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RDN - Radian Group Inc at JMP Securities Financial Services and Real Estate Conference

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CORPORATE PARTICIPANTS

Bob Quint *Radian Group Inc. - EVP and CFO*

PRESENTATION

Unidentified Participant

We'll go ahead and get started. I've got Radian Group presenting. Radian is credit enhancement company formed in 1991 with a focus on providing mortgage insurance in the domestic market on first lien loans.

The Company conducts business through three operating segments: mortgage insurance; Clayton Holdings, which was recently acquired; and Financial Guaranty, which discontinued writing new business in 2008. As of the end of the second quarter, the Company has roughly $165 billion in insurance in force.

And today presenting, I have Bob Quint, Executive Vice President and Chief Financial Officer; and Emily Riley, head of IR.

So I will just kick it off with everybody's favorite question on the P Myers. Can you sort of -- now that the comment period is over, can you give us an update on your comment letter? Where you think the most important points that you highlighted in your letter are and where you expect to see the changes from here?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes, so I think overall with regard to the P Myers, the broad fact that they are meant to strengthen the MI industry and standardize the capital regs in the MI industry is a positive. It's a strong thing; it's a good thing. Our product isn't worth much unless everyone values it and that's a really important point.

In terms of some of the details with regard to them, there's a lot of operational stuff, which we commented on which people aren't as interested in. With regard to the financial requirements, we do think there are some things that we would like to see changed.

A few of the highlights -- because I think there are probably too many to enumerate -- but a few of the highlights are a seasoning factor, so if you follow these rules closely, you can -- the proposed rules say that you are charged a certain amount of capital, but if a loan becomes delinquent, you are required to hold more capital against that then delinquent loan.

We think it is fair, because it's proven over time as we are in season, there is less of a chance of them going to foreclosure and claim ultimately there should be a benefit, so offsetting the fact that they are charging more for the delinquent loans, there could be a seasoning factor that is a benefit.

That is certainly one that we think has a chance of being changed. We don't know for sure.

Another big one is premium credit. These rules are charging us on day one when we write the business for a stress level of future claims that will take place over three, four, five, or more years.

However, as the rules are currently proposed, we are not receiving credit for our new premium reserves, which is money that we have, nonrefundable, that we think we should get credit for or some level of credit for as well future premiums on the monthly business, which is the substantial portion of our business.

We are only in the proposed rules getting credit for the legacy book, which is, we think, not enough and that will go away over time.

So some kind of premium credit, we think, makes sense, is valid, matches well with the capital rules. Again, might there be some changes? We hope so, but we don't know.

There are a lot of other things more specifically. Two-thirds of our legacy book, meaning our book written in 2008 and prior, has never been delinquent. So to charge excessive capital charges for a six-, seven-, eight-year-old loan that is not been delinquent even once through the downturn, we think that is a little bit onerous.

So our comment letter -- it's out there for everyone to see. I think there's a lot of comments. And it's not only about lowering the charges for weighting in the other MIs, it's about more. It's about credit access to first-time homebuyers.

We think the market is less accessible than it needs to be and we think that these rules will not help that effort to expand homeownership to borrowers that are very capable and hopefully we'll have access to the market, but under these rules, may not be. So that's a big part of it as well.

Unidentified Participant

Any questions in the audience?

Unidentified Audience Member

Do you think that those new rules will change the mix for your view towards single premium upfront versus the [redirect] marketing premiums going forward and the value of one versus the other?

Bob Quint - *Radian Group Inc. - EVP and CFO*

It's a good question. It shouldn't really changed, because single premiums are earned over time and the expectation is that as the single premium business is earned, you would get credit for it over time. Just like the monthlies. So there's no real difference in a credit given today as proposed for singles versus monthlies.

Now does it make singles less attractive for us to do? I would say on the margin, a little bit. So might you see the mix change a little bit? Probably not because of the P Myers themselves.

I think single premium business is something that the lenders are choosing to do. It's a little bit harder to sell to the borrowers, because the interest rate is higher than on the standard business, so I think the market drives the amount of singles we're going to do rather than the P Myers.

