03-Nov-2021

Radian Group Inc. (RDN)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Radian's Third Quarter 2021 Earnings Call. My name is Yanin. I'll be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the call over to Senior Vice President, Investor Relations and Corporate Development, John Damian. Mr. Damian, you may begin.

John Damian
Senior Vice President-Investor Relations and Corporate Development, Radian Group Inc.

Thank you, and welcome to Radian's third quarter 2021 conference call. Our press release, which contains Radian's financial results for the quarter, was issued yesterday evening, and is posted to the Investors section of our website at www.radian.com. This press release includes certain non-GAAP measures that will be discussed during today's call, including adjusted pre-tax operating income, adjusted diluted net operating income per share, and adjusted net operating return on equity.

In addition, specifically for our homegenius segment, other non-GAAP measures that will be discussed today include adjusted gross profit, adjusted pre-tax operating income or loss before allocated corporate operating expenses, and the related homegenius profit margins. A complete description of all of our non-GAAP measures may be found in press release Exhibit F, and reconciliations of these measures to GAAP may be found in press release Exhibit G. And both exhibits are on the Investors section of our website.

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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, President of Radian Mortgage.

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 2020 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

Now, I would like to turn the call over to Rick.

Richard G. Thornberry

Chief Executive Officer & Director, Radian Group Inc.

Thank you, John, and good morning. Thank you, all, for joining us today and for your interest in Radian. I am pleased to say that we continue to see strong growth in the housing and real estate markets, driven by historically low interest rates and robust demand. And while we continue to closely monitor the pandemic and the economic environment, we are encouraged by the favorable credit trends within our insured portfolio that increasingly reflect the return to a more certain operating environment. Frank will discuss the details of our financial position shortly, but let me first share a few highlights and insights from the third quarter.

We reported net income of $126 million or $0.67 per share for the third quarter, and adjusted diluted net operating income per share was also $0.67. We grew our book value per share by 9% year-over-year. We achieved this growth even after accounting for more than $100 million of dividends that we returned to stockholders over the past year.

For our mortgage segment, we remain focused on writing new business at attractive returns that we believe will generate long-term economic value and future earnings for Radian and its stockholders. During the third quarter, we wrote $26.6 billion of high-quality, new mortgage insurance business, and our primary insurance in force grew by $4.3 billion from the second quarter to $241.6 billion at September 30.

As we noted last quarter, we believe the industry has transitioned to a more stable, competitive environment where we would expect to maintain a pro-rata share of the market over the long term with some expected quarter-to-quarter market share shifts across the industry. We have seen continued improvement in the credit performance of our portfolio, with a 46% year-over-year decline in our total number of defaulted loans.

We saw a 60%decline year-over-year in the number of new notices of default received in the quarter. In fact, the number of new notices of default during the second and third quarters were at or below pre-COVID levels. Strong cure activity has continued, with cures outpacing new defaults for each month since June 2020. The cure to new default ratio in the third quarter of 2021 was 178%.

As I've mentioned, since the onset of the pandemic, the outstanding support by the government, GSEs, and industry in the form of forbearance programs for homeowners struggling to meet their mortgage payments has proven to be very beneficial to all stakeholders. As these forbearance programs began to expire at September 30 and beyond, we are working closely with servicers and the GSEs as they seek to successfully migrate these borrowers to a current status, including through the use of payment deferral programs or the appropriate workout solution. We expect that we will have greater visibility over the next few quarters into the ultimate resolution of the loans exiting forbearance programs.

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In terms of the overall housing market, we saw positive trends continuing in the third quarter. Based on September data from our own Radian Home Price Index, continued strong housing demand and relatively limited supply in the market led to an annualized 17.6% increase in home prices across the country. We continue to expect the rate of home price appreciation to moderate over time, and we believe the combination of an improving economy; strong housing dynamics in terms of demand, supply, home values and mortgage underwriting; relatively low mortgage interest rates; as well as strong income growth, are well aligned for a healthy and sustainable housing market.

Our new mortgage insurance business was 90% purchase volume in the third quarter versus only 71% a year ago. Based on updated market projections for 2021 mortgage originations, we now expect the private mortgage insurance market to be approximately $575 billion to $600 billion, which will be slightly lower than the record volume in 2020, but still represent the second highest MI volume year in history.

Looking ahead, total mortgage originations for 2022 are estimated to be approximately $3 trillion, reflecting a 10% increase in purchase originations and a 55% decrease in refinance activity. While the overall market is projected to be smaller in 2022 than 2021, the growth in the purchase market is positive for the mortgage insurance industry, and is expected to fuel another strong market for private MI given the higher likelihood that purchase loans will utilize private mortgage insurance as compared to refinance loans. It is expected to be among the largest private MI markets in history.

