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Radian Group Inc. (RDN)

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for patience and standing by, and welcome to the Radian's Third Quarter of 2019 Earnings Call. At this time, all participant phone lines are in a listen-only mode. Later, there'll be an opportunity for your questions. [Operator Instructions] Just a brief remainder, today's conference is being recorded.

I'd now be happy to turn the conference over to Senior Vice President of Investor Relations, Emily Riley.

Emily Riley

Senior Vice President-Corporate Communications & Investor Relations, Radian Group Inc.

Thank you, and welcome to Radian's third quarter 2019 conference call. Our press release, which contains Radian's financial results for the quarter, was issued last evening and is posted to the Investors section of our website at www.radian.biz. This press release includes certain non-GAAP measures which will be discussed during today's call, including adjusted pre-tax operating income, adjusted diluted net operating income per share, adjusted net operating return on equity, and Services adjusted EBITDA. A complete description of these measures and reconciliation to GAAP may be found in press release Exhibits F and G and on the Investors section of our website.

In addition, we have also presented a related non-GAAP measure, Services adjusted EBITDA margin, which we calculate by dividing Services adjusted EBITDA by GAAP total revenue for the Services segment.

This morning, you will hear from Rick Thornberry, Radian's Chief Executive Officer; and Frank Hall, Chief Financial Officer. Also on hand for the Q&A portion of the call is Derek Brummer, Senior Executive Vice President of Mortgage Insurance and Risk Services.

Before we begin, I would like to remind you that comments made during this call will include forward-looking statements. These statements are based on current expectations, estimates, projections and assumptions that are subject to risks and uncertainties, which may cause actual results to differ materially.

For a discussion of these risks, please review the cautionary statements regarding forward-looking statements, included in our earnings release and the risk factors included in our 2018 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

And now, I would like to turn the call over to Rick.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Thank you, Emily, and good morning. Thank you all for joining us today and for your interest in Radian. Our team is hosting today's call from Austin, Texas where we've been meeting with customers this week, attending the Annual MBA Convention.

During the past few days I've had many discussions with customers and other industry players and I've been pleased with the positive response to our One Radian business model. Our customers appreciate the value we bring to them across the entire mortgage and real estate value chain. It is clear that our broad set of products and services are strengthening our customer relationships and positioning us as a valued strategic business partner.

Turning to our financial results, I am pleased to report another excellent quarter for our company. Net income for the quarter was $173 million or $0.83 per diluted share. Adjusted pre-tax operating income was $213 million and adjusted diluted net operating income per share increase to $0.81. Book value per share grew 24% year-over-year to $19.40, and return on equity was 18% with an adjusted net operating return on equity of 17.4%.

I would like to take a moment to congratulate our entire Radian team on these results, which reflect their talent and dedication. I'd also like to thank our customers who continue to place their trust and confidence in us.

Turning to our mortgage insurance business, we grew our primary insurance in-force by 9% year-over-year to $237 billion. Our mortgage insurance portfolio, which is one of the largest in the industry is the primary driver of future earnings for our company. We believe the projected future earnings from this portfolio represents unrecognized economic value for shareholders and provides us with significant strategic financial flexibility.

The mortgage origination market was strong in the third quarter with low interest rates, driving an increase in high quality purchase loans, where mortgage insurance is three to five times more likely to be used, as well as increase refinance activity. Mortgage rates remain at attractive levels both for homebuyers and certain homeowners looking to refinance their existing loan and the market continues to be fueled by first-time homebuyers, who represent one-third of home sales.

In terms of home values across the country, according to the data from the newly released Radian Home Price Index, annualized home price appreciation has increased as of the third quarter compared to the second quarter of this year. In fact data from the September 2019 HPI shows a 7.9% year-over-year increase in medium home values as compared to a 5.8% annualized growth rate reported in the second quarter of 2019.

Given this positive environment, we continue to break company records of Radian. We wrote $22 billion NIW which is a 19% increase over our previous record volume written in the second quarter of 2019 and a 40% increase over the third quarter of 2018. This contributed to the growth in our high quality portfolio that I mentioned of 9% or $20 billion year-over-year. We remain focused on providing customized pricing options and excellent customer service and continue to offer various options for doing business with Radian that are based on customer needs and preferences, and align with our appetite for appropriate risk in return. We are pleased that this approach resulted in record levels of new mortgage insurance business that we project will generate attractive risk adjusted returns in the mid-teens.

Our mortgage insurance results reflect the successful execution of our strategy, namely to effectively aggregate, manage and distribute mortgage credit risk in order to manage our risk return profile and drive economic value. And our expert team continues to leverage our proprietary data and analytics platform to carefully analyze the business we write, including risk attributes at the loan level as well as originator in servicer quality and performance.

Based on our performance thus far in 2019 and our strong new business pipeline, we now expect to write new mortgage insurance business in 2019 in the range of $65 billion to $70 billion, which would represent an approximate 20% increase over last year's record breaking levels. As you have heard me say many times, this is a great time to be in the mortgage insurance business. The business fundamentals are very strong with guardrails in place for mortgage lending and servicing under Dodd-Frank, and our mortgage insurance industry is governed by clear, consistent and transparent risk based capital requirements under PMIERs and operating guidelines with a uniform master policy. The credit quality of our existing book of business is excellent as is the credit environment we operate in today. For example, the number of defaulted loans in our portfolio remains at one of the lowest levels we've seen in 20 years, with cure activity at 10-year highs.

