortgage segment.

Spin-off related expenses are split between the goodwill impairment of \$239 million in PHH Arval and \$41 million of "other" spin-off related expenses. It is important to note that these spin-off expenses are not included in the segment results as they are one-time items and will cloud the underlying performance of the two business segments.

The write-off of \$239 million of goodwill was related to the fleet business. The goodwill had been generated principally during Cendant's acquisition of Avis, PHH Arval having been owned by Avis at the time of the acquisition. The goodwill had been evaluated on the basis of PHH Arval and Wright Express being considered one segment with one goodwill amount.

The removal of Wright Express from PHH Corporation resulted in an allocation of goodwill between the two companies and the ultimate determination of an impairment at the PHH Arval level. PHH Arval has no goodwill on its books subsequent to this impairment charge. And we had previously disclosed our intention to bake this write-off.

There are two items in the "other" category. The first is a \$37 million negative impact of the prepayment of \$443 million of private placement notes. The \$37 million consisted of a \$44 million make hold provision for the debt, a write-off of \$1 million of deferred financing cost, and an \$8 million gain on the reversal of an interest rate swap, which had been structured to convert the debt to a floating rate basis. We had previously disclosed in our filings our intention to make this prepayment and absorb the impact.

The second item is a \$4 million negative impact for the conversion of certain Cendant stock options to PHH Corporation options for our employees. As previously disclosed, all options with a stock price exceeding \$18 per share were converted to PHH options. This represented approximately 3.2 million Cendant shares. And a \$4 million charge was required to ensure that our employees maintain the same intrinsic value, post conversion to the PHH Corporation options.

Loss from continuing operations before income taxes was \$204 million versus a \$6 million gain for continuing operations in 2004. Excluding the one-time items, the company would have generated income from continuing operations before income taxes of \$76 million, with the largest positive earnings in our mortgage segment. The total net loss was \$250 million, again, due principally to our spin-off related items.

I'd like now to address our tax provision. On an ongoing basis, we are estimating a 41% tax provision. However there are one-time factors relating to the spin-off which have caused our provision to be higher. Of the goodwill write off of \$239 million, \$233 million is not tax deductible, and hence full benefit was realized.

Additionally the contribution of STARS resulted in a \$24 million tax expense relating to the separation of STARS from Cendant upon the spin-off. This tax expense was booked in January of 2005, and will be a non-cash tax expense from PHH Corporation's perspective as it will be included in a consolidated February turn for Cendant for calendar year 2005.

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There was an additional impact of \$4 million caused by PHH Corporation's higher tax provision rates on the deferred tax liabilities remaining on our books relative to the lower provision rate utilized by Cendant on a consolidated basis when the deferred liabilities were created. This one-time impact occurred at spin-off and the deferred tax liabilities had to be revalued.

Finally there was a valuation allowance of \$4 million to reserve for state net operating losses generated during the first three months ended March 31st, 2005. Despite the high book tax expense we are aggressively evaluating tax planning strategies including lifetime exchange to minimize our cash tax payments and ultimately to lower our provision rate.

As discussed during our road show, the fleet and mortgage businesses contain tax attributes, which have historically resulted in our not being a full cash taxpayer.

Now I will cover our segment results. Relative to the mortgage segment results, recognize that our business is focused in the prime mortgage markets and hence we do not benefit from the economics in the sub prime segment. For the quarter, the mortgage segment generated \$61 million of income before taxes.

Before we delve into specifics, let's cover some of our key metrics. The total servicing portfolio increased 4% to \$146 billion. The weighted average note rate is 5.5% versus 5.3% for the comparable period on 2004. Approximately 57% of the portfolio is fixed rate mortgages, which is a slight decrease from the 59% maintained last year.

Total closing for the quarter decreased 16% to \$9.4 billion. As expected we experienced a higher decline in refinanced closings, which decreased 1.2 billion or 27% while purchased closings declined only \$0.6 billion or 9%.

The capitalized servicing portfolio was 1.23% of the related UPB up eight basis points during the quarter. The weighted average servicing fee was 33 basis points, producing a 3.8 multiple at quarter end. Our total MSR value is in line with top industry players. As we have told you, we believe our unique business model generates servicing that prepays slower than the industry, which will provide us future benefits.

In terms of revenues, net revenue growth within the mortgage segment increased 27% to \$222 million, driven principally due to the recovery of a provision for the impairment of the MSR. Specific income changes consisted of the following: • Mortgage fees, which consist principally of fees collected on loans originated for others, and appraisal fees decreased 18% to \$55 million. This decline was primarily related to the 16% decline in total closings, previously discussed. • A gain on sale of mortgage loans declined 6% of \$48 million due to a 3% decline in loans sold and lower margins on loans sold. • Net finance income decreased 45% due to the lower volumes of loans held for sale, the note rate of those loans and higher short-term borrowing costs. • Loans servicing income increased 5% to \$126 million due to a 5% increase in the average loan servicing portfolio.

The amortization and valuation adjustment related to the MSR was impacted by three factors: • Amortization increased \$34 million due to a decline in the weighted average life of the portfolio and an increase in the gross book value of the MSR. • There was a recovery of \$114 million in the MSR valuation due primarily to increased mortgage interest rates during the quarter leading to slower projected prepayments. Twenty-eight million dollars of the recovery can be attributed to the application of the amortization rate to the valuation allowance. • Additionally, a net hedged loss of \$26 million was realized due to a lower valuation of the derivatives related to our MSR assets.

The net result of these three factors was a loss of \$20 million versus a loss of \$93 million in the first quarter of 2004 in the total MSR impact.

Other income declined \$7 million as there were no marketable securities sold in the first quarter of 2005, which is the principal component of other income. Total expenses declined \$15 million or 9% due to lower headcount or lower headcount expenses reflecting the 16% decline in total closings.

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We have provided a net contribution breakdown between production and servicing. Production income relative to our enhanced reporting includes mortgage fees, gain in sale of mortgages and the net finance income. These items aggregate a \$115 million in revenues for the quarter and represent a \$25 million decline from 2004 levels. This decline in revenues is the primary factor driving the \$17 million decline in the net contribution from production. It should be noted that the first quarter is typically a slow quarter for the mortgage segment. However, we continue to focus reaching the \$48 billion target for closings during the year.

The net contribution from servicing totaled \$88 million for the quarter driven by the improved net MSR performance. While the increased interest rates resulted in a very positive first quarter, you should not assume that a similar rise of rates would generate a result in the future.

As Terry indicated, we continue to focus on the core business. It was a solid but opportunistic quarter, and we will continue to focus on new outsourced opportunities.

The fleet segment also had a very strong quarter with income before taxes increasing \$6 million or 60% to \$60 million. It should be noted that PHH Arval benefited from certain of the capital structure movements related to the spin-off, which decreased their interest expense by \$4 million. This positive impact had been reflected in our pro forma 2004 results presented in the road show and filings, so we will continue to see this positive advantage through the remainder of the years when compared to historical results.

Additionally, the results include our acquisition of First Fleet Corporation on February 28th 2004. And therefore, 2005 reflected the full quarter results versus the one month included in 2004. Excluding these impacts, the fleet business still generated 20% plus growth for the quarter.