It is also important to highlight that the expected decline in refinance originations in 2022 is likely to result in an improved persistency in our mortgage insurance in force portfolio. Overall, we believe the improving macroeconomic conditions and strong home purchase market fueled by first-time homebuyers provides strong tailwinds for long-term growth in the economic value of projected future earnings of our mortgage insurance portfolio.

Turning to our homegenius segment. Total revenues for the third quarter were $45.1 million, representing a 35% increase from the second quarter of 2021 and a 51% increase year-over-year. This was primarily driven by an increase in our title revenue, which grew 106% year-over-year, as well as growth of our valuation business.

As we discussed during our homegenius Investor Day in June, we believe homegenius has the potential for significant value creation and financial contribution going forward, and Frank will discuss our progress against our financial projections.

In terms of capital strength, at September 30, Radian Group maintained a strong capital position with $1 billion of total holding company liquidity. Additionally, at September 30, Radian Guaranty's PMIERs excess available assets was $1.7 billion or a cushion of 49%. Frank will provide additional details on our capital actions and position in a moment.

Turning to the regulatory and legislative landscape. Since assuming the role of Acting Director of FHFA in June, Sandra Thompson is taking meaningful steps to prioritize access and affordability in mortgage credit. Notably, the recent lifting of the preferred stock purchase agreement caps on layered risks, the newly proposed amendment to the Enterprise Capital Framework to reduce GSE required capital levels and the various direct market actions such as eliminating the 50-basis-point adverse market fee for refinance loans and expanding eligibility for the RefiNow and RefiPossible programs represent a notable shift in focus.

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We expect the FHFA's efforts to expand access to homeownership to continue, and as the only source of private capital currently dedicated the first loss mortgage credit protection, we look forward to working with the FHFA and the GSEs to identify and pursue thoughtful and meaningful opportunities to increase sustainable homeownership among low and moderate income borrowers. Ultimately, this is good for the economy and for homeownership, and given our strong alignment with first-time homebuyers for the mortgage insurance industry as well. At Radian, it aligns perfectly with our values and overall mission to ensure the American dream of homeownership.

Now, I'd 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 issued last evening, we reported GAAP net income of $164.1 million, or $0.67 per diluted share for the third quarter of 2021, as compared to $0.80 per diluted share in the second quarter of 2021 and $0.70 per diluted share in the third quarter of 2020. Adjusted diluted net operating income was $0.67 per share in the third quarter of 2021 compared to $0.75 in the second quarter of 2021 and $0.59 in the third quarter of 2020.

I'll now turn to the key drivers of our revenue. As Rick mentioned earlier, our new insurance written was $26.6 billion during the quarter compared to $21.7 billion in the second quarter of 2021 and $33.3 billion in the third quarter of 2020. New insurance written for purchase transactions was $23.9 billion, an increase of 2% year-over-year and 43% compared to the second quarter of 2021. Purchase volume accounted for 90% of our total new insurance written for the third quarter, an increase from 77% of volume in the prior quarter and 70.5% in the third quarter of 2020.

Primary insurance in force increased $4.3 billion during the quarter to $241.6 billion. On a year-over-year basis, primary insurance in force has declined approximately 2%, primarily driven by sustained low persistency resulting from policy cancellations during a low-interest rate, high-refinance period. It is important to note, however, the mix shift of our in force portfolio during this past year. Monthly premium insurance in force, which drives the majority of our earned premiums, has grown 6% year-over-year compared to a 25% decline in single premium insurance in force.

It should also be noted that prepayments in single premium insurance in force enhances our realized returns as the life over which the single premium is recognized is shortened. Our quarterly annualized persistency rate was 67.5% this quarter, an increase from 66.3% in the second quarter of 2021 and 60% in the third quarter of 2020. The year-over-year increase in quarterly annualized persistency is primarily driven by lower refinance activity in the third quarter of 2021, as compared the same quarter last year. While persistency is expected to improve during the remainder of 2021, we also expect persistency to remain below our historic long-term levels for the foreseeable future given the current pace of refinance activity.

Moving now to our earned premiums and other revenues. Total net premiums earned were $249.1 million in the third quarter of 2021 compared to $254.8 million in the second quarter of 2021 and $286.5 million in the third quarter of 2020. The decrease on both in linked quarter and year-over-year basis are primarily driven by lower accelerated premium recognition due to single premium policy cancellations, as well as a continued decline in our in force premium yield.