Now moving to our Services segment, we continue to make progress across our Mortgage, Real Estate and Title Services business, and we are pleased to report a total Services segment revenues of $47 million in the third quarter, which represents growth of 10% from the prior quarter, and 16% compared to a year ago. We believe these improved results are a testament to the hard work of our excellent services team and the customer relationships we continue to grow and value.

In terms of capital management, Frank will discuss our actions this quarter in detail, but I am pleased with the steps we have taken to improve our debt maturity profile and return capital to our stockholders. We completed one share repurchase program during the quarter and authorized a new one and in total, we have repurchased today more than 13 million shares representing approximately $300 million in value. I am pleased that our strong financial position has afforded us the opportunity to consider share repurchases opportunistically within the context of our overall capital strategy, which is designed to enhance our already strong capital structure and position.

Turning to the regulatory and legislative landscape, on Monday, Director, Mark Calabria spoke to the MBA Convention attendees about his priorities for the GSEs. His comments were preceded by the release of the FHFA's 2019 strategic plan and scorecard for the GSEs, which largely reflect the same themes that were present in the Treasury's plan for housing finance reform released in September. These themes include the fostering of a competitive efficient and resilient national housing finance markets, ensuring the safety and soundness of the GSEs, preparing the GSEs to transition out of conservatorship and better harmonizing the role of the FHA and the GSEs.

While the 2019 score card and strategic plan are limited in terms of specifics, we continue to be encouraged by many themes including for example, the FHFA's desire to encourage the greater use of private capital, to increase transparency of the GSEs, to level of playing field with private competitors, and to appropriately restrain the GSEs activities where they encroach on areas where private capital is available and willing to serve.

HUD Secretary, Ben Carson also spoke to the group and with respect to FHA pricing, he communicated a strong desire to continue to increase FHA's financial strength and see the FHA's capital position grow well above the 2% statutory minimum to withstand cyclicality and future downturns. As a result, we believe a reduction in FHA pricing is unlikely.

In terms of the items on our watch-lists, we expect an announcement shortly from the FHFA regarding the new capital standards for the GSEs. And we understand that the CFPB is continuing to evaluate potential QM replacements for the GSE patch, which expires in January 2021. As to QM, we believe there is a growing consensus that the CFPB will land on a solution that preserves credit access for worthy borrowers in a transition away from the GSE patch will be orderly and not overly disruptive to the housing market. We remain actively engaged in the discussions around these important items as well as the broader dialogue on housing finance reform.

In his speech here in Austin, Director Calabria stated that Fannie and Freddie's risk must be supported by private capital. Based on Calabria's comments, we continue to believe that given our industry's strong and consistent capital standards, our proven ability to manage and distribute risk, our uniform, master policies and our high operational standards, private mortgage insurance will remain a critical component of any new housing finance system.

Now I would like to turn the call over to Frank for details of our financial position.

J. Franklin Hall

Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.

Thank you, Rick, and good morning everyone. To recap our financial results reported yesterday evening, we reported net income of $173.4 million or $0.83 per diluted share for the third quarter of 2019, as compared to $0.78 per diluted share in the second quarter of 2019 and $0.66 per diluted share in the third quarter of 2018. Adjusted diluted net operating income was $0.81 per share in the third quarter of 2019, an increase of 1% from the second quarter of 2019, and an increase of 14% over the same quarter last year.

I will now focus on some of the drivers of our results for the quarter. I'll start with the key drivers of our revenue. Our new insurance written was $22 billion during the quarter, compared to $18.5 billion last quarter and $15.8 billion in the third quarter of 2018. Our third quarter 2019 volume marks our highest quarterly new insurance written on a flow basis.

Total NIW increased 40% compared to the third quarter of 2018, and our monthly premium NIW increased to 52% year-over-year. Direct monthly and other recurring premium policies represented 85% of our NIW this quarter, an increase from 83% for the second quarter of 2019 and an increase from 78% over the third quarter a year ago. Borrower paid policies represented 97% of our total new business for the third quarter 2019. Borrower paid single premium policies represented 13% of our total NIW this quarter, a significant increase from two years ago when they accounted for less than 2% of total and NIW. In contrast lender paid single premium policies were less than 2% of NIW this quarter, a dramatic decline from over 21% of total production two years ago. This shift in business mix is expected, intentional and designed to improve the return profile of our single premium business overall, as borrower paid singles have higher expected returns relative to lender paid policies, due impart to auto cancellation under the Homeowner's Protection Act creating shorter expected lives and lower required capital under PMIERs.

Primary insurance in-force increased to $237.2 billion at the end of the quarter with year-over-year insurance in-force growth of 9%. It is important to note that monthly premium insurance in-force increased 12% year-over-year and has grown by over $35 billion over the past two years. Our 12-month persistency rate of 81.5% declined from 83.4% in the prior quarter and increased slightly from 81.4% in the third quarter of 2018. Our quarterly annualized persistency rate declined to 75.5% this quarter from 80.8% in the second quarter of 2019 and 83.4% in the third quarter of 2018. The decline in quarterly annualized persistency compared to the third quarter of 2018 is primarily driven by increased refinance activity observed in the quarter, while our long term expectations for persistency remain in the low to mid 80% range. We have said previously that near-term persistency may fall below this level as was the case with the quarterly persistency metrics in this reporting period. It is worth noting however that Radian's insurance in-force grew by over $6 billion in the third quarter, slightly more growth on a dollar basis than in the third quarter of 2018.