Key drivers for the business all increased from the prior year. Leased vehicles 7,600 units or 2%, as growth is generally low single digits for leased units. The fee-based services typically grow on a faster basis than the leased units, and we experienced good performance from the prior year. Maintenance units are up 2%, or 7,500 units. Fuel cards were up 8% or 23,800 units, and accident management vehicles were up 7% or 22,000 units.

The total net revenues increased 12 million or 27%. Specific areas of growth included fleet management fees, which includes income from our fee-based services, such as maintenance fuel and accident management, and the management fees on the open-end leases. These increased \$4 million or 12% due to the growth in units, increased transaction volumes and higher subrogation recovery for our clients.

Net finance income increased \$8 million due to the aforementioned \$4 million of lower interest costs due to the capital restructuring, a \$2 million increase of motor company monies retained by the business, which are treated as the basis of judgment, due to higher volumes, \$1 million of improved closed end used car results, and 1 million of other net impacts.

The Fleet Lease Income increase was due to the inclusion of First Fleet, higher leased units resulting in higher depreciation, and higher interest costs due to increased interest rates. It should be noted that over 70% of the leases are floating rate leases whereby the interest component of the lease bill will change in synch with changes in a certain floating rate indices.

Other income, which includes our dealership income and certain programming fees to unrelated parties, was flat on a comparable basis.

Total expenses increased 17% or \$6 million in the fleet segment. Approximately \$2 million of the increase was due to the inclusion of First Fleet Corporation. The remainder was due to higher salaries due to compensation increases and higher direct operating expenses on full maintenance leases.

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Again, fleet had a very good quarter. Our projection of \$70 million to \$80 million of pre-tax income remains our current forecast. However, the comparables to prior years will become less favorable in the third quarter and fourth quarter due to the one-time items, which were booked in 2004.

The balance sheet presentation has also been updated and no longer is presented utilizing our assets under management and liabilities under management approach. We believe this presents a cleaner picture of the business. Wright Express and Cendant Mobility assets and liabilities are segregated in the December 31st, 2004 balance sheet as assets and liabilities of discontinued operations.

We have experienced growth in our mortgage loans held for sale, mortgage servicing rights, and net investment leases while utilizing our cash, the \$100 million equity infusion from Cendant, and cash flow to reduce our debt levels by \$359 million. The result is a balance sheet, conservatively leveraged at a 4.3:1 debt to equity ratio, which Terry has previously addressed.

A key item in our balance sheet is our equity level at quarter end, which is lower than our pro forma forecast. The spin-off of PHH Corporation was completed, effective January 31st, 2005, as originally planned. In both our 8-K and road show filed in January, we provided a pro forma balance sheet based upon Cendant's estimates of the adjustments, equity contribution and true-ups which we believe will be reflected in PHH Corporation's beginning balance sheet.

The estimated equity which is reflected on the pro forma balance sheet was \$1.458 billion. The final adjusted balance sheet, which was in place effective with our spin-off, reflected an amount which was approximately \$68 million short of the pro forma estimated amount.

This shortfall resulted from three principal areas. A \$3 million difference in the pension adjustment due to the final allocation of assets and liabilities tied to the creation of the new PHH Corporation pension plan, a \$7 million shortfall of results in January 2005 for PHH Corporation, which included the Wright Express and Cendant Mobility results. And finally, \$58 million of tax adjustments relating to final true-ups of the pension impact, final mortgage tax position, and an adjustment to the fleet Canadian tax position. Although the pro forma balance sheet indicated that it was based upon best available estimated time, these items were deemed to be appropriate.

Now I'll turn it back to Terry.

Terry Edwards - PHH Corporation - President and CEO

Thanks, Neil. And now let's talk about the remainder of the year and what that looks like. And as we stated in our road show, our guidance was a \$170 million to \$190 million of pre-tax pro forma income after minority interests. And as we stated in the press release we are holding that guidance stable.

The same risks that we discussed on the road show exist today with regard to hitting our targets, our guidance. Those risk areas are our ability to hit the 48 billion in the mortgage closings, and the pricing environment within the mortgage industry.

With regard to the 48 billion, production is dependent on our ability to recapture market share. Recall that our share slipped during the period of time last year when the mortgage company was for sale. In fact, it also slipped in the first quarter, although we were on plan for closings. But market share did slip, as we continue to be hampered by the for sale sign.

The initiative that we talked about on the road show and that we are using to reverse this trend is our MyChoice program. That's where our mortgage advisor can drive customers to the phone, to the Web, or that mortgage advisor can take a face-to-face applications. And this is what we hope to drive additional business with.

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As we stated, we intend to double our field sales force to over 500 mortgage advisors. An update on MyChoice is that it's going well. Where it's been deployed we are seeing market share increases. In fact, capture rate within Cendant NRT operated offices is back to the levels we saw in 2003.

However, in terms of the complete rollout, we are a little behind where we thought we would be. Our territories are about 66% occupied so far. And we hope to complete the rollout by August.

The other driver to achieving 48 billion in originations is signing new accounts. While we've only been back in the market for three months, we're encouraged by the pipeline for new outsourced clients. We're having great dialog with a number of great brands that we would love to have as partners.

So that's the update on the volumes front.

Now let's talk about pricing. Despite what you may have heard from other industry players, the prime credit pricing arena has been very competitive. Margins have been tracking below expectations we set last December. Our theory is that large services are using some of the servicing profits, which is a new phenomenon. Servicing as a new segment hasn't been profitable since 2001. So we think some of those profits are being used to drive origination volume with aggressive pricing.

While this is painful in the short-term, we continue to believe it will cause more financial institutions to take a harder look at their in-house originations business, and elect to outsource their platform. And hopefully were a likely candidate for that outsource.

Our expectation will be this difficult environment will burn out at some point. But we don't know exactly when that will occur. So that takes care of the areas of risk.

Let's talk about servicing. As you just heard from Neil, servicing made money, which included a pickup from higher rates. We estimated that out of the 87 million, 58 million was the net impact of the higher rates. Therefore normalized servicing would have been \$29 million for the quarter.

Assuming a stable rate environment, we would expect servicing to make about \$21 million during the remaining quarter, as payoffs pick up because of the seasonality associated with the housing market. This is consistent with what we have planned for the road show.

Turning to the fleet business, as Neil just said, we expect that to continue to be a contributor of \$70 million to \$80 million on pretax basis. The business -- the fleet business did have a great quarter. And we announce a new service for customers which offers in-vehicle technology for remote monitoring of a vehicle's performance, location, and security. It also includes real-time reporting via the Internet.

While this is not expected to be a significant source of revenue, we'll use it as a value added service in the foundations for new offerings to our clients. It tells our clients that our potential clients, we're the forward thinkers in this business.

With regard to new signings in the first quarter, we had mentioned on the road show, that we expected to sign ServiceMaster, and we did. In addition, within the large fleet segment, we signed five other Fortune 500 companies, representing potentially, another 13,000 units.

We also said we would focus on national fleets. We signed 22 clients there, and now we'll over time, phase in about 4,000 units from those national fleets. And we're also happy to say, we didn't lose any clients during the quarter. So, a great quarter was had by the vehicle business.