Title premiums increased to $12.3 million in the third quarter of 2021 compared to $7.7 million in the second quarter of 2021. Slide 10 shows the mortgage insurance premium yield trend over the past five quarters. Our

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direct in force premium yield was 40.3 basis points this quarter compared to 41.1 basis points last quarter and 43.2 basis points in the third quarter of 2020.

With regard to pricing on new business, we remain focused on maximizing projected economic value and generating attractive risk-adjusted returns, and while we expect to generate a pro-rata volume overall, we target the volume with the highest economic value.

Our homegenius segment revenues were $45.1 million for the third quarter of 2021, representing a 35% increase compared to the second quarter of 2021 and a 51% increase compared to the third quarter of 2020. Our reported homegenius pre-tax operating loss before allocated corporate operating expenses was $600,000 for the third quarter of 2021 compared to a loss of $4.5 million for the second quarter of 2021. Our reported homegenius adjusted gross profit for the third quarter of 2021 was $17.9 million compared to $11.7 million for the second quarter of 2021. A reconciliation of these items can be found on Exhibit G.

As noted on slide 22, we continue to make progress against our targets as communicated earlier this year, with homegenius revenue still tracking towards our goal of $150 million for 2021. Our target for pre-tax operating income before allocations was updated primarily to reflect adjustments made this quarter to recognize the impact of company-wide incentive expense accruals.

Our investment income this quarter of $36 million was relatively flat compared to the prior quarter and same quarter prior year due to lower investment yields, which were partially offset by additional investment balances from underwriting cash flow. At quarter end, the investment portfolio duration was approximately 4.5 years, unchanged from the prior quarter.

Moving now to our loss provision and credit quality. As noted on slide 13, the mortgage provision for losses for the third quarter of 2021 was $16.8 million, an increase compared to $3.3 million in the second quarter of 2021 and a decrease compared to $87.8 million in the third quarter of 2020.

As shown on slide 14, we had approximately 8,100 new defaults in both the third and second quarters of 2021 compared to approximately 21,000 in the third quarter of 2020.

Also, as noted on slide 13, the provision for losses for the third quarter 2021 includes a positive development on prior defaults of $16.5 million. This positive development was primarily driven by more favorable trends in cures than originally estimated, which resulted in a reduction in certain default to claim rate assumptions related to defaults first reported prior to the onset of the COVID-19 pandemic.

We maintained our prior quarter assumptions for defaults reported since the start of the pandemic, including the default to claim rate assumption on new defaults at 8% for the third quarter of 2021. We continue to closely monitor the trends and cures and claims for that portion of our default inventory, including the resolution of COVID-19-related forbearance programs.

As shown on slide 16, 67% of all defaults were reported to be in a forbearance program as of September 30, 2021. Based on information provided by servicers, we currently expect that substantially all defaults as of September 30, 2021 under a forbearance plan will reach the scheduled expiration of their forbearance term by the end of the third quarter 2022, and that approximately half of this population will reach that expiration before year-end 2021. These estimates are based on the date each loan was reported as entering forbearance and the maximum forbearance term available to the borrowers at that time.

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As a reminder, forbearance programs are positive for our industry and for homeowners as they are intended to keep people in their homes through what is expected to be a temporary economic disruption. It should also be noted that approximately 89% of new defaults from the second quarter of 2020 and 85% of new defaults from the third quarter 2020 have cured as of the end of October.

Now, turning to expenses. Other operating expenses were $86.5 million in the third quarter of 2021, flat to the second quarter of 2021 and increased compared to $69.4 million in the third quarter of 2020. The increase in other operating expenses as compared to the prior year is primarily related to an increase in incentive compensation expense, including long-term share-based incentive compensation, as well as a $6.7 million decrease in ceding commissions associated with lower single premium acceleration.

It should also be noted that as homegenius revenues and earnings continue to grow, our total expenses will grow as well. Over the next year, we expect consolidated normalized quarterly operating expenses to grow from approximately $72 million to approximately $85 million, which will depend largely on the timing and the execution of our homegenius segment revenue growth strategy.

Our mortgage segment, however, should have relatively flat quarterly expenses at just under $60 million.

Moving now to taxes. Our overall effective tax rate for the third quarter of 2021 was 21.8%. Our annualized effective tax rate for 2021 before discrete items remains generally consistent with the statutory rate of 21%.