Moving now to our portfolio premium yield, as a reminder, the second quarter of 2019 included a positive cumulative adjustment to the expected lives of our single premium policies, which resulted in $32.9 million of additional net premiums earned. Slide 11 shows the premium yield trend over the past five quarters excluding the impact of this adjustment. Two other lines worth noting on slide 11, our direct in-force premium yield and single premium policy cancellations. Our direct in-force premium yield was 47.4 basis points this quarter compared to 47.9 basis points last quarter and 48.6 basis points in the third quarter of 2018. Our level of single premium policy cancellations contributed 4.6 basis points of yield in the third quarter compared to 2.1 basis points in the same quarter a year ago. As we have noted previously, the level of single premium policy cancellation may fluctuate given the certain macroeconomic factors primarily interest rates and can create volatility in our reported premium deals.

For the past several years, we have expected the in-force portfolio yield to decline gradually. And over the past year, it has in fact declined by just over one basis point because of two key drivers. The first driver is the natural turnover of the portfolio. Older vintages that have relatively higher risk profiles written at higher premium rates are running off and are being replaced by new vintages, which carry lower premium rates due in part to industry price changes following tax reform in 2018.

The second driver is the lower premium rates on our new business commensurate with the lower risk profile as we have recently written record levels of very high quality business with continued strong risk adjusted returns. The recent trend of lower persistency and record levels of NIW, which have further contributed to the turnover of our in-force portfolio accelerating the expectations of a lower overall in-force portfolio yield. While we continue to expect a gradual decline of the in force portfolio yield, the timing and magnitude of future in-force portfolio yield changes will continue to depend on several factors including the volume and mix of new business relative to the volume and mix of cancellations and prepayments of older vintages in our portfolio.

Our recent production has consisted of a higher weighted average FICO, lower expected losses and capital requirements relative to our previously written business. In terms of future NIW, our mix of business will continue to be guided by where we see value across the risk spectrum and the credit mix may vary quarter-to-quarter. This may result in periodic variability in the profile of our NIW including weighted average FICO, LTV and other risk metrics that impact average premium levels.

What is most important to remember about pricing however is that we continue to remain focused on maximizing economic value and generating attractive risk adjusted returns in the mid-teens. These projected returns do incorporate the impact of our single premium quota share reinsurance program but do not include the impact of insurance-linked notes.

Net mortgage insurance premiums earned were $281.2 million in the third quarter of 2019, compared to $299.2 million in the second quarter of 2019, and $258.4 million in the third quarter of 2018. The decrease of 6% on a linked quarter basis is primarily attributable to the $32.9 million cumulative adjustment to unearned premiums, recognized in the prior quarter, partially offset by an increase in single premium policy cancellations, as well as the growth in our insurance in-force.

Setting aside the impact of the adjustment, our net premiums earned grew 6% quarter-over-quarter. Similarly the 9% increase from the third quarter of 2018 was primarily attributable to the growth in our insurance in-force, as well as the increase in single premium policy cancellations.

Total Services segment revenue increased to $47.4 million for the third quarter of 2019, compared to $43 million for the second quarter of 2019 and $40.9 million for the third quarter of 2018. The increase in revenue compared to the prior quarter was due to the continued growth and expansion of customer relationships. Our reported Services adjusted EBITDA for the third quarter of 2019 was $3.7 million.

Our investment income this quarter of $43 million was down slightly from the prior quarter, but approximately 10% higher than the prior year. The increase over the prior year was due to higher balances in our investment portfolio. At quarter-end, the investment portfolio duration increased slightly to 4 years from 3.7 years in the prior quarter. Our $5.5 billion investment portfolio has grown approximately 10% or just over $500 million since the third quarter of 2018, a sizable increase given that over the same time period, we have paid off debt and repurchased over $275 million of our common shares.

Moving now to our loss provision and credit quality. As noted on slide 14, the provision for losses for the third quarter of 2019 includes a positive development on prior period defaults of $12.6 million. This positive development was driven by a reduction in certain default to claim rate assumptions on age defaults, partially offset by an increase of $11.8 million in the company's IBNR reserve estimate related to previously disclosed legal proceedings regarding the Servicers claims on loss mitigation activities largely on pre-2009 vintages.

Our primary default rate is now at 1.9%, flat relative to last quarter and down from 2.1% a year ago. Consistent with typical default seasoning patterns, the shift in our portfolio composition towards more recent vintages is expected to result in slightly increased levels of new defaults in our portfolio for 2019 as compared to 2018 as new defaults for recent vintages will outpace the reduction in pre-2009 new defaults. Our total default count has consistently declined and is currently near the lowest level we have seen in over 20 years at approximately 20,000 loans with very high cure rates. As economic indicators have continued their positive trends, cumulative loss ratios on our post-2008 business continued to attract historically low levels. As these positive economic and performance metrics have continued, we did lower the Default to Claim assumption on new defaults from 8% to 7.5% during the third quarter.

Now turning to expenses, other operating expenses were $76.4 million in the third quarter of 2019 compared to $70 million in the second quarter of 2019 and $70 million in the third quarter of 2018. The increase in operating expenses compared to prior quarter was primarily driven by a reduction in ceding commissions relative to last quarter, as well as increased incentive compensation expense based on year-to-date performance.

Moving now to taxes, our overall effective tax rate for the third quarter of 2019 was 20.3% and our expectation for our 2019 annualized effective tax rate before discrete items is approximately the statutory rate of 21%.