Unidentified Participant

Any others?

Unidentified Audience Member

Just curious how you see the new entrants in the market? A couple of new players with, let's say, easier to understand balance sheets and whether that matters at all from a competitive standpoint?

Bob Quint - *Radian Group Inc. - EVP and CFO*

It does. The good news about the new competition is that this is a great business. We are in a really, really good business; it's a good time in our cycle. The credit strength of the new business is strong. Very, very good. The pricing is, for the most part, very, very good.

So it's a good time to be writing MI. So if people weren't coming in, it would probably -- you would probably question why that's happening.

Now clearly the new players, yes they do. They have excess capital, they have clean capital, they don't have legacy, so there are a lot of advantages. On the other hand, they don't have necessarily the infrastructure or the relationships we have. We do a lot of things with our lending customers that some of the new players do not have.

So it's all give-and-take, I think, in terms of compliance with P Myers. We fully expect to comply with P Myers, just like the new players, so we expect to be an investment grade company over time, just like the new players.

So we don't think from that standpoint there will be very much difference. Certainly, the GSEs -- if you are complying with P Myers, there's not going to -- they are not going to look at it differently.

So we are competing for new business very fiercely with everyone, just like the new players, the legacy players. The Magics and the Genworths and the AIGs of the world are competing very fiercely just like we are.

I don't think there's too much differentiation in terms of the new players having clean balance sheets without legacy. Over time, that is disappearing. Our legacy book -- not only is it much smaller than it was, but it's performing pretty well right now. So it's not really a disadvantage at this point.

Unidentified Audience Member

Thank you.

Bob Quint - *Radian Group Inc. - EVP and CFO*

Sure.

Unidentified Participant

Touching on something you just mentioned, becoming an investment grade company at some point. How much of a priority is that for you and what are the driving factors that make you want to get back to an investment grade company?

Bob Quint - *Radian Group Inc. - EVP and CFO*

So the return to investment grade, I think, is a medium-, long-term view. Short term, all the business we're doing in the MI side is with the GSEs. And with the GSEs, it's their eligibility that matters. It's not investment grade.

Investment grade is not part of the P Myers at all. So in the short term, it's not really necessary, but if you look a little bit longer term, and we do that, certainly, we're expecting that we will be doing business with a market that is not necessarily all GSE. We think it will be some proportion of non-GSE.

If you're doing any non-GSE, if you are doing regular securitizations that the rating agencies are weighting, investment grade will be very, very important.

So it is a goal of ours. We think we are on the way, certainly from an operational performance standpoint. We are clearly on the way from a balance sheet, leverage standpoint.

We probably have too much debt today, but over the next couple of years, those levels will be reduced or expected to be reduced. And we think return to investment grade over the next year or two is a clear possibility. But it's really for the future; it's not for the GSE relationship that we need it.

Unidentified Participant

Any questions out there?

Unidentified Audience Member

(inaudible - microphone inaccessible)

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. One of the many expansion opportunities for our industry and for Radian is the higher LTV mortgages. Today, based on the differential between the GSE pricing and the FHA, any loan pretty much that has 3% down is going to the FHA.

Now consistent with the view that many want the private market to be doing more business -- vis-a-vis the government -- and in conjunction with that, our desire to do 97% LTVs. We think we can make money and we think we can prudently do 97% LTV lending, but it's going to require some changes from the GSEs. They've got to reduce their pricing in order to make the deal competitive with the FHA.

So it is an expansion opportunity for us. Today, it's something that would be difficult with the GSE pricing. As well, the P Myers capital regs penalize the 97%. So might there be some changes there? We don't know.

But some combination of capital charges for us or GSE pricing via their low level price adjustments needs to change or we will likely be pretty much closed out of a 97% LTV market, which is the way it is today. But it is an expansion opportunity for the future that we are very willing to participate at some level.

I think prudently, it makes sense. We would be careful about doing it, but we can do it and we think it can be done profitably. If you go back to -- if you sort of revisit the downturn and the poorest underwriting vintages, 2006 and 2007, which are well documented, there was a set of loans in 2006 and 2007 which included 97% LTV loans, which were very profitable for us.