Now, moving to capital and available liquidity. Radian Guaranty's excess available assets over minimum required assets was $1.7 billion as of the end of the third quarter, which represents a 49% PMIERS cushion. As of September 30, 2021, we have reduced Radian Guaranty's PMIERs minimum required asset requirements by $1 billion by distributing risk through both insurance-linked notes reinsurance and other third party reinsurance arrangements, as noted on press release, Exhibit L.

And subsequent to our third quarter end, Radian announced the pricing of a $484.1 million aggregate principal amount of mortgage insurance linked notes issued by Eagle Re 2021-2 Limited. In connection with this transaction, Radian Guaranty will receive $484.1 million of fully collateralized aggregate excess of loss reinsurance coverage from Eagle Re at closing. The excess of loss reinsurance will cover mortgage insurance losses on new defaults on an existing portfolio of eligible policies, with risk in force of $10.8 billion that were issued predominantly between January 1, 2021 and July 31, 2021.

For Radian Group, as of September 30, 2021, we maintained $768 million of available liquidity, compared to $923 million as of June 30, 2021. The primary driver of this decline was share repurchase activity, which I will discuss in more detail in a moment, along with our recurring shareholder dividend payment, partially offset by a $36 million ordinary dividend paid by our Radian Reinsurance subsidiary. Total liquidity, which includes the company's $267.5 million credit facility, was $1 billion as of September 30, 2021. It is important to reiterate that most of the cash flows of the parent company are funded by long-established regulator-approved expense interest and tax sharing agreements with its subsidiaries, and not through dividends from subsidiaries. This provides us with an enhanced level of certainty and predictability in parent company cash flows.

During the third quarter of 2021, we repurchased 7.1 million shares, and year-to-date through October 31, we have purchased 13.3 million shares, or approximately 7% of our outstanding shares, at an average share price of $22.78, or an approximate 3% discount to our current book value. As of October 31, we have approximately $95 million of remaining repurchase authorization, which expires on August 31 of next year.

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We have also continued to pay a dividend to common shareholders throughout the pandemic, including during the third quarter of 2021, as we returned approximately $27 million to shareholders through dividends during the quarter. As a reminder, and as previously announced, we increased our quarterly dividend by 12% to $0.14 per share during the second quarter of this year. The combination of dividend payments and share repurchase represent a return of capital of approximately 82% of our after-tax operating income for this year.

Given the capital strength at Radian Guaranty and the financial flexibility provided by our available liquidity at Radian Group, we believe that we are well-positioned to support our businesses and deliver value to our shareholders.

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 highlight for you that we increased book value per share by 9% year-over-year and maintained a strong capital position with $1 billion of total holding company liquidity. We've seen continued improvement in the credit performance of our portfolio that reflects a return to a more certain operating environment. We wrote $26.6 billion of high-quality new mortgage insurance business, which helped grow our primary mortgage insurance in force to $241.6 billion. Homegenius revenues increased by 51% year-over-year.

Finally, I wanted to mention how proud I am of our team's continued dedication to our customers, our communities and each other. During the quarter, we were recognized as a Champion of Board Diversity by The Forum of Executive Women; and raised a total of $165,000 for the MBA Opens Doors Foundation, an organization that shares our mission of enabling and protecting homeownership. I know many of you are familiar with our annual fundraiser for the foundation, which helps families with critically ill or injured children to remain in their homes while their children are in treatment. I want us to take a moment to thank all who helped to make our campaign a huge success for an outstanding cause.

Now, operator, we would be happy to take questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Doug Harter from Credit Suisse. Please go ahead.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. I was hoping you could just talk a little bit about the competitive dynamics that that happened on the MI space during the quarter, and just if – any particular areas where you think you were more effective at winning business this particular quarter.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Hi. Yeah. This is Derek. So, in terms of the competitive dynamics, and Rick alluded to this in his opening remarks, what we kind of saw, I would say, kind of the second half of the second quarter, we saw increased kind of stabilization in the competitive environment. We saw some price decreasing in the first half, but that really stabilized. And that allowed us an effective opportunity.

As we've indicated, long term, we'd expect our market share to be in kind of that pro-rata range to give up market share in kind of phases where you've seen price volatility. So, with that stability, we found better opportunities to distribute capital across the credit spectrum. We also saw opportunities this quarter to lean into certain credit segments. So, our NIW was up. Our capital deployment was up even more this quarter. So, we saw pretty good value, and that also plays to our strengths when we have that stability.

Really, what we're looking for, as Frank referenced, is that portion of the market with the highest economic value. And so, a lot of our analytics are focused on that really moving in and out of positions based upon where we see that relative value. And I would characterize, overall, kind of where we see value and pricing. We see good value kind of across the spectrum and under the different pricing schemes. Most of our pickup was really in the Black Box segment and our RADAR Rates is where we kind of picked up, I would say, the most market share this quarter.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you, Derek.