Now moving to capital, for Radian Guaranty as previously disclosed, we entered into our second insurance-linked note transaction of approximately $562 million in April of 2019, bringing the total insurance-linked note issuance by Eagle Re to just under $1 billion and covering origination years of 2017 and 2018 for our monthly premium business.

In total, we have reduced Radian Guaranty's PMIERs capital requirements by $1.4 billion as of the third quarter 2019 by distributing risk through both the capital markets and third-party reinsurance execution. We expect that this prudent risk distribution strategy and our disciplined capital management will continue to enhance our risk profile and improve our financial flexibility and while we expect to continue utilizing risk distribution on an ongoing basis for new vintages, we currently do not expect to pursue additional risk distributions on our older [ph] books (00:26:33) of monthly premium business. These vintages have experienced significant home price appreciation since originally written and also have shorter expected lives given recent prepayment activity. As a result the combination of the cost of capital expected PMIERs benefit and duration of risk coverage do not currently meet our objectives.

Radian Guaranty had PMIERs available assets of $3.4 billion and our minimum required assets were $2.7 billion as at the end of the third quarter 2019. The excess available assets over the minimum required assets of $652 million represents a 24% PMIERs cushion. We have also noted on slide 19 our PMIERs excess available resources on a consolidated basis of $1.6 billion, which if fully utilized represents 59% of our minimum required assets as of September 30, 2019. We expect our PMIERs cushion to be sufficient to support projected organic growth, as well as potential volatility such as a cyclical economic downturn before giving any consideration for the additional benefit of future premium revenue.

Moving now to our capital plans for Radian Group. During the third quarter 2019, the company redeemed the remaining $27 million of Senior Notes due 2020 and the remaining $70.4 million of aggregate principal amount of Senior Notes due 2021. Also during the third quarter of 2019, Radian repurchased 3.3 million shares or $77.5 million of Radian Group common stock including commissions. This repurchase activity completed the company's $250 million share repurchase program initiated in August 2018 and included shares purchased under the company's new $200 million program authorized in August 2019.

In addition, after quarter end in October 2019, the company purchased an additional 1.1 million shares for approximately $25 million of Radian Group common stock including commissions. As of October 30 2019, the purchase authority of approximately $150 million remained available under the existing program, which expires on July 31, 2020. On October 17, 2019 Moody's Investors Services upgraded the senior unsecured debt rating of Radian Group to Ba1 with a stable outlook. Moody's cited expectations for continued strong profitability for mortgage insurers due to favorable US housing market and economic fundamentals, as well as Radian's recent actions to reduce its financial leverage, extend its debt maturity profile and increase liquidity at the holding company. Moody's also upgraded the insurance financial strength rating of Radian Guaranty to Baa1, noting our strong position in the market, our increased risk distribution through insurance-linked notes and traditional reinsurance, our substantial PMIERs cushion and our significant capital resources to absorb potential losses during periods of economic stress.

Holding company liquidity at the end of the third quarter 2019 was $731 million compared to $879 million at the end of the second quarter of 2019, excluding any consideration for our $268 million credit facility. As we continue optimizing our capital structure and evaluating appropriate uses for capital, we will continue to update you on our progress. At Radian, we have a strong history of taking thoughtful, prudent and shareholder friendly actions and managing our sources and uses of capital. Over the past several years, we have completely restructured our debt, lowered our absolute cost of debt and recently extended and enhanced the debt maturity profile to better match the expectation of future contingency reserve releases from Radian Guaranty.

We have enjoyed improved ratings from the rating agencies, we've repurchased approximately 15% of our outstanding shares at value prices. We prudently managed our PMIERs capital through surplus notes and risk distribution. We have returned $825 million of capital from Radian Guaranty to Radian Group over the past 12 months.

All that said and as we have stated previously, the range of options that we will continue to consider are focused on creating value for our shareholders. The form, timing and execution of potential actions are available to us because of the considerable actions we have taken to position all of our financial resources for maximum flexibility and in a risk-appropriate manner. As of now, we are returning capital to our shareholders by utilizing the previously authorized $200 million share repurchase, of which we have approximately $150 million remaining. It is our continued practice to announce the specifics of our capital actions as they occur.

I will now turn the call back over to Rick.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Thank you, Frank. Before we open the call to your questions, let me remind you that net income was $173 million and diluted net income per share was $0.83. Adjusted diluted net operating income per share grew to $0.81. Book value per share increased 24% year-over-year to $19.40. Return on equity was 18%. Our $237 billion mortgage insurance portfolio grew more than 9% year-over-year and is the primary driver of future earnings for Radian.

Our Services segment grew 16% from a year ago to $47 million. And we made progress against our capital strategy completing our $250 million share repurchase program and initiating a new program with more than 13 million shares repurchased thus far in 2019.

Now, operator, we would like to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] First we'll go through the line of Mihir Bhatia. Your line is open.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch
Q

Hi, thanks for taking my questions. Well, maybe I'll just start with the FHA. Certainly encouraging to hear that the FHA is not looking at cutting prices. I was curious what would you, like, there has been some talk about the FHA maybe adapting risk-based pricing. Could you comment on what's an impact of the FHA adapting such would have on the MI industry just in terms of whether your mix or your volume as opposed to their current fixed rate pricing across the banks? Thanks.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.
Q

Hi, Mihir. This is Rick and I appreciate your question. And yeah, there's been – there has been discussion around the FHA. Considering that this past week – the FHA is primarily focused on fixing a number of their internal challenges if you will from a technology and operations point of view. And I think from the comments this week from Dr. Ben Carson when he spoke to the MBA here in Austin, he was – he's very, very focused on rebuilding the capital balances of FHA the fund, and so I think his comments really lead us to really believe that building that capital above the 2% to be able to sustain the fund through the cycle from a credit risk point of view is really the primary focus, and what we hear and what we understand is that really when they think about risk based pricing that's largely around some of the higher risk areas, which we don't really participate in.