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So when you pull this all together, regarding our expectations for the year, our guidance remains unchanged, as we stated. Now the question you would ask is, while with servicing, with the one time hedge gain, when you add those numbers up, when you add up what we expect to make from the vehicle business, you would have to plug in about a \$50 million loss in the originations business to get back to our guidance.

Now you would say, if that's the case, do we expect to lose \$50 million in the originations business? The answer here is, we have modeled out no change in pricing. So if the pricing -- if the competitive market that we're seeing right now -- remains unchanged for the year, which is somewhat unlikely, we could lose between \$45 million and \$55 million in the originations business. And when you meld that with the servicing forecast I provided, with the fleet business, that gets us back into the range of our guidance.

So that said, it's for that reason that we don't want to don't want to go out on a limb, we don't want to over-promise and under-deliver, and therefore we're holding our guidance steady.

At this point, before we open out to questions, I want to thank you for the interest that you've shown in our company. We've learned from the questions you've asked. And your input, and the discussions that we've had with folks like you will ultimately help make us a better company. So we thank you for that.

And at this point, Sara, we will be happy to open it up to questions.

QUESTIONS AND ANSWERS

Operator

[Operator Instructions]

We'll go first to Paul Miller of Friedman, Billings, Ramsey.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

Yes, thank you very much. And I thought your call, your very first earnings call went very, very well.

Unidentified Company Representative

Thank you, Paul

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

Your share count -- you didn't have any share count numbers. I got like -- I'm estimating like \$52.7 million shares, is that right around the ballpark of your share count?

Unidentified Company Representative

Yes, that's the primary. The -- with losses again, its not a fully diluted calculation, but 52.7 is approximately the count that ...

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Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

Do you have a fully diluted number for the income statement?

Unidentified Company Representative

Well, it's technically the same because of the loss, we don't do the fully diluted. However in the Q we disclose that there will be about another 300,000ish kind of units if there was a fully diluted calculation being done.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

OK, and your book value. I'm getting like a 20 -- on a per share basis -- on a book like a 26/34. Is that in the ballpark?

Unidentified Corporate Representative

Yes, there's another 50 million of intangible assets buried in other assets, so you would have to take that out, to get the tangible.

Unidentified Company Representative

To get tangible.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

So OK, by your calculations, what is the tangible book value then?

Unidentified Company Representative

We will work that out. Yes, it's \$118 million round to \$120 million worth of intangibles in the balance sheet. So if you take the equity, minus the sort of 120 divided by the 52.7 on a primary basis that's it. Somebody calculate that out.

Unidentified Company Representative

Yes, I guess, it'll be about 24.86.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

24.86. OK guys. And the other question I had was, your gain on sale margin. You talk about the pressure. I just did a back of the envelope calculation. I would guess I would only use the loans that you're selling, not your fee-based loans? I'm getting a 70 basis points gain on sale margin, is that in the ballpark?

Unidentified Corporate Representative

That sounds a little high.

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Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

Sounds a little high?

Unidentified Corporate Representative

Yes.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

OK, I'm just wondering, I mean for our models, we use a gain on the sales number on the model. I was just wondering, what type of gain on sale numbers? Could you talk about how the pricing -- you are getting some price competition out there. You don't think this number goes negative, is that what you're alluding to, with the possible loss in the mortgage banking space?

Unidentified Corporate Representative

No, that number doesn't go negative. But, it's not where it's been, where it was, say last summer.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

OK, and do you know what your pipeline was? And loans -- applications that you haven't closed yet?

Unidentified Company Representative

No, that's not a number that we prepare. That's, you know, we recognize that's the number that others provide, but that's not a number that we prepare.

We can tell you that we did hit our closing targets for the month of April. So we're still on plan, for our 48 billion through April

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

And then there's -- and you said you had 500 mortgage advisors, as of March 31st, am I correct?

Unidentified Company Representative

No, our goal was -- you know as we came into this year, we had about 250 people in the field. We operate two platforms, one where we use traditional loan officers and the other where these 250 people used to drive business through the telephone.

We're taking those 250 people, doubling them to 500, and then give them the ability to also take applications. So that's about -- we're about 380 now, on the way to 500 of that type, what we call mortgage advisors.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

And I know you guys are a prime lender, but if you -- are you planning to expand your product mix? I know you don't really want to get into sub-prime -- never heard you actually talk about sub-prime, but devoid of Alt-A, a lot of different ARM products out there. The product mix today versus just a couple of years ago is just tremendous. I mean can you talk about a little bit about what your product mix could be, looking forward?

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Unidentified Company Representative

Yes, we'll do Alt-A. Our goal is to help customers of our clients buy homes. And so that hasn't been -- debt consolidation is where sub-prime activity goes on, that hasn't been a big driver for us. And hence, we haven't ventured into the sub-prime market. It's about 2% of what we do. We'll do the Alt-A. We're watching what others have done with the option ARM program and we're evaluating that. It's not a product that will tell you that if we look at 12 to 15 months ago, we would have been big fans of, but at some point, if you can't beat them, join them had to come into play. So we have to evaluate that.

In the operations that we operate in the field, where we do more traditional loan officer business, where some of our folks are able to broker business and that shows up in our reporting as fee-based business. Some of our folks argue a lot in the option ARM program.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

What about the 80-10-10 products?

Unidentified Corporate Representative

80-10-10 we do. We have a systems change going in place, later in July. We've been a more traditional mortgage insurance provider. It's a little bit clunky for our people, meaning you have to work with the technology. You have to go out of scope if you will, in order to do an 80-10-10. That technology will become seamless in July. So we would expect that we will do more 80-10-10 business beginning then.

Paul Miller - *Friedman, Billings, Ramsey and Co. - Analyst*

OK, thank you very much.

Unidentified Company Representative

You're welcome Paul, thank you.

Operator

We move next to Ed Groshans.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

Good morning. You mentioned in talking about pricing and rates and things on those lines. What I want to get into is a little bit on the derivative gains or the MSR risk management, as you put it.

You know, we've basically seen the 10-year back up all the way if not given up all the gains that we achieved in the first quarter. How does that come into your guidance, for the year looking forward?

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Unidentified Corporate Representative

We mark our market on the year on the servicing book everyday. And as we sat, when the 10-year was at 420, the other day, we were sitting our hedge position through this quarter, would have been about \$5 million in the hole.

So what that tells you is, when rates ran up towards the end of the first quarter, and we got up towards the 450 type 10-year, one of the things we rely on, is the natural hedge. Or in the 10-year treasury, we're sitting at 450, a real pickup from originations could not be expected, until you got back down, to around 4%. And then it really gets hot and heavy in terms of volume when you get down to a 380, 10-year treasury.

So, at that 450 level, we put more financial hedges on because we couldn't rely on the natural hedge because we were so far away from 4% and 3.8%. So, as I said at 420, we are about \$5 million in the hole. At 413, we're probably about \$10 million or \$12 million in the hole. And if the rates continue down, we'll consider lifting more hedges, as we get closer and closer to the natural hedge.

