02-Nov-2023

Radian Group Inc. (RDN)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

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

OTHER PARTICIPANTS

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

Mihir Bhatia
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Radian's Third Quarter 2023 Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would like now to turn the conference over to John Damian, Senior Vice President, Investor Relations and Corporate Development. Please go ahead.

John Damian

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

Thank you and welcome to Radian's third quarter 2023 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 may 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. A complete description of all of our non-GAAP measures may be found in press release Exhibit F, and reconciliations of these measures to the most comparable GAAP measures may be found in press release Exhibit G. These exhibits are on the Investors section of our website.

Today, you will hear from Rick Thornberry, Radian's Chief Executive Officer; and Sumita Pandit, 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 2022 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

Now, I'd like to turn the call over to Rick.

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

Good afternoon and thank you all for joining us today. I am pleased to report another excellent quarter for Radian. GAAP revenues grew year-over-year to $314 million. We generated net income of $157 million or $0.98 per diluted share. Our annualized return on equity was 15%, and adjusted net operating ROE was 16% in the third quarter.

Book value per share increased 12% year-over-year to $26.69. Radian Group paid a $35 million dividend to stockholders, reflecting the highest yielding dividend in the industry. We repurchased 1.9 million shares or $50 million of common stock in the quarter. And our overall liquidity and capital positions remained very strong. These results reflect the quality and earnings power of our highly valuable mortgage insurance portfolio combined with our successful track record of effectively managing our capital resources.

We continue to monitor macroeconomic trends including heightened geopolitical risks. While we continue to experience mortgage and real estate market headwinds in terms of higher interest rates, housing supply constraints, and affordability challenges, market conditions for our mortgage insurance business remain positive, including increasing home prices, employment stability, decreased inflation, and an improved reinsurance market for risk distribution.

In terms of our mortgage insurance business, we continue to leverage our proprietary analytics and RADAR Rates platform to successfully identify and capture economic value in the market. As a result, we wrote $13.9 billion of high quality mortgage insurance business in the third quarter of 2023. This contributed to 4% growth year-over-year in our primary mortgage insurance in-force portfolio, which is the main driver of future earnings for our company.

We continued to see positive credit performance in our mortgage insurance portfolio during the quarter, and our persistency rate remained strong. From a quality perspective, our $270 billion mortgage insurance portfolio has been well underwritten and has a strong overall credit profile. It's also worth repeating that higher interest rates result in higher yields on our $6 billion investment portfolio. This supports higher returns and generates incremental income that flows directly to our bottom line.

In terms of the housing market, based on the industry projections for the total mortgage originations of $1.6 trillion, we now expect the private mortgage insurance market in 2023 to be approximately $300 billion. And based on early industry projections, we expect a similarly sized MI market in 2024.

While low inventory and strong market demand continue to create challenges for first time homebuyers, these dynamics help to mitigate downside risk in home values, which is positive for our insured portfolio. And we believe the resulting pent-up demand also provides strong support for future purchase volume, which drives the growth in our large and valuable insurance in-force portfolio. Given that our mortgage insurance business benefits from increases in demand, home prices and purchase volume, our overall outlook for the business remains generally positive.

With regards to our homegenius business, we continue to navigate the market challenge of higher interest rates and limited inventory, which has constrained mortgage and real estate activity. We will continue to adjust our cost structure and align our strategy investments to the current market, while positioning for an improved market in the opportunities ahead. And we continue to build on our strong track record for managing our capital resources, with Holding Company liquidity continuing to remain strong at $1.3 billion.

Sumita will discuss our capital position in more detail, including our two new reinsurance agreements. It's important to note that we continue to leverage our expertise in managing credit risk using an array of risk distribution strategies and structures in order to effectively manage capital and execute our aggregate, manage, and distribute mortgage insurance business model. We believe the strength of our capital position significantly enhances our financial flexibility now and going forward.

Over the years, we've consistently demonstrated a strategic focus on capital optimization. As we've noted previously, we carefully consider the balance between organic growth, the return of capital to stockholders, and other accretive capital allocation opportunities. Many of you have highlighted our differentiation from peers in terms of the capital return, as well as our effectiveness in unlocking trapped capital wherever feasible.

As you've heard me say before, our company is built to withstand economic cycles, significantly strengthened by the PMIERs capital framework, dynamic risk-based pricing, and the distribution of risk into the capital and reinsurance markets.

Sumita will now cover the details of our financial position.

Sumita Pandit

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

Thank you, Rick, and good afternoon to you all. I am pleased to provide additional details about our third quarter results, which demonstrated the continued strength of our high quality mortgage insurance in-force portfolio and our ongoing strategic focus on capital management.

We produced another strong quarter of operating results in the third quarter of 2023, earning GAAP net income of $157 million or $0.98 per diluted share, compared to $0.91 per diluted share in the second quarter. Adjusted diluted net operating income per share for the quarter was slightly higher at $1.04 compared to $0.91 per share in the second quarter. We generated a 15% annualized return on equity and 16% adjusted net operating return on equity for the third quarter. Our book value per share grew 12% year-over-year to $26.69 as of September 30.

Despite continued challenges in the macroeconomic environment, we generated $314 million of total revenues during the third quarter, compared to $290 million in the second quarter. As a reminder, our total revenues and net premiums earned in the second quarter were reduced by a one-time increase in ceded premiums earned of $21 million due to the Eagle Re tender offers and subsequent retirement of certain seasoned insurance-linked notes and the corresponding portion of the reinsurance agreements that no longer provided any capital benefit to Radian Guaranty.