So I think at this point we don't really see a risk from lower premium pricing. We think more of the trend is towards trying to build capital within the within the FHA fund and capital structure. And I think at this point we're – it's not a concern of ours from a pricing perspective.

Operator: And next in queue we have the line of Jack Micenko with SIG. Your line is open.

Jack Micenko
Senior Equity Research Analyst-Housing, Mortgage and Banking/Associate Director of Research, Susquehanna International Group, LLP
Q

Hey, good morning. I wondered as what the expense ratio came in a little higher than we are thinking and obviously you had a really, really big NIW quarter. But just wondering as we think of that as sort of the normal run rate or do you think you can leverage that more as the insurance in-force book continues to grow just some thoughts there.

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.

A

Yeah Jack, this is Frank. Good morning. So this quarter was a little choppy on the expense side, primarily for the reasons cited on the linked-quarter basis. We did not have the ceding commission and then we also had a little uptick in FTI. I think the way to think about expenses going forward is instead of on an expense ratio basis, maybe just looking at the absolute dollars and I think on go-forward basis, something around a $72 million expense level just on a normalized basis is probably the right level to think about.

Jack Micenko
Senior Equity Research Analyst-Housing, Mortgage and Banking/Associate Director of Research, Susquehanna International Group, LLP

Q

Okay. And then Rick on the regulatory side on the FHA, I hear you on the price cuts or lack of price cuts on out of the FHA, but it seemed like there was some commentary this week on kind of maybe ring-fencing the False Claims Act issues and trying to bring more banks into the fray to do more FHA business. How do you think about that from a competitive standpoint?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. Now, thanks for the question. So it's a great question. I think in that there was a great deal of focus on the kind of the memorandum of understanding that I think as I've sat through meetings with customers and other kind of industry meetings, yeah, I think it's clearly good for the lenders who sat on the sidelines kind of with the uncertainty out there. But when you say specifically, some of the large banks, I think there's really, when you think about it, it's still the same FHA business that were – that we did exist today, there's no changes.

So when you take the pricing aspect or without, all you're really doing is looking to having more competitors enter the marketplace and I think you could see market share shifts among competitors, mortgage originators, maybe some shift from independent mortgage banks back to banks if the banks [indiscernible] (00:38:36). There are still a number of issues to resolve, FHA from an operational point of view, from a servicing point of view, and it's pretty clear today that the execution around a conforming loan with MI, is a smoother transaction for lenders to the extent that it's eligible.

So I think, when I look at the memorandum of understanding, it's the FHA is moving in the right direction to really kind of modernize their programs and bring certainty and clarity to kind of the legal structure of doing business with FHA. But I don't see it really impacting the market share for MI, because it's still the same FHA product. So largely I think – I think largely a market share kind of transition between originators is more likely the impact.

Jack Micenko
Senior Equity Research Analyst-Housing, Mortgage and Banking/Associate Director of Research, Susquehanna International Group, LLP

Q

So, FHA to FHA, not FHA to PMI or is that how you are thinking?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

I mean when you really think of it, there's nothing changing on the FHA product side. It's just, it's a new set of competitors. So, if you take pricing changes off the table, it's still the same FHA product that we compete with every day today. You just may have a new set of players, and remember, many of those players today, many of the large banks exited the origination business, but they stayed in on the corresponding side because of less issues around the False Claims Act and from a risk point of view.

So, it's really, these players kind of reentering the origination market to go after the same products that exist today. So, there's really not a change in product, a change in price, a change in economics. So we still think MI competes very favorably where we feel like we want to compete right on the types of products, the risk profile, the credit profile. So, I think it's a well needed clarification across the industry and I commend the FHA for taking the steps to bring more clarity and certainty, but I think from an MI business point of view it's not impactful.

Jack Micenko
Senior Equity Research Analyst-Housing, Mortgage and Banking/Associate Director of Research, Susquehanna International Group, LLP

Q

Right. Thanks for taking my questions.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Sure. Thank you.

Operator: Next in queue we have the line of Bose George of KBW. Your line is open.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey, good morning. Just with...

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Good morning.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

...four MIs having reported, do you have any feel for if there are changes in your market share?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Hi, Bose. This is Rick. Thank you. Great question. I think – and good morning – I think it's, obviously, there's still two more to go. We don't know, and as you've heard me say, we're not, we don't focus on market share. We focus on doing the right business with the right customers who ultimately produce quality and will service the risks that we take very well. So, I think we had a very strong quarter. I think our team did a phenomenal job. The sales team, the operations and risk team, I think this market environment we feel like we're producing very high quality book of business with our NIW. We feel like it plays to our strength from an analytics point of view, and our ability to really kind of pick and choose again who we do business with, but also the types of loans and the risk and the risk return and the economic value that we generate from these loans.