Therefore if the rates were to go back to 450, we would be back in the position of having a modest hedge gain. If rates were to sit at this level, or drift lower, we might have some hedge losses, but turning it back to our overall guidance, we would expect it to bid this overall and the industry would be pretty robust. And therefore we would expect originations pricing to pick up. And therefore that would offset some of the loss.

Ed Groshans - Fox-Pitt Kelton - Analyst

So you expect to see better gain on sale margins?

Unidentified Corporate Representative

Yes, we would expect to see better gain on sale margins if, you know, the 10 years of 413, as we speak I guess.

Ed Groshans - Fox-Pitt Kelton - Analyst

Right.

Unidentified Corporate Representative

If we sit at that level, we would expect that 35 would continue. We would expect that we would get into the typical higher housing market that exists in the May, June, July period. Therefore volume picks up and we would hope that others would enhance their pricing, and that enhanced pricing would offset that \$12 million potential hedge loss that sits there as we speak

Ed Groshans - Fox-Pitt Kelton - Analyst

And then the \$12 million you're talking about or the \$5 million on hold, is that related -- if I'm looking at -- that would be the 58 million in this quarter?

Unidentified Corporate Representative

Yeah, it would be on an apples-to-apples basis with that 58 million that we made in the first quarter and an apple-to-apple basis, we'd be sitting 425 million in the hole and 413 plus \$12 million in the hole.

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Ed Groshans - *Fox-Pitt Kelton - Analyst*

And in your price ratio, you talk about part of the reason that the origination activity had a loss was because of the excess capacity that you're maintaining for the partnership. So could you just get into - have you started to move into those partnerships or are you ramping them up, or are they in negotiations?

Unidentified Corporate Representative

We are in negotiations with some, and we are having nice dialogue with others. But I would caution you, bringing all the accounts on takes time, and so I just want to caution you on that. There's no reason to say, start plugging it in the street. This is a business we are going to be out for a long time and we expect to sign accounts for a long time. But we are encouraged by the dialogue we are having.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

OK. In the fleet business, as you go forward, do you -- you say the goodwill's all gone now due to the restructuring charge from the spin-off. Going forward goodwill will only be achieved through additional acquisitions? Or is there some other things in the business that start to develop the goodwill.

Unidentified Corporate Representative

Basically the goodwill we had was tied to an acquisition and there's nothing going on -- we have a -- first week that we made an acquisition in 2004, there was a little bit of a earn out, which could create a little bit of goodwill, couple of million dollars in the next year. Other than that, incremental would have to be another acquisition that we made incremental for that.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

And the returns -- I'm not too familiar with the fleet business but looks like they are fairly stable, generating business. And do you look at it from a cash flow yield standpoint or anything on those lines?

Unidentified Corporate Representative

Well, as we said, or I said in my presentation, it has tax attributes that are usually favorable, them not being a full cash tax payer, which allows the -- if you will, cash return to be higher than the GAAP book return. So my answer to you is, yes. I mean, we look at it in terms of the profits it's generating and the cash flow shelter it provides to itself and possibly mortgage to the extent that we have excess to and they have income. So we contemplate that cash flow advantage when we look at the business.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

And if I'm looking at the fleet management business do you know, is there some sort of normalized run rate you look at for growth? Not necessarily the target that you have but, like historically how fast the business has grown?

Unidentified Corporate Representative

Now we felt -- we've suggested that people model that business flat. Although there are lots of positive things happening we still like people to model that business flat. We'll be the first ones to tell you when to model it up.

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Ed Groshans - *Fox-Pitt Kelton - Analyst*

OK, and what would be additional signings that would lead to pick up in the business?

Unidentified Corporate Representative

Well, we're in the large fleet business, and we have a lot of large fleets -- national fleets that are very competitive. So I think my view is it will not likely be pricing increases. So it will be a mix of more units, maybe some more products -- some product stuff that we can add on to it. But it would be that kind of driven, not that we have pricing powering. And so it would not be pricing, it would have to be unit growth or product growth.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

So it would be growth on margin or incremental types of growth but nothing -- is that kind of about right?

Unidentified Corporate Representative

Model it flat.

Ed Groshans - *Fox-Pitt Kelton - Analyst*

Model it flat, all right. Thank you very much gentlemen.

Unidentified Corporate Representative

You're welcome, thank you.

Operator

We move next to Basswood Partners, Adam.

Adam Weinrich - *Basswood Partners - Analyst*

Good morning. Two quick questions please. Could you tell us what the amount of entitlement reserve was at the end of the quarter? Presuming that you currently account for it on a low-comp basis, do you have any intent to change that?

Secondly, you may have already said this and if so, I apologize. But as you mentioned before that you think you are under-levered given what the rating agencies want for you at this point in time. If that's the case, could you tell us what your target leverage is in a year or two?

Unidentified Corporate Representative

I would say our target would be a number like 6:1 from a leverage standpoint. And with regarding the number on the valuation reserve, it's approximately \$442 million.

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Adam Weinrich - Basswood Partners - Analyst

So you have quite a ways to go before you would have your MSR of the market-value MSR more than the book value.

Unidentified Corporate Representative

Yes. And then hopefully the accounting that's been talked about, their value accounting hopefully will go in place sometime 2006. So we got enough to hold up to 2006.

Adam Weinrich - Basswood Partners - Analyst

Right.

Unidentified Company Representative

We might have an issue on a particular bucket level because you have to look at it bucket-by-bucket. So, some of our ARMs might be capped out. Some of our hybrids might be capped out. But overall, we have \$440 million to work with.

Adam Weinrich - Basswood Partners - Analyst

Thank you very much.

Unidentified Company Representative

Thank you, Adam.

Operator

We'll hear next from Daniel Beltzman of Huron Capital.

Daniel Beltzman - Huron Capital - Analyst

Hi guys.

Unidentified Corporate Representative

Hi, Dan.

Daniel Beltzman - Huron Capital - Analyst

Quick question. Just if and I want to be very careful. I realize that you have not been in control of your own books up to this point. I congratulate you on the ability to move forward with this. But I think it would be useful if you could tie in at least present something that showed how the book value has moved. Because the assets have moved quite a great deal as well.

And it's unclear to really see from the pro formas that were presented to us how we end up where we are today. And that includes the stockholders equity. All of these, it's as if you didn't have two quarters of earnings. That should in theory have

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accreted over time, that don't seem to be in these numbers as well. And I realize this isn't you guys. That Cendant was in control of these numbers. So, I'm by no means I'm holding you guys accountable. But if there's anything you guys could present to us that give us greater clarity.

Unidentified Corporate Representative

Yes I think that the, when you get the Q which will probably be Monday or -- Monday it'll be filed, to get it more -- there is a statement of shareholder's equity there that shows the world forward that has -- gives some detail there.

Daniel Beltzman - *Huron Capital - Analyst*

OK.

Unidentified Corporate Representative

So if you would, I would start with that. And then we can have sort of an offline conversation after that if you want to go into that in more detail. But that will give you some idea.

Daniel Beltzman - *Huron Capital - Analyst*

All right. And congratulations, guys. I mean you guys have done a great job on presenting everything absent, what the adjustments have been. So thank you for the greater clarity. I appreciate it.