So if we look back, you can do it, even through a cycle if you're careful and you keep to certain credit standards.

Unidentified Audience Member

You said for non-GSE, do you mean non-QM? (inaudible - microphone inaccessible)

Bob Quint - *Radian Group Inc. - EVP and CFO*

Well, the GSEs can do non-QM. But no, I met non-GSE. So I met private label securitization. Certainly, a big opportunity in private label is non-QM. Another one is jumbo.

Today, there is not too much of that. And what is done, not that much of it has private mortgage insurance on it. But clearly, non-QM via the private label is an opportunity.

Not only an opportunity for MIs and for Radian, but a big opportunity for Clayton and a big reason that we saw a lot of potential upside in the acquisition of Clayton is the return of the non-GSE securitization market.

And non-QM -- I think people are still very cautious about non-QM because of the potential repercussion then. We still see mortgage originators being fined and having to settle in terms of loans that weren't originated properly and the clarity around non-QM is still not to the level that originators are comfortable enough to originate non-QM and understand or get comfortable that there wouldn't be potential recourse to them.

Unidentified Participant

Any other questions? You've touched on it a little with your comment, but looking at Clayton, the Clayton acquisition, what opportunities did you see that made it attractive and what do you see the growth opportunities in that area being in the next five years?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes. So with regard to Clayton, which is our recent acquisition, this quarter -- the third quarter -- you're all going to be able to see the results of Clayton in a third segment. As Christine had said, that's our mortgage and real estate services segment, which will contain the results of Clayton.

A few things there. One, I think on a standalone basis, Clayton is a successful, profitable company. So it does well on its own and that was important. So to us, that said, kind of a low downside. So the downside was minimal, in our view.

The upside, in our view, is really high. So we like that combination -- low downside, high upside. And the high upside is related to the return of the non-GSE securitization market, which Clayton has a substantial share of. And if that grows, then their revenues and income can grow substantially. So that's really the upside.

As well, they've got a couple other areas of the Company. It's a very comprehensive service provider. A couple other areas of the Company are fast-growing and leveraged to today's mortgage market.

The other one that comes to mind is the surveillance area, the compliance area. So many of the servicers are looking to Clayton to provide services to make sure that they are servicing properly and they won't be fined in the future. So compliance work, sub-servicer reviews, that's a good part of the business that's very relevant today and is potentially growing.

The component services, which is the real estate area where the Clayton company, Green River, virtually owns the market that is dealing with the rent-to-own securitization market, which seems to be a sustainable market.

When we bought Clayton, we thought it was a possibility, but we weren't sure about that. But that seems to be a very strong market that can be sustainable. So we see a lot of upside with those potential markets. We see the low downside because it's a successful Company on a standalone basis.

We also see synergies with Radian. Obvious ones are we buy a lot of services from third parties that Clayton provides. So transitioning to Clayton in terms of those purchases would save the consolidated Radian the profit margin on that business, which is pretty high. So that's an obvious one.

Another one is differentiation in the MI space. It's very hard to differentiate in the MI space. Our pricing is similar, our product is the same, the master policy is going to be the same for everybody. So very hard to differentiate.

Clayton is a differentiator. We can go to our customers and provide services that Clayton has to our customers as a differentiator. So those are some of the things that we saw. And so far a few months later, nothing has changed our view in terms of ownership of Clayton.

The other obvious one is nonregulated cash flow. It is not a huge number, per se, but we have all regulated companies that we've got to have permission or got to comply with regulations before we take dividends.

Clayton is a situation where -- low capital-intensive business. Any free cash flow that they can provide in the future could come right up to the holding company, perhaps.

Unidentified Participant

What about your volume expectations for the year? I believe you previously disclosed $35 billion to $40 billion in new insurance written. The beginning of the year, it was off to a slower start than many were expecting. You think we'll get enough in the back half of the year to sort of fill the hole that we got in the first half?