So I'm very pleased with the volume we did, not really concerned about market share other than we're focused on doing business with the right customers at the right risk return and we are 100% focused on creating economic value for our investors, and I think our team's done an excellent job on that. And I think truthfully the results of the NIW we had this quarter, I think somewhat speak for themselves in terms of our effectiveness to be good stewards of capital, good fiduciaries from an economic value creation point of view and do business with customers who align with our objectives. So I feel very good about where we sit.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

[ph] I'm kind enough.(00:42:42) Makes sense, thanks. And then actually switching to the last reserve, you had that $11.8 million increase in the IBNR related to that litigation and you had a charge there last quarter. Any thought for is that kind of getting closer to the end or in any ways to think about that?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. We believe we're appropriately reserved for all the matters and we do not currently expect any further material increases related to these matters. That said, given the nature of litigation, it's hard to predict future outcomes as possible; their accrual could go up or down in future as things develop, but I think that's probably how I can comment today.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Sure. Sure. Okay. Thanks. If I could, just one more. The Services segment, can you just talk about the outlook there, just given the improvement?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. Thank you. As I mentioned in my comments, we have been very pleased even this week while we've been here in Austin meeting with dozens and dozens of customers about how their view of Radian is changing in the marketplace to be a company beyond just MI. And I think you know as I said at our Investor Day, these are business – our Services businesses are in different stages of maturity and development and we're investing where we see strategic opportunity. I think we're starting to see the results of that. I think I'm very pleased with the receptivity in the marketplace and I think as you look at the revenue, we gave revenue guidance that we would hit a run rate this year is somewhere between $175 million and $200 million of revenue.

Obviously we hit that this quarter, 10% to 15% EBITDA. I think we're right around 8% this quarter. And quite frankly, I'm less focused on that because to the extent that we make investments along the way that maybe cost us a little bit in EBITDA from an expense point of view, but allow us to grow and position strategically for the future; we're going to do that all day long. So I think today I'm very – I feel very good about where we sit and specifically, I think our – the opportunity we have around Title and Real Estate from a growth perspective are quite interesting and the receptivity that we're getting from the marketplace obviously existing MI customers and others around the Services we can provide from Title perspective, Title Insurance, Title and Settlement Services. And also the different real estate data and analytics valuation services are really playing – being received well in the marketplace, and I think that's where we expect to see the greatest growth in the coming years.

So we're excited about it. The team's doing a great job. Couldn't be happier with how the team is laser focused on our business and making sure that we deliver great quality service to our customers. And I think our customers are responding very well. The number of customers that came to me this past week and said, we're looking at Radian very differently. We're looking at you as a strategic business partner is what we've been focused on for the last couple of years. I feel good about it.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. That's helpful. Thanks.

Operator: Next in queue is the line of Mackenzie Aron, Zelman & Associates. Your line is open.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Thanks. Good morning. Just wanted to follow-up on the comments around the [ph] VLC (00:46:17) Services business and the revenue growth this quarter. Were there any particular areas of the business that really drove the strength this quarter or was it more broad-based but just any color you can provide on the different areas?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. So thank you Mackenzie. This is Rick. I think where I see the growth developing, and I would put Title was such a small starting point I think I've referred to it in the past as really an industrial strength startup where we've invested in technology and people and facilities and put these two top, two companies together to create Radian Title Services and we acquired an underwriter to really be in a position to control our own destiny and to some degree. So I think the Title is the one that is because of the low starting point is beginning to show a strong momentum and acceleration. I'm very pleased with that but I also expected that, and I think as we go forward that is a very interesting growth opportunity.

I think around the real estate valuation side, not only traditional appraisals through kind of an appraisal management company that we have, but also the other kind of automated valuations tools. And then also this quarter, we rolled out our Home Price Index. You might have read about which we think is very unique in the marketplace, provides – exposes our unique data set from a valuation point of view, in another way from a product that we can see evolving into a really strong kind of subscription based product. So I think Real Estate and Title, the mortgage services business kind of grows based upon the volume, but I would say the growth opportunities that we're seeing today and the opportunities we see in the future really do revolve around Title and true real estate data and analytics and technology that we have in place today.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay great. And then I think this one is for you Frank, but when you think about the capital and the significant excess that you continue to hold, can you just talk about how you think about weighing the pros and cons of a dividend versus increase from the dividend versus a continuation of the opportunistic buybacks?

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.

A

Sure, Mackenzie great question. I think that is – that's certainly one of the topics that we talk about. I think a more than theoretical distinction between the two is just the sort of on-demand nature of a share repurchase program, you can announce an amount, you can be sort of in and done if you will. A dividend does require I would say a higher hurdle to clear just as it relates to the ability to sustain it over the long term.

And so, I just want to be very careful as we contemplate different methods of capital return to shareholders to make sure that before we start something that it can sort of meet that high threshold that we would have. But I would tell you that right now, we've been very successful in implementing our share repurchase program, both with our previous $250 million authorization having been completed and also our existing $200 million share repurchase program underway.

So if you look at what we've done over the last five years, we have repurchased about 15% of our outstanding shares. So, we feel that we've been very successful in taking out shares at value prices and so we think that's been a very effective means of capital return to our shareholders. And so, that is the path that we're currently on right now. But as you would expect from us, the conversations are broader than that and incorporate a couple of different dynamics there.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Great. Well, thank you so much.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Thank you.