Unidentified Corporate Representative

You're welcome, thank you.

Operator

Up next from Davidson Capital Partners, we'll hear from Phil Hilal.

Phil Hilal - *Davidson Kempner Partners - Analyst*

Congrats on the good quarter, guys.

Unidentified Corporate Representative

Thanks Phil.

Phil Hilal - *Davidson Kempner Partners - Analyst*

You mentioned earlier that you marked the hedge book to market every day. I was just wondering how the correlation trends have been tracking versus their requirements for FAS 133 hedge accounting?

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Unidentified Corporate Representative

We don't do hedge accounting because we've got that the valuation reserve to work with. It's not something that we need to be using right now. And again as I said, hopefully the fair value accounting will come into place sometime in '06.

Phil Hilal - Davidson Kempner Partners - Analyst

In terms of our current hedging practices though, to anticipate that meeting the standards for hedge accounting would require a change in how we currently manage the hedge book?

Unidentified Company Representative

No. We do not. We think if we needed to, we could go to FAS 133. And we will get the correlation.

Phil Hilal - Davidson Kempner Partners - Analyst

Great. And then the last question was: what is the status of the equity compensation program for executive officers and directors?

Unidentified Corporate Representative

The compensation committee is actually looking at it to be honest with you. So the long-term incentive plan has not been approved by the compensation committee.

Unidentified Corporate Representative

Well, we did have a charted grant. We had a charted grant shortly after the response. And then we got a long-term incentive plan, grant that will be done sometime in June. And, but we've got, we've got to operate within 7.5 million shares which have been approved. Right now the total number of shares that are outstanding under that plan are about 5.9 million.

Phil Hilal - Davidson Kempner Partners - Analyst

So of the total amount of equity that would be expected to be granted to directors and senior officers and keep to a certain stock price in terms of restricted stock grant or stock options. What fraction of that has been fixed? And what fraction of that has yet to be struck?

Unidentified Corporate Representative

Look, there's 5.9 million shares that have been set. And then we've got the difference between that 7.5 million as options and/or grants that can be given out in the next couple of years.

Phil Hilal - Davidson Kempner Partners - Analyst

Got it. Thank you.

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Operator

Our next question for today comes from Robert Roell of American Express.

Robert Roell - American Express - Analyst

Hi good morning. Thanks for taking my call.

Unidentified Company Representative

You're welcome, Robert.

Robert Roell - American Express - Analyst

I've got several questions actually. Terry, you almost answered my first, part of my first question here in your final comments. So I just want to go through all the numbers to make sure that I understand exactly what's going on.

So if you, so in the quarter you had an unusually large net MSR write-up. And I guess the first question I ask is, if I just look at the, on the short page it is in the supplement. But the 114 million versus the hedge loss of 28 million. It looks like the hedge ratio is about 25%, which is as low as it's ever been based on historical data that you've provided. Usually it hedged out closer to 1:1 or 90%. And so my first question is, how did that actually happen in the quarter?

Unidentified Corporate Representative

The way -- that hedge ratio is not correct by the way. We were far more hedged than you mentioned. The way it happened is shortly, as luck would have it, shortly after we were spun, the 10-year treasury worked its way down towards 4%.

As we get down to that 4% level, the level I was talking about a little bit earlier, the chances of refi mainly are picking up. You're getting closer and closer to that level again. In that environment, margins pick up. Volume picks up. So we bake that potential -- when we rechalk our portfolio, we bake into that rechalk to pick up from what's called the natural hedge should rates dip down to the 380 type level.

As a result, we're relying on the natural hedge in the overall financial hedge related for, related to the servicing. So when the 10-year treasury gets down to 4% we look at our overall look and we say, you know on a quarter basis we might experience losses but if, if rates went to 380. But if they went to 380 and stayed there we would have significant business come over, come in overtime that would more than offset those losses.

Therefore we made the call to say let's lift some of the financial hedge just in case rates go down. And as luck would have it, shortly after we were spun, you know the 10-year went up to 450. And then as I stated, we covered up as quarter end came along. Because if rates went back down, we weren't going to be able to rely on the natural hedge until rates got all the way down to 4% or 380.

Therefore we, we potentially would have had \$30 million or \$40 million loss. Almost a million dollar loss per basis points as rates went down. To avoid that, we covered up the hedge. We covered up. Now as rates have been trending back down as we hit levels like 420. As we hit levels like 418. Yesterday we peeled a little bit of the hedge off when we hit 418.

Because we look at what's our exposure down 20, and down 25 basis points. And at that down 20 and 25 basis points you're now down below 4% where rates would pick up. And you would where origination volume would pick up. Margins would pick

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up. So you baked that into financial hedge, into the financial hedge, therefore you lift. You bake that into the overall hedge. Therefore you lift some of the financial hedge.

Robert Roell - American Express - Analyst

I see. So you actually did reduce. You lightened up on the hedge early in the quarter. And then covered up right at the end?

Unidentified Company Representative

Yes.

Robert Roell - American Express - Analyst

And so now based on where it's now what would we expect the hedge ratio to actually be at or pro forma going forward, right now?

Unidentified Company Representative

Yes. It's 85%, 90%. We view it as -- our goal is to always be hedged. Although we tried to build in a little bit of upside, if rates could run up. Therefore, and the way you see that is you spend money on some options to cover the portfolio. So you got limited loss, the loss of the option value if rates rise. But it's not as expensive as trying and putting a swap on which is a linear relationship.

Robert Roell - American Express - Analyst

OK. And I'm not sure if the CPS figure I'm going to quote is accurate because I excluded the amortization that you plugged in against the MSR write-up. But I think overall amortization looked like it was about 19.5% on an annualized basis which seems about in line with everybody else.

But the write-ups. The question is, the write-up was, net of the hedge was \$0.98 a share after tax and you, I think so, reported excluding the restructuring charges. And you reported \$0.87 a share after tax. So, and Terry you alluded to this in your comments, so you basically are effectively reducing guidance for the rest of the year, because of the challenging environment on the production side.

And so my question is, I guess my question is, is that correct -- that the correct read?

Unidentified Corporate Representative

Well the correct read is we have run a scenario that said if pricing doesn't change from where we were the other day, before the 10-year tracked 420. If pricing did not change for the entire year, we would have between a \$45 million and \$55 million loss in the origination segment.

We reported 26 million loss for the first quarter. So approximately \$29 million potential more loss from the origination segment for the remainder of the year, if a) we hit the volume and b) prices don't change. But when you put that in with the expectation that we've got the hedge gain, our overall guidance as a company would remain unchanged.

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Robert Roell - American Express - Analyst

So the assumption is pricing unchanged and you hit your 48 billion, is that correct?

Unidentified Company Representative

Yes.

Robert Roell - American Express - Analyst

So I guess, the question then becomes, so the volume was 9.4 billion in the first quarter, which is down 16.5% year over year, in an environment where the market actually grew 4% year over year. And the top 40 mortgage originators grew 8% year over year. This is according to Inside Mortgage Finance. So you've, I mean you've lost market share again seemingly. And you sort to be seem to be on sort of the low end or below expectations on the volume side.