Operator: And our next question comes from Cullen Johnson from B. Riley Security (sic) [Securities] (29:46). Please go ahead.

Cullen Johnson
Analyst, B. Riley Securities, Inc.

Q

Hey. Good morning. Thanks for taking my questions. Within the homegenius segment, I think, in 2020, the lowest quarter for revenue was the fourth quarter. Is there any sort of seasonality to the top line there that might make that the case again in 4Q 2021? Or do you think that was more of an isolated data point there?

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

Yeah. Cullen, that's a great question. This is Rick. I think, today, we remain committed to our guidance that we provided in terms of total revenue. I think there is seasonality in the mortgage business and real estate business generally, right? So, we would look at homegenius today as being kind of in that market space today where you could see seasonality. I think different factors played in the last year than what we would see this year. And I think we've given guidance around both 2021 and 2022 in terms of revenue, and we continue to remain confident about that.

I would say that our – I couldn't be more proud of the team that's executing our homegenius plan and really the progress being made. And when you look at kind of from our side, we're continuing to see our customer pipelines build. But just as important, not only are we adding new clients, we're penetrating existing clients. So, we're happy about the business that we're doing. But we're in those – we're in the mortgage real estate cycles, if you will, and we'll manage and navigate those through and feel comfortable with the guidance that we've provided.

Cullen Johnson
Analyst, B. Riley Securities, Inc.
Q

Got it. That's helpful. And then just sticking with the homegenius segment, kind of, in the presentation the SaaS contribution to revenue has been lower than the low end of the target. So, I was just curious what might cause that to ramp up and get closer to that target here, kind of intermediate term?

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

Yeah. I think as we went through – again, thank you for the questions. As we went through in Investor Day, we really our focus on kind of the growth in SaaS. It really comes starting in 2022, so anything that you see happening this year is kind of on the early side. I would say this, from a homegenius perspective, our title business – as we said and kind of forecasted, our title would lead the growth kind of early on here with kind of our SaaS business following, and our other real estate services providing a very steady and valuable contribution along the way.

So, we've – in our SaaS business, we're early in the rollout. I would say, from a customer point of view, the feedback on our smart workflow system and our property intelligence platforms have been very positive and very encouraging. And so I think as we roll to 2022, we would expect to see the contribution start to develop from the SaaS business. I think what we did is we focused on Investor Day more about the number of users that we grow over a period of time, and so we would look to start to discuss and provide that information as we get into 2022.

Cullen Johnson
Analyst, B. Riley Securities, Inc.
Q

Okay. Great. That's helpful. I'll leave it there. Thank you.

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

Yeah. Thank you, Cullen.

Operator: And our next question comes from Mark DeVries from Barclays. Please go ahead.

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Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Yeah. Thanks. I understand that the net yield is tough to model given some of the drivers there. But for the in force portfolio premium yield, yeah, how close do you think we are from seeing that bottom just given the risk you're writing today?

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

Yeah. Mark, this is Frank. It's a good question, and one that I think we've been answering for many quarters now. I think, as we've said before, it really is a matter of the mathematics associated with bringing in new business with particular risk mix and a particular premium level relative to what stays in the portfolio and what runs off, and looking at all of those attributes there. Generally speaking, we have guided that we expect to see that the premium yield decline over time, actually for several years now. In fact, our in force portfolio yield has declined about just under 7 basis points over the previous seven quarters. So, you're seeing about a basis point per quarter coming out of there. And I would say our decline here isn't that much different. That's not to suggest that that's a run rate to bake in. But it really is difficult to predict in that regard. But I do think, directionally, we would expect to see that continue for a bit longer.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Okay. Understood. And then sorry if I missed this. Did you discuss kind of what caused the year-over-year increase in the MI underwriting expenses?

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

Yes. So, year-over-year, it was incentive comp expense.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Okay. Got it. Would you expect that to remain elevated in the fourth quarter?

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

No. It's generally seasonal. As we look to true up accruals and things like that for year-end, the magnitude of change generally in the fourth quarter is muted.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Okay. Got it. Thank you.

Operator: And our next question comes from Mihir Bhatia from Bank of America. Please go ahead.

Mihir Bhatia
Analyst, BofA Securities, Inc.
Q

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Hi. Thank you for taking my questions. And let me apologize upfront for maybe beating a dead horse, but I did want to follow up on Mark's question about premium rates and where they've stabilized. Maybe talk about your yield on NIW, how that has been trending or where that is relative to the in force yield, or at least some puts and takes from you on the premium yield.