Operator: And next in queue we have the line of Mark DeVries of Barclays. Your line is open.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah. Thanks. I had a question about market share. It feels like the last couple of years as players in the industries have rolled out their risk-based pricing models, we've seen more quarterly volatility in market share across the industry than we've seen historically. Just interested in getting your thoughts on kind of that pricing dynamic and what you're observing in terms of like the sustainability of your business with each individual customer you have?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Yeah. Thank you, Mark. This is Rick. I really think again from a market share point of view, we're less focused on market share. I think if you look over time, we've largely been pretty consistent and I think we haven't seen the same volatility because we don't participate in some of the large, I'll call them bidding situations that create the volatility around market share and I think you'll see ebbs and flows of different volume from quarter-to-quarter as different participants play in those different programs. We're focused on doing business with the customers that align well with our risk return profile and where we can enable them to be very competitive in the marketplace. And I think as I've said before I think you know Derek and the team and the sales team are highly focused, we're very data and analytics driven in our business. So when you think about the environment we're in today, I think it 100% plays to our strength.

And I think the evidence of our success is really how we've been able to sustain strong relationships with a broad base of very high quality players, produce high quality volume at very attractive mid-teens returns as Frank went through and generate significant economic value as we displayed at our Investor Day kind of presentation. So we feel very good about it. I can tell you the only time I hear the market share words in our own discussion is really around earnings call time because we're focused on doing business with the right customers, the right – to do business the right way and truthfully, I think we're unique in the way we deploy data and analytics not only around loan attributes, but we do just as thorough review of our customers and how they originate quality and how they service our risk.

So I'm much more comfortable with how we select, where and who we do business with, based upon our alignment with their strategic objectives and our ability to help make them more competitive, and I think we're winning business where we see the opportunity and we're going to continue to. I think we're well-positioned and this environment plays to our strength, and I feel very comfortable about it.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. So just to clarify, it sounds like your observation is that most of the share shift in that you're seeing is due to the more of the bulk bid business, you're not necessarily seeing pockets of your flow where there's elements of risk that just looks like it's going away because maybe the pricing moved against you and you have to respond. Is that a fair...

[indiscernible] (00:53:42)

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

I think the big market share shifts are exactly as you describe. I think from an overall pricing point of view, we see a fairly – a stable rational environment. And I think you know we feel very well-positioned to compete and where we don't choose to participate, I think that's where you see the volatility.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. That's helpful. And then Frank just interested to hear if there are any tangible benefits that you're looking for as a result of the Moody's upgrades?

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.

A

That's a great question Mark. I think we've talked about this for a number of years. We have and continue to have a stated goal of returning to investment grade for strategic reasons. Practically speaking it doesn't prevent us from doing business with any of our customers on the MI side, so that is certainly a practical consideration there. We'd still love to return to investment grade for just a broader set of strategic options, but as it relates to our core business, practically speaking, there's not a significant distinction with the upgrade, but happy to have the upgrade and hope to see more in the future.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Got it. Thank you.

Operator: [Operator Instructions] Next we have the line of Philip Stefano with Deutsche Bank. Your line is open.

Philip Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks. Quick, I guess, geography question on the other operating expenses. It feels like the mortgage insurance, other operating expenses has been coming down. And a larger proportion of the total has been allocated to corporate, which I think gets allocated back to the segments. Is that right? And can you help me understand why the geography there is changing?

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.
A

Sure. Phil, this is Frank. I can't tell you it's right. And in the geography, I will say will change from time to time just as we reposition resources across the different segments. So, I wouldn't say there's a wholesale reason why that happens. I would just say it's ordinary course review and just updating of our allocation methodologies and where the expenses reside. But I would say that's because there is the opportunity for a little bit of movements and perhaps a little bit of noise period to period there, I would just try to circle you back to the total expense line just to make sure that you're just grounded in what the total expense base for the organization is.

Philip Stefano
Analyst, Deutsche Bank Securities, Inc.
Q

Got it. And that was the $72 million issue that you had mentioned before.

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.
A

That's right.

Philip Stefano
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. And looking at the proportion of LTV, the 85% and below, it feels like that has been growing with time, I guess, over the past couple of quarters when we think about refinances and the increasing number of people who are refinancing, but not able to drop mortgage insurance, I mean, is there different returns for this business given that it probably won't be around as long with housing price appreciation? Should we be thinking persistency might be pressured a bit just because again these guys might be falling off of their MI coverage faster than that maybe some of the other policies and thinking back historically over the business?

Derek V. Brummer
Senior Executive Vice President, Mortgage Insurance and Risk Services, Radian Group Inc.
A

Hi, this is Derek. So in terms of from a return perspective, I'm kind of looking at across different credit characteristics. The expected returns are pretty stable. And so obviously when we project that we factor in the fact that 85% and below are going to have shorter duration, and all things being equal to the extent that the portfolio becomes more skewed towards a lower LTV that is going to have an impact on persistency over time.

Philip Stefano
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. The last one I have is on the Services revenue and Rick, maybe you can just give us a reminder, how much of the Services revenue is repetitive business versus the quarterly revenue is dependent upon sales that happened quarter or two ago. I guess when I think about the insurance broker segment, it feels like 90% of their businesses on January 1st they wake up and know that it's going to renew, and they only really have to do 15% new business and then get some 5% organic and everybody is happy. Can you put that to Services business in similar terms as to how we might be able to think about it?