So I guess at this point, what is your response to that? And how do you sort of manage through that to get to the 48 billion?

Unidentified Corporate Representative

Our response to that is 1) a lot of that impact was the result of being for sale. A year ago, we lost the Fleet relationship because they were acquired by Bank of America. We were also unlucky in that USAA after a period of five years had fully in-sourced its program. So when we look back quarter over quarter, there is -- those two combined accounts were over a billion dollars in lost originations on the look back quarter over quarter.

Because we were for sale all last year, we weren't able to replace the Fleet relationship or add any other relationships. Because no one knew what our destiny was going to be. And at the same time last year we watched some of the larger players, add more and more loan officers to the Street.

So our response is twofold. One we are back in the market. And we'll sign more accounts. Two, we are changing the tires on the cars as we were being spun off, meaning that whole mortgage advisor, MyChoice concept we're talking about, all our people had to come in out of the field, had to come in and get retrained. They had to go on an entirely new comp plan, which is all variable.

We are out there recruiting additional people. And we had to get through this spin. So, all those things. Our market share slipped during the year last year and as I said in the remarks, our market share continued to slip during the first quarter.

The positive is within the Cendant world, within the NRT world, our market share is moving up again. In fact it's back to levels that it was in '03. So we're seeing that tide turn. We're seeing the MyChoice work. And we are actively talking to accounts. And to the extent that we sign accounts. That's new market share.

In addition, our business is more purchase than others. And the first quarter is seasonably impacted by the purchase business -- by the lack of purchase business. So that's something that hurts us also.

Robert Roell - American Express - Analyst

OK. What was the NRT capture rate in the quarter?

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Unidentified Corporate Representative

It's around 17%.

Robert Roell - American Express - Analyst

And that's up from what?

Unidentified Corporate Representative

We had gotten down to the, we had been down in the 15% type range.

Robert Roell - American Express - Analyst

OK. And then I just, as long as we're on the volume. I just want to ask the question I think Paul Miller brought up products. And as you all know that the market in the last several years has evolved and changed quite a bit with respect to mortgage products. How much of that you think is responsible for your loss of market share?

Unidentified Corporate Representative

As we look at why we're losing volume, it isn't sub-prime. And to some extent basically the amount of options ARMs that are been out there, you have to say it's having some impact. Although we do have an attractive short term ARM that does not come with negative amortization.

So what would, I would be an idiot to say no impact. It's had some impact. I can't put a number on it for you.

With regard to these other products, we work very closely with the agencies. And the agencies have gone all day and have gone down market. And as those guys go down market, our systems slugs in seamlessly with those folks. And so we're doing those all day. And we're sub-prime -- and sub-prime loans where people are actually buying some homes with sub-primes. But again, it's a limited percentage of what we do.

Robert Roell - American Express - Analyst

OK. And would you care to comment on how much new outsourcing business you're assuming in the 48 billion?

Unidentified Corporate Representative

We are not assuming anything in the 48 billion.

Robert Roell - American Express - Analyst

not assuming anything. OK is that...

Unidentified Corporate Representative

We are assuming a lot of things go right with MyChoice. So that does not mean that the 48 billion does not have any risk associated with it. But in terms of new signings, we don't have any baked to the plan.

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Because those signings, they might not come till late summer or early fall. And they really won't get ramped up till later in the year.

Robert Roell - *American Express - Analyst*

OK. And with respect to the guidance and potential operating losses in production, how are you, what kind of expense increases are you baking in for the added staff? How should I think about modeling expenses?

Unidentified Corporate Representative

Well, that staff is already on board.

Robert Roell - *American Express - Analyst*

The 500,000?

Unidentified Corporate Representative

The people we are adding for the sales force. Those guys have all come in on in variable basis, variable comps, pure variable comps. So the expense is the minimal.

Robert Roell - *American Express - Analyst*

And they earn no base salary?

Unidentified Company Representative

No base salary.

Robert Roell - *American Express - Analyst*

OK. Last question with respect to the joint venture we train them...

Unidentified Company Representative

You're sure this is the last one? Rob, we're having such a good time.

Robert Roell - *American Express - Analyst*

Well, I could come with more. For now, I guess this might be the last one. The joint venture, I'm sorry. With respect to that, is that a revenue sharing agreement or is that a profit sharing agreement?

Unidentified Company Representative

Profit.

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Robert Roell - *American Express - Analyst*

It's profit.

Unidentified Company Representative

Yes.

Robert Roell - *American Express - Analyst*

And that kicks in when?

Unidentified Company Representative

That we expect to go operational sometime around August 1.

Robert Roell - *American Express - Analyst*

And that's, so you basically will pay Cendant 49% of your profit on NRT business. Is that right?

Unidentified Company Representative

NRT and relocation business done via Cendant Mobility.

Robert Roell - *American Express - Analyst*

OK. Is that in the guidance?

Unidentified Company Representative

Yes.

Robert Roell - *American Express - Analyst*

OK. That's all I have at the moment. Thank you.

Unidentified Company Representative

Thank you, Rob.

Operator

We'll move next to Brandon Stranzl of BGS Partners.

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Brandon Stranzl - *BGS Partners - Analyst*

Hey guys. How are you doing?

Unidentified Company Representative

Good. How are you?

Brandon Stranzl - *BGS Partners - Analyst*

Congratulations on your first quarter as a public company.

Unidentified Company Representative

Thank you very much.

Brandon Stranzl - *BGS Partners - Analyst*

Just one question with respect to the strategy of getting market share back and keeping your infrastructure in place. Just from the perspective of considering the risks involved. In the event that things don't happen according to plan, how easy is it for you guys to resize the cost structure and get back to the profitability? If your eventual volumes don't get to where you expect, is it very easy for you to resize the business accordingly?

Unidentified Company Representative

Obviously, one should do it if one needed to do it. It wouldn't be easy. It's not anything we want to do. We are allowing attrition to do some work for us where people either get managed out of the business because they're not performing to our standards. Or they decide that the mortgage business is not one for them.

That said, we are very confident, based on the discussions that we're having. Based on the degree of difficulty that exists around the mortgage platform today. And we hear that from the people that are talking to us.

We are very confident that we'll add accounts and we will get the balance of the origination -- the originations volume and the platform balanced via new signings coupled with some level of attrition.

Brandon Stranzl - *BGS Partners - Analyst*

And just generally speaking how are people feeling being a separate entity? How is the team feeling? Are people are excited? Are they nervous? What sort of morale doing?

Unidentified Company Representative

Morale, given that the vehicle business has been, was independent, was a part of Cendant. Was a part of Avis, was a part of Cendant. So those guys have been through it. They have been independent before and they like the independence. Many of the people were here way back beyond 1997.

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Not that any of us had any issue with being a part of Cendant. It's a great company. We think it's a great company today. And will continue to be a great company. And we're going to be, we're proud to say it's a large account in mortgage business and we expect it to be for a long time.

With regard to morale in the mortgage business, having been operating not knowing who is going to own you for most of 2004, morale is terrific. Now that people understand and control their own destiny.