I guess, like, the part we're struggling a little bit with is last year you raised rates a little bit and then this year you – I guess rates are back to pre-pandemic levels and we're seeing in force premium yields decline. And the question, I guess, is will they be declining at a faster pace a little bit here as this year's policies come on at a lower – NIW comes on at a lower yield than even last year's, or anything you can help us more on that on just in terms of the outlook for premium rates would be great.

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

A

Sure. Sure thing, Mihir. I'll start. This is Frank. I'll start and then maybe turn it over to Derek for some additional color on the market dynamics. But what I would suggest to you again, and I know it's frustrating to try to predict this, but as we look at where value is across the risk spectrum, we want to maintain a nimbleness and make sure that we are able to write the business where we see the greatest value.

That doesn't always mean that it's the same risk dimension. And so because of that, it also means that the premium rates can vary. And so that's what really makes this particular metric a difficult one to predict. Directionally, is probably the best that we can do for you, and then keep in mind also, and Derek can touch on this a bit more, the rate dynamic that we saw before COVID, during COVID, and post-COVID, I would say was unusual volatility just for a very specific event there. So, again, the best I can do for you directionally is just to say that the trend is likely to continue. It is a competitive pricing dynamic overall, and that's not unusual. We've been saying that for years. But again, what we're focused on is finding value, and that can create some differences in what's actually produced on an NIW basis from a risk perspective.

So, Derek, I don't know if you'd add anything else there.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

Yeah. I think you hit upon it, Frank, in terms of the risk mix is very important, right? So, what we're doing is we're deploying capital. We're looking to maximize the economic value and the return on that capital. And so, with respect to that, and I alluded to this as well, we will move in and out of different credit segments; and correspondingly the premium rates will kind of shift as we move in and out. So, you can have situations, and I would argue we've kind of seen that this year where you've seen overall in the industry a premium rate decline in the first half. You've seen stabilization. I would say our premium rate has stayed relatively stable, but that's as we've moved risk mix.

Now, we're not looking to maximize necessarily that premium rate. That's an important component, but that's kind of an output in terms of our decision, which is to focus on economic value and maximizing that. So, it's very hard to say. The other thing you have in is just the shift between refi and purchase mix. So, you've seen that purchase volume increase, you've seen that move around as well. You also have to factor in what you think the duration is on the policies. So, as a result – and then finally, I would say, whatever we seek to do, we live in a competitive environment, so ultimately when we're trying to project kind of the portfolio yield that's dependent upon what the competitive environment looks like as well, I think that's why it does make it difficult to give a projection, here's where it will be in this period of time.

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

A

Yeah. And Mihir, this is Frank again. I would just close it out with one other observation, which I know you know, is as you look at persistency and increasing persistency, that's actually going to decrease the rate of change you're likely to see in the portfolio yield overall. That lower persistency is going to cause a faster turn in the portfolio. But we're starting to see some modest upticks there in persistency. So, we think that bodes well for us.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Okay. No. I appreciate that. And anecdotally, I think we appreciate that you're pricing to – you're maximizing returns not premiums. It's just a little challenging from the outside, I think, early on in the process to see that. Maybe just switching a little bit on homegenius. It continues to be an area of investment and, obviously, you talked about it at your homegenius Investor Day a few months ago. But maybe just talk a little bit about where the growth is coming from? Who are you competing against in those businesses, particularly on the – I guess, on the title side, it's kind of straightforward, but outside the title side, who are you competing from? Are you winning this new business from competitors? Is it just people choosing to outsource? Like talk about some of the dynamics and some of the non-title businesses within that, please? Thank you.

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

A

Yeah. Yeah, Mihir. Thank you for the question. And I think, first off, I don't want to exclude the title business because I think what's interesting about the title business since we are new entrant, right, and you could consider us a new entrant. And leveraging our relationships on with lenders through our MI business and other businesses. We've been able to gain relationships on the title side with some of those key relationships. So, we're growing new relationships on the title side, and at the same time through service and just the execution by our teams from a service delivery perspective. We're penetrating those clients which is very, very important kind of as we see market shifts on the mortgage side. So, I think, title, as we said at our Investor Day, would start – would kind of lead the growth, and it's done that. And we feel good about our business, and we look forward to growing that.