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes, we have not changed our expectations -- our revised expectations, but we had changed our original expectation. So between $35 billion and $40 billion is still a fair estimate of where we think we're going to be, volume-wise.

I guess you guys see our monthly volumes, so you've seen that the third quarter so far has been pretty good and -- so we expect the third quarter to be a strong quarter volume-wise.

It will likely be the strongest quarter, because the fourth quarter typically, from a seasonal standpoint, comes down as the weather starts getting colder. The fourth quarter is usually downed from the third quarter.

So we don't have any different expectations there, but in terms of the full year, $35 billion to $40 billion is still a reasonable expectation and we will update if we see reason to, but so far, we've not updated that.

Unidentified Audience Member

Can you talk a little bit about Financial Guaranty business and what the plan is for that? (inaudible - microphone inaccessible)

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes, so Financial Guaranty has been a really important component of Radian for the last 13 years. And for the last 6 years, it's really kept Radian in a capital position where we can keep writing.

And now has the MI business now turned the corner, it's very profitable, expected to sustain that profitability. So it has served a tremendously important purpose for Radian, providing us capital support. And today, the Financial Guaranty sub-Radian asset has about $1 billion of statutory surplus.

Well, the P Myers proposal gives no credit in the P Myers for the Financial Guaranty business. Hence our looking today at monetizing or utilizing the business. So what does that mean?

It means that we are exploring our options. Included in that could be a potential sale of the business, either full sale or partial sale. It could be a spinoff of the business. It could be the use of surplus notes or reinsurance.

So what we want to do is turn the value in the Company, which we think is very strong, the economic value, into not only economic value, but P Myers qualifying value.

So that's the challenge for us. We feel very good about our ability to do so. We're still in the initial phases of looking at that and discovery in terms of that, but if you look at the Company, the runoff and the proactive reduction of risk in the Company, has created a company that has relatively small amount of risk, a significant amount of overcapitalization.

However you measure the capital levels, everyone agrees the Company is well overcapitalized, so it's a good situation for us and now we've got to determine that balance. Realizing economic value, creating P Myers qualifying assets, which is very important.

And then the third one is making a judgment about the longer-term value of Financial Guaranty and it's clearly not our core business. And whether or not having it within the Radian family or not having it creates a more simplified company that's easier to understand and invest in.

So all of those things together with our realization of what the market value is and what we can potentially do, talking with the GSEs, that's sort of all in the mix and then hopefully soon, or relatively soon, we will figure out a course of action and go down that course.

Unidentified Audience Member

Just in the timeframe now [or discussed] in terms of when you'll make a decision on whether to go forth [planning].

Bob Quint - *Radian Group Inc. - EVP and CFO*

Yes, that's right. And that's deliberate, because I think we have time. There's a transition period for P Myers. I don't think we intend on using the full transition, but we do have time and we want to realize that value.

We think it has strong value, so it would be distasteful to give up a lot of that value. It could be very soon. It could be prior to the P Myers being finalized, which we expect to be the end of the year or maybe shortly thereafter. Or it could be after year end.

We don't really have -- the more important thing for us is doing the right thing and getting the right value for it as opposed to we've got to do something by next whatever.

Unidentified Participant

We have time for one more quick question, if anybody has one. What would you say your top priorities for Radian are over the next two to three years?

Bob Quint - *Radian Group Inc. - EVP and CFO*

If I wait 16 more seconds, I don't have to answer that. But I'll answer it.

Clearly, the top priority is to grow our MI book of business, which we think is terrifically profitable and strong. So strong market presence in the MI space in the near term is a number one priority.

While we are doing that, we've got some time, but we also have started through Clayton this diversification effort and not depending so much on the GSEs and business that the GSE is ultimately doing, non-GSE business, doing nonregulated business within our core strengths, which is mortgage, risk analytics, and credit analytics.

Those are our priorities and we're -- we had a good start and we are planning to just feed off that and continue down that path for the next few years.

Unidentified Participant

Great, thank you very much.

Bob Quint - *Radian Group Inc. - EVP and CFO*

Thank you.