Brandon Stranzl - *BGS Partners - Analyst*

I'm just trying to understand that the people are excited at the opportunity to build the business on their own without the constraints that might have been involved ...

Unidentified Company Representative

... Absolutely, positively.

Brandon Stranzl - *BGS Partners - Analyst*

OK. And they just one final question quickly on numbers. Do you have the average, the average size of the loan originated or the number of loans originated in the first quarter by any chance, handy? Or will that be in the 10-Q?

Unidentified Company Representative

The average loan size is 201,000.

Brandon Stranzl - *BGS Partners - Analyst*

201,000. So it's increased significantly since the past I guess?

Unidentified Company Representative

Yes, that's one of the things we need to get done. We recognize that that's the weakness we have, loan size.

Brandon Stranzl - *BGS Partners - Analyst*

OK. And then just could -- would it be possible for one of you guys to walk through the calculation of how you get to the 123 basis points because we just did it and came up with something more like a 115 basis points of servicing asset divided by unpaid principal balance.

Like I mean if the end of the quarter was 146 billion, and you have a 1.692 billion, we're coming up with something like a 116 basis points.

Unidentified Company Representative

Yes. You probably have got warehouse loans in the calculation.

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Brandon Stranzl - *BGS Partners - Analyst*

OK.

Unidentified Company Representative

And they don't have any value yet.

Brandon Stranzl - *BGS Partners - Analyst*

Got it.

Unidentified Company Representative

But that would be detailed in the Q, which you should have by Monday.

Brandon Stranzl - *BGS Partners - Analyst*

OK great. Just wanted to say again, congratulations on a successful spin and we look forward to -- and see what you guys execute on the business plan.

Unidentified Company Representative

Thank you.

Brandon Stranzl - *BGS Partners - Analyst*

Talk to you later.

Operator

OK. We'll move now next to Art Winston, Pilot Advisors.

Art Winston - *Pilot Advisors - Analyst*

Terry, congratulations on a great quarter and really an excellent presentation.

Unidentified Company Representative

Thank you, Art.

Art Winston - *Pilot Advisors - Analyst*

And maybe one suggestion if I might. Maybe you can limit the question to each guy after about 10.

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I have two questions. Would it be off the track or wrong to say that the company has about \$6 billion of investment in fleet leases and plus mortgage loans held for retail. And same amount of debt so that really the amount of debt in the company from your perspective or even mine, is not that great. Or is that incredibly wrong to look at it that way?

Unidentified Company Representative

Yes, I think historically if you go back, PHH Corporation had its assets under management and liabilities under management, kind of approach. Where the assets under management included the two categories you were talking about there. And I think that net to net you're right. Virtually, all the assets were in the assets category. The debt really supported those assets.

So there is very little debt other than supporting the loans held for resale, re-MSRs and the book value of the leased units.

Art Winston - Pilot Advisors - Analyst

OK, so I'm more on the right track than wrong track, looking at it that way.

Unidentified Company Representative

Yes, right.

Art Winston - Pilot Advisors - Analyst

OK. So one another question on the profitability of mortgage servicing. We know we have 114 million recovery of the MSRs. And we have 106 millions of net loans servicing income.

I'm curious, what would be if more or less the cash in and cash out or the cash profits from servicing at a time like this? Is it positive or is it negative? What's the cash profit on this thing?

Unidentified Company Representative

The servicing is cash positive but then to the extent we're doing a decent volume in originations, will eat up some of that cash with the originations business.

Art Winston - Pilot Advisors - Analyst

With the (inaudible) going it to servicing?

Unidentified Company Representative

Yes.

Art Winston - Pilot Advisors - Analyst

But do the cash -- there is a definite positive cash flow from servicing by itself?

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Unidentified Company Representative

By servicing by itself, yes.

Art Winston - Pilot Advisors - Analyst

That's all right. All right, thank you very much.

Unidentified Company Representative

You're welcome.

Operator

Joel Jolson of JMP has our next question.

Joel Jolson - JMP - Analyst

Hey guys, I promise to ask only one question here. And it's little bit clarification of a few earlier ones. Just so to understand clearly here, did the previous guidance that you had include MSR gains?

Unidentified Company Representative

It did not.

Joel Jolson - JMP - Analyst

OK so the ...

Unidentified Company Representative

Previous guidance would have been 100 million to 110 million of earnings in the servicing platform. Zero earnings from the origination platform. And 70 million to 80 million of earnings from the vehicle platform.

Joel Jolson - JMP - Analyst

OK. So just, so I understand this thing, its kind of clarifying, I think someone's previous question. Since you're current guidance now does include I guess what ended up being, I mean if I look at your numbers \$0.66 net after tax on the head, on the gainer right.

Does that mean you're lowering your numbers for the year?

Unidentified Company Representative

What we have tried to explain and maybe we haven't done perfectly Joe, is the reason for not taking our guidance up is because the risk associated with the pricing that we see in the originations business.

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Joel Jolson - *JMP - Analyst*

No, I got that and I appreciate that it makes sense to be as conservative as possible particularly given some current transfer rational pricing. I just want to make sure I understood that because it was a little confusing.

So I mean if your new guidance ends up being what happens for the year, then for those of us that would just exclude these kind of, hedge gains or losses kind of unpredictable in nature and not core. Your real number for the year would be closer to a \$1.40 or something, \$1.35/\$1.40?

Unidentified Company Representative

You've taken out the 58 million. That would be ...

Joel Jolson - *JMP - Analyst*

Well, if you had a \$58 million I would take that out too is what I'm saying?

Unidentified Company Representative

Yes I understand and ...

Joel Jolson - *JMP - Analyst*

So I just, is that right?

Unidentified Company Representative

I agree with your assessment.

Joel Jolson - *JMP - Analyst*

OK well. I really like all the disclosure. I just add to what other people said. It's really good to get all these numbers for people like us that like to pore through these things. I appreciate that. Thank you.

Unidentified Company Representative

You're welcome.

Operator

Up next from Galleon, we'll hear from Will Keaton.

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Will Keaton - Galleon - Analyst

Just to reiterate, I think I missed that. You said that the real number taking out the 58 gain is really 140 for the year? That's what we should think of before excluding some of these adjustments?

Unidentified Company Representative

You're taking 58 away from 190?

Will Keaton - Galleon - Analyst

Yes.

Unidentified Company Representative

And 180?

Will Keaton - Galleon - Analyst

OK.

Unidentified Company Representative

That's a way to look at it but again that assumes no improvement in pricing for the rest of the year.

Will Keaton - Galleon - Analyst

OK.

Unidentified Company Representative

And you also have to, when we said that, when we model that, when we look at that recognize that if interest rates move in one direction or the other that's going to change.

Will Keaton - Galleon - Analyst

Right. And so I guess I'm just -- if there is some level of 10-year that you think of in your guidance range? The high end versus the low end?

Unidentified Company Representative

I didn't quite hear the question.

Will Keaton - Galleon - Analyst

Is there a level of the 10-year, to use that as a proxy? Do you think of that frames your guidance range?

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Unidentified Company Representative

Yes. That would have assumed that the 10-year just sat there between 420 and 430. So when we modeled up, no change. Pricing doesn't improve at all in the prime sector of the business. And we hold that for all year.