On the real estate services side, say, valuation, asset management, SFR, we've actually seen – we're very strong and a market-leading player across the asset management side. And even though ROE has been pretty much shut down because of the foreclosure moratorium, we see that kind of lifting going into 2022. And we've seen great strength in the SFR business. So, we're a leading player in that business. It's small, but it's a very nice contribution to our business.

And then on the SaaS business, it is early. We are competing – the competition there is generally other technology players with, I would say, niche solutions, kind of narrow solutions. And I think what we're doing is we're bringing a – kind of people have described as kind of a new category in terms of smart workflow systems for realtors and property intelligence platforms for realtors. So, not to say we don't have competition, because we do, as we define kind of a better way of doing business for real estate agents, I think we're competing with existing and legacy players there to take market share away from them, right, so – but with new and different and better models, so it's early, but again the feedback's been very positive from the customers and kind of the discussions that we've been having as we've been starting to unveil our different capabilities, and so that's what gives us kind of, I guess, gives us the confidence in the future. So, hopefully that helps you.

But I would say, look, we're – everything we do is in a competitive market, and we try to determine, are we able to do it better than the competition, cheaper, with better value proposition? And I think in all cases today, we feel

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confident about the value proposition we offer across our homegenius business to be highly competitive, kind of what's next, and an opportunity to be more of a disruptor than kind of a traditional legacy player.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Understood. Thank you. I'll just ask one last question, and then – I don't want to monopolize the call. Just on the regulatory, you mentioned the FHA offerings looking to expand. Can you just talk about some of the puts and takes from that? Have you heard any rumblings of doing away with life-of-loan coverage or a sliding scale in terms of adopting sliding scales for premium rates, changes to the MI program, whether – or even like rate cuts? Just your views on some of that. Thank you.

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

A

Well – and Derek could add to this because he's – as Chairman of USMI, he also has great visibility into this, but I would say, look, we saw FHA, right, in terms of – and I think you're referring to FHA, take a very considered view early this year when there was discussions about premium cuts. I think as an industry, certainly as Radian, we all felt like what we heard being discussed would not have had a material impact on our business. So, I think we still feel that way.

Obviously, any changes from an FHA point of view could also be – there could also be changes from the GSE perspective too in terms of loan level pricing adjustments. So, I think, today, obviously there's the actuarial report on the strength of the fund on FHA coming out soon, and we'll see where that is. But I think there's still – there's been great discipline around kind of considerations about changes to FHA pricing. I think it's a balance between public policy and maybe politics, if you will, compared with what is sound business practices. So, we'll have to see. Recently, I've not heard much chatter.

I don't know, Derek, if you want to add anything to that.

Derek V. Brummer
President-Mortgage, Radian Group Inc.

A

No. I think you hit the key points. I think the other important thing to keep in mind is it's just a less of a significant risk for us than what it had been historically because there's just less about credit overlap in terms of where we're generally writing business. And I think when we look at in the past, I think if we thought about like a 25 basis point reduction on FHA premium, I think back when this was kind of a hot topic, I think we estimated that was probably going to be less than 5% of the volume GSEs' way. But as Rick alluded to, the GSEs are also looking out, and the FHFA is, I think, focused on things like minimum level price adjustments in g-fees as well. So, you could have a shift there also where that market's expanding in size. So, it's tough to see where it all shakes out.

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

A

Yeah. I think it's important to think that nothing happens in isolation. And the other issue that's just a primary consideration out there, which we've talked about before, is anything you do to reduce price only further extends the issue of supply and demand, right? So, you increase demand by providing more attractive pricing, and the supply side of things is extremely limited. So, you could actually cause issues with affordability just by reducing price thinking you're helping borrowers, right, because increasing demand against a finite supply. We all learned that in Economics 101.

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So, I think the good news is there's been very thoughtful consideration as we've gone through, and we'll continue to work – we're working very closely with FHFA and the GSEs, Derek and team, around opportunities for us to really work together to address the low to moderate income affordability and access to financing in a constructive, sustainable way. And I'm very optimistic that there's going to be some very positive outcomes to those efforts as we work together as an industry to really kind of once and for all trying to solve some of those issues, and I think it's time to do it.

Mihir Bhatia
Analyst, BofA Securities, Inc. Q

Understood. Thank you.

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

Yeah. Thank you.

Operator: [Operator Instructions] Our next question comes from Bose George from KBW. Please go ahead.

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

Hey. Good afternoon. I just wanted to go back to the discussion on expenses. The $60 million that you guys guided to, when we – is that just for the operating expense number and then we should add whatever mid-single digits or the policy acquisition cost?

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

Yeah, that is for the other operating expenses. That's correct.