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.
A

Yeah, that's a great question, and I think if I look back 2.5 years ago, I would have said it was a little bit more episodic as my favorite word. I would say today given the nature of the business, it's becoming increasingly recurring. And what I mean by recurring just to we define the term, it's becoming recurring because we're creating relationships with customers who have continue – that were integrated with from a technology point of view, whether it's Title and Settlement Services, whether it's valuation services and we're also seeing a steady flow from a mortgage services perspective as a securitization market kind of as a level of stability and growth to it. So I think today it's away from the special project work that maybe occurred during the financial crisis here, and much more focused on kind of normal flows and integration on mainstream business around origination activities or securitization activities, SFR financings, REO transactions that are in our pipeline.

So where the volatility will come in as obviously there can be some cyclicality in that from an origination cycle, so a purchase market cycle and seasonality around that. So but from a customer relationship and integration point of view, much like we see on the MI business in terms of kind of embedding within our customer relationships and partnering with them, that's really where the business is heading and really is more there today than it was two years ago.

Philip Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

That's a great question by the way. Thank you.

Operator: Next in queue , we have the line of Geoffrey Dunn of Dowling & Partners. Your line is open.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Thanks. Good morning.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Good morning, Geoff.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Obviously we've seen what has been driving the ability to keep lowering the incidence assumption now to 7.5%. And I doubt there's much more room, although there could be maybe another 50 basis points or some like that based on how you guys talked about in the past, but what are some of the leading indicators we should watch for that might move that back up towards a normalized level. For example, what's the sensitivity if home prices slow down to 1% or 2%, what's the sensitivity if unemployment went up to 4% or 5%? How can we think about credit going forward and watching the macro-economy?

Derek V. Brummer
Senior Executive Vice President, Mortgage Insurance and Risk Services, Radian Group Inc.

A

Sure, this is Derek. I mean I think that you hit upon the two main ones in terms of home price appreciation is going to be an indication not only unemployment rate, but also reemployment rate, that ends up being a big factor in our model as well as it's going to have an impact on cure rates. And then looking at kind of our reported results, so what you're going to be looking for a kind of cure rates and then cure rates and kind of the distribution of kind of how long loans have been in default, the number of missed payments. So I don't have particular sensitivities that the HPA goes down by X% how that translates into kind of default performance. But those are going to be your standard early indicators of performance that you're going to see across the [indiscernible] (01:01:48).

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Is it fair if home prices did slowdown into that zero to 2% that 7.5% is probably not the right rate?

Derek V. Brummer
Senior Executive Vice President, Mortgage Insurance and Risk Services, Radian Group Inc.

A

It's tough to say. The other thing you have to factor in is the distribution of the book in terms of I would say pre-crisis and post-crisis, right. So with respect to that a lot of it's going to depend upon also the embedded HPA you have within those loans. Obviously on the margin higher home price depreciation is going to be favorable. But the other thing we certainly see is kind of on those post-crisis defaults as those increase, they have higher cure rates. The other thing to factor in, certainly if you see home price depreciation really kind of back up and you see kind of increases in default, you see more modification and modification kind of opportunities I think going forward. So I think it's hard to just kind of draw a straight line and say it works, it really kind of depends on the distribution of defaults as well.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

This is Rick. I would just add. I think the other important factor to consider in all of this which there's not a tremendous amount of historical experience, but it'll work to the positive in the future which is servicers have a lot more tools in their tool belt so to speak, they ultimately resolve defaults. So you may see an incident of kind of an increase in defaults based upon certain macroeconomic factors. But we also see servicers and investors and even the political environment much more focused on ultimately curing borrower situations more effectively in the past. So, I think that all comes into play with how we think about the go-forward and what some of the kind of the upward problems are around, ultimately how these things move through from initial defaults equate.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. And then just last follow-up I guess. Is it conceivable that the rate could still further decline?

Derek V. Brummer
Senior Executive Vice President, Mortgage Insurance and Risk Services, Radian Group Inc.

A

Yeah. I think that's – I mean that really is tough to judge. I mean, I think we may have guided toward a lower balance, a couple of hundred basis points ago. So it really is tough to say.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thanks.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

A

Thank you.

Operator: And our last question here in queue comes from the line of Sam Choe of Credit Suisse. Your line is open.

Samuel Choe
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Most of my questions have been answered, but are there any additional ILN issuances or reinsurance that we should be aware of and the timing on that will be great. Thank you.

J. Franklin Hall
Chief Financial Officer & Senior Executive Vice President, Radian Group Inc.

A

Thanks, Sam. This is Frank. A great question. As I mentioned in my prepared remarks, we do feel that the ILNs are a valuable tool for risk distribution and it's something that we would consider on a flow basis. So, that is certainly something that we are contemplating. And to the extent that we would move forward with anything you would see an announcement around that.

Samuel Choe
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: And with no further questions here in queue, I'll be happy to turn it back to our host for any closing remarks.

Richard G. Thornberry
Chief Executive Officer & Director, Radian Group Inc.

Thank you. And I want to thank our team for just a great quarter and all the hard work that everybody's putting into this, and obviously the support we get from our board. And I want to thank each of you for your interest in Radian. We truly appreciate it. And I want to make one last comment as a diehard St. Louis Cardinals fan, I want to congratulate all the Nats fans out there with the Wonderful World Series win, and so I hope you get to celebrate. And we look forward to talking to each of you meeting with each of you in the future and certainly welcome any questions. So thank you, and have a great day.

Operator: Ladies and gentlemen, that does now conclude the conference for this morning. We thank you very much for all of your participation and using our AT&T Executive TeleConference Service. You may now disconnect.