And this servicing would have made the \$21 million a quarter for the remaining or remainder of the year. And the vehicle business does the 70 to 80. That assumed a 10-year of 420 to 430 if you will.

Will Keaton - Galleon - Analyst

OK. Thank you.

Unidentified Company Representative

Right now based on the structure of the hedge, if the tenure backed to 10-year we'd have more hedge gains. But you can show us now that you all don't count those so maybe we won't root for those anymore.

And then if the rates went lower, we might have some hedge losses but we'd expect the origination business to get healthy.

Ultimately for us, the key driver is we've got to sign additional accounts. Additional accounts to give us the volume necessary to cover the fixed cost with running the high service platform that we run for our clients.

Will Keaton - Galleon - Analyst

OK. And now thinking about second quarter, and inclusive of your MSR risk management activity, you mentioned that 58 really looks like a loss of 12 million now? I mean should we -- if rates stay where they are now, should we expect sort of a breakeven type second quarter on just a no-adjustment basis?

Unidentified Company Representative

Don't want to go there, Joel.

Will Keaton - Galleon - Analyst

Will.

Unidentified Company Representative

I'm sorry. I'm sorry. Will, don't want to go there.

Will Keaton - Galleon - Analyst

OK. I mean, am I thinking about that correctly? I mean it seems that the mortgage servicing segment, all else equal with this level or at that level of loss would offset basically your fleet management income for the quarter breakeven ...

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Unidentified Company Representative

The 12 loss in the servicing would be -- or from the servicing, if we just sat here would be taken away from the \$21 million gain. So then you've got a profit net from servicing.

And then we've got, whatever we were able to do with the originations business for this quarter.

Will Keaton - *Galleon - Analyst*

The production is running at the loss currently?

Unidentified Company Representative

I would -- yes, possibly.

Will Keaton - *Galleon - Analyst*

OK. Thank you very much.

Operator

Moving next to Steve Gavios with Jenison.

Steve Gavios - *Jenison - Analyst*

Thank you. My questions have been answered.

Operator

We'll go next to Robert Roell with American Express for a follow-up question.

Robert Roell - *American Express - Analyst*

Hi, it's me again. I lied, I have more questions. Just back to the gain on sale margin. I believe Paul Miller touched 70 basis points. I think I was calculating a number similar to that. Just taking -- and this is just taking the 48 million gain on sale over the loans, over to the 6.4 billion. Not sure how else to calculate that number. But you suggested it was actually lower than that. My question is -- it seems -- I'm sorry, go ahead.

Unidentified Company Representative

It's actually running, that 70 number was pretty close to where it's at.

Robert Roell - *American Express - Analyst*

It is. OK. OK, that makes sense. That's the right amount, right?

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Unidentified Company Representative

Yes.

Robert Roell - American Express - Analyst

OK. So the question is, that seems a bit inconsistent with what some of other major mega-lenders have said about the market. If I just quote Countrywide, I mean they've said -- largest player in the market, right -- they've said that pricing has actually been fairly rational is what they said. And they actually put up a 124 basis points gross gain on sale in their prime business. And they have a big wholesale and corresponding channel, which are less -- theoretically less profitable than your retail channels.

My question is, where is the disconnect? Where am I missing in your commentary versus your commentary?

Unidentified Company Representative

I can't tell you. A lot of their profits, Countrywide runs a great shop. Runs a fabulous shop. We'd love to be just like them someday.

A lot of their earnings are coming from the sub-prime and they've mentioned a lot of what was driving their earnings on their call were the option ARMs. We don't have the percentage of the sub-prime. We're not running the option ARM. So we think that that is eating their profitability.

Robert Roell - American Express - Analyst

You're probably right. I'm sure, I mean definitely the mix has an impact.

How much of your production is -- with respect to that -- how much of your production is straight-up 30-year fixed rate mortgages?

Unidentified Company Representative

It's running about 55%.

Robert Roell - American Express - Analyst

55% of the total.

Unidentified Company Representative

Yes.

Robert Roell - American Express - Analyst

OK. And the last question. And I promise you, this is your last question.

Back to the joint venture again. I believe you said in press release that it got extended to 12 years. Is that, how firm is that? Can they ever cancel it on you?

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Unidentified Company Representative

The minimum term is 12 years.

Robert Roell - American Express - Analyst

Minimum term is 12 years.

Unidentified Company Representative

Twelve years.

Robert Roell - American Express - Analyst

And you could sue them for some damages if they -- would make, right?

Unidentified Company Representative

We wouldn't expect them to do anything like that. It's not their nature.

Robert Roell - American Express - Analyst

The question is, there was a reason why they might want to do that based on the nature of the JV, is that it's a profit-based relationship where they collect 50% of the earnings. Wouldn't they make a lot of more money on a bigger scale player that makes more money --- that has higher margins, in general.

So, the question is, is there a risk that they pull this from you and go to Wells Fargo or Countrywide with it?

Unidentified Company Representative

When Cendant decided to spin the company, they had had discussions with other potential players in the marketplace. And the one of the things that gave them comfort in doing this spin was the fact that they could work with someone who continued to partner with their settlement services business. They could work with someone that they had worked with for the past eight years. And they could work with someone who has the high service standards that we provide for people like Merrill Lynch and American Express. And they knew that we will provide, and to-date have provided those same service standards for their agent base.

So, a part of this spin discussion versus sale discussion included, who do we want to work with on a go-forward basis. And I would expect, we have -- the thought of them pulling out is not something that crosses their mind.

Robert Roell - American Express - Analyst

OK, you sound pretty confident, so.

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Unidentified Company Representative

We are.

Robert Roell - American Express - Analyst

Good. Thanks very much. I appreciate it.

Unidentified Company Representative

Thanks Rob.

One last question.

Operator

And our final question today comes from Moshe Orenbuch with CS First Boston.

Moshe Orenbuch - CSFB - Analyst

Hi. Just a clarification. You were talking in the earlier commentary about the differences between some of the other lenders. How does the sharing that you have with your JV partners play into that gain on sale percentage?

Unidentified Company Representative

That gain on sale is the gross number. And then we've got a relationship fee that we pay that gets paid depending on the type of contract.

Moshe Orenbuch - CSFB - Analyst

The revenue sharing doesn't --- isn't kind of embedded before you calculate the gain on sale?

Unidentified Company Representative

No, it's not.

Moshe Orenbuch - CSFB - Analyst

OK. Thanks.

Unidentified Company Representative

You're welcome.

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Operator

And Mr. Edwards, I will turn the conference back over to you for any closing remarks.

Terry Edwards - PHH Corporation - President and CEO

Thank you very much, Sara.

We thank everyone for their interest. And again, as we said at the top, we appreciate the meetings that we've had with folks. We appreciate the questions that you ask us because that forces us to think about the business perhaps a little bit differently than we would ordinarily think about it. And ultimately that makes us a better company.

So again, thank you for your interest. And we look forward to updating you on our second quarter results, sometime in August.

Have a great day, everyone.

Operator

This concludes the PHH first quarter 2005 conference call.

[Operator Instructions]

Thank you for your participation. You may now disconnect.

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