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

Okay. And then like if I look at that numbers, say, $65-ish million a quarter, it seems to work out to kind of close to a 30% expense ratio. I mean, like when you target your mid-teens-ish ROE, what kind of expense ratio do you kind of build into that?

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

Yeah. So, we look at really just our historic, and we do a periodic update on the expense assignment that we give for our return calculation. And so we look at our historical costs associated with that. There are some allocations that we put in there, so it's a combination of direct and some indirect costs, but it's an estimate that we've put forward in estimating that.

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

Okay. I'm just curious, I mean, your – I guess your peers with similar insurance in force are kind of in the low-20s. So, do you think there's room to kind of get the expense ratio down a little lower?

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

A

Yeah. I mean, we're always – and Bose you've followed us long enough to know that we're always looking for ways to be more efficient, to leverage technology, to create positive operating leverage in the business. I would say, it is to the point where we wouldn't want to suggest there are big gaps that we're managing to, but more just the refinements that we'll see over time.

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

Q

Okay. Great. Thanks a lot.

Operator: And our next question comes from Ryan Gilbert from BTIG. Please go ahead.

Ryan Gilbert
Analyst, BTIG LLC

Q

Hi. Thanks. Good morning, guys. First question is on insurance in force, really nice to see the sequential pickup in the third quarter. And just thinking through your prepared remarks around persistency and the total market in 2022 being smaller than 2021, do you believe or do you think that you can continue to grow insurance in force or do we think that the improvement in persistency that we expect isn't going to be enough to offset decline in NIW?

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

A

Yeah. That's – this is Frank. I appreciate the question. I think, one is, especially given the size of our in force portfolio, which is among the largest in the industry, and our market share expectations, I think the factors that would influence growth are things like just the size in the overall market, et cetera, relative to higher persistency. So, I wouldn't want to suggest that there would be significant growth there, but I think the growth factors are certainly possible in the coming years just given some of the variables that you mentioned.

But it is similar to our portfolio yield. It's a bit challenging to predict just given what the landscape for refinance activity might be like and what the NIW might be like. But I would certainly suggest that some modest growth could be there.

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

A

Yeah. And I'd add to Frank's comments, too, Ryan. I mean, when you look at the macro factors, as I shared on my prepared remarks, when you think about the refinance market projected to decline by 55% next year, that has – assuming that plays out, that should have a positive impact on persistency. And we also talk about in the context of the purchase market continues to have strong tailwinds. So, we see growth in purchase market where MI is likely to participate. So, we do still see one of the larger markets, albeit maybe smaller than 2021 and 2020, for the MI business.

So, when you look at the – macro factors are kind of all potentially pointing in the right direction to kind of increase persistency and also continue to see strong mortgage insurance participation across some purchase mortgage market. But again, in terms of forward forecast, we look at more of the macro trends and participate and go full force at it. And I would agree with Frank's comments that it's sometimes hard to predict because of timing of some of these factors.

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Ryan Gilbert
Analyst, BTIG LLC

Q

Okay. Got it. Really helpful. My second question is on homegenius. I'm wondering if Zillow's exit from the iBuyer business has changed your view on homegenius' total addressable market?

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

A

Thank you. No, not at all. I don't want to comment on Zillow. I read the stories and they – I give them credit for trying something bold. But why they made the decision to get in and get out, I'll leave that to them. But for us, our focus and conviction on the homegenius and the size and scale and the addressable market of homegenius across mortgage and real estate markets remains very large, and no part of it really related to – yeah. So, we actually do business with iBuyers and SFR investors. And I think much of the iBuyer focus was kind of addressing some of the SFR investors' needs. But I think their exit doesn't really impact our business. And for us, we continue to see the same opportunities we've seen for the last year or two around the space and why we're so focused on it.

Ryan Gilbert
Analyst, BTIG LLC

Q

Okay. Great. Thanks very much. I appreciate it.

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

A

Yeah. Thank you.

Operator: We have no further questions at this time. I will now turn it over to CEO, Rick Thornberry.

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

Thank you. And thank you, everybody, for participating on our call today, and we appreciate your questions. And hopefully, we'll have an opportunity to talk to many of you in the coming days or weeks. But as always, stay safe, be safe. I hope the holiday season goes well for everybody over the coming months. And we look forward to seeing you in person at some point. Again, thank you for your participation today. And also thank you to our team who's doing a fantastic job. And I couldn't be more proud across our mortgage and homegenius businesses, how the dedication and commitment that they've demonstrated every day really helps us drive this business forward. So, thank you. Have a great day.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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