In the third quarter, our total revenue, net premium yield, and net premiums earned, all began to benefit from the ongoing savings in ceded premiums, resulting from the successful Eagle Re tender offers.

Slides 10 through 12 in our presentation include details on our ceded premiums, as well as other key drivers of our net premiums earned. Our primary insurance in-force grew 4% year-over-year to $270 billion as of September 30, 2023, generating $237 million in net premiums earned for our mortgage segment in the third quarter. Contributing to the growth of our insurance in-force was $13.9 billion of new insurance written for the third quarter compared to $16.9 billion in the second quarter.

While the industry-wide decrease in mortgage originations has provided headwinds over the past year for our new insurance written, it has significantly benefited the persistency rate of our insurance in-force, which remained high at 84% in the third quarter based on the trailing 12 months compared to 76% a year ago.

We provide more detail on our persistency trends on slide 10. We expect our persistency rate to remain strong, given the sharp and continuing rise in mortgage rates, following an extended period of exceptionally low rates. Greater than 80% of our insurance in-force had a mortgage rate of 6% or less as of the end of the third quarter, and is therefore less likely to cancel in the near term due to refinancing. The natural hedge provided by the relationship between our new insurance written and persistency rates has helped to sustain our insurance in-force growth and earnings power in varied interest rate environments.

As shown on slide 12 and consistent with our prior expectations, the in-force portfolio premium yield for our mortgage insurance portfolio remained stable in the third quarter at 38 basis points, compared to the level reported at year-end 2022. With strong persistency rates and the current industry pricing environment, we continue to expect the in-force portfolio premium yield to remain relatively flat over the near term. The higher interest rate environment has also benefited our investment income, which grew 34% year-over-year to $69 million in this quarter.

As shown on slide 14, our total investment portfolio of $6 billion consists of well-diversified, highly rated securities. The yield on our investment portfolio of 4.2% continued to increase during the third quarter as shown on slide 15. And the higher rate environment should continue to be positive for our investment income and revenues. In addition, our homegenius segment revenues totaled $15 million for the third quarter of 2023, consistent with the second quarter.

I now move on to our provision for losses. The positive credit trends that we have been experiencing continued into the most recent quarter. We recognized a net benefit of $8 million in our mortgage provision for losses in the third quarter, compared to a net benefit of $22 million in the second quarter. Our defaults continue to cure at rates greater than our previous expectations, resulting in releases of prior period reserves.

On slide 17, we provide trends for our primary default inventory, which continues to benefit from the strong cure trends. Our ending primary default inventory as of September 30th was approximately 20,000 loans, representing a portfolio default rate of 2%, consistent with the last few quarters. The number of new defaults reported to us by servicers increased in the third quarter of 2023 to approximately 11,200 from 9,800 in the second quarter, consistent with the expected seasoning of our growing insurance in-force portfolio and seasonal trends in the quarter.

Cures remained strong at approximately 10,500, consistent with the second quarter of 2023. We continued to maintain our default to claim rate frequency assumption for new defaults at 8%, resulting in $47 million of loss provision for new defaults reported during the quarter. This provision for new defaults was offset by $55 million of positive reserve development on prior period defaults due to the favorable cure trends and higher claim withdrawals by services.

These favorable trends are driven primarily by the significant embedded homeowner equity, resulting from the strong home price appreciation experienced in recent years. 82% of our existing defaults have estimated embedded home equity of 20% or greater using an index based approach.

Turning to our other expenses. For the third quarter, our other operating expenses totaled $79 million, a decrease compared to $90 million in the second quarter. The lower expenses recognized this quarter were consistent with our expectations and reflect the benefit from our expense savings actions to date.

Our combined year-to-date consolidated cost of services and other operating expenses through September 30th have decreased by $56 million or 16% compared to the same nine-month period last year. Assuming these positive trends continue, we will remain on pace to achieve the higher end of our previous full-year guidance for the 12-month savings of $60 million to $80 million or 13% to 17% for 2023, and we continue to actively manage our expenses.

Moving finally to our capital, available liquidity, and related strategic actions. The financial position of our primary operating subsidiary, Radian Guaranty, remained strong. Consistent with the first two quarters of this year, Radian Guaranty paid another $100 million ordinary dividend to the Holding Company, Radian Group, in the third quarter.

Based on current performance expectations, we are increasing the low end of our previous guidance and now expect Radian Guaranty to pay another dividend to the Holding Company of between $50 million to $100 million in the fourth quarter, bringing the expected full-year 2023 total dividends from Radian Guaranty to between $350 million and $400 million. Our statutory capital framework continues to remain a binding constraint to pay future ordinary dividends from Radian Guaranty to Radian Group.

Radian Guaranty's excess PMIERs available assets over minimum required assets remained stable at $1.7 billion as of September 30th. We continue to diversify our sources of capital as we use a broad range of risk distribution strategies to effectively manage capital and proactively mitigate risk. We are pleased with the increasing demand across the reinsurance and ILN markets, which allow us to distribute risk at an attractive cost of capital.

Subsequent to quarter-end in October, Radian Guaranty finalized two new reinsurance agreements under attractive terms. We closed a traditional excess of loss reinsurance agreement covering approximately $250 million of existing risk. We also entered into a new ILN transaction covering approximately $350 million of existing risk. Pro forma for these transactions, Radian Guaranty's PMIERs cushion at the end of the third quarter would have increased to $2.2 billion.

Our available Holding Company liquidity remained stable at slightly over $1 billion at the end of the third quarter, net of dividends and share repurchases for the quarter. During the third quarter, we paid a dividend to Radian Group stockholders of $0.225 per share, totaling $35 million and purchased 1.9 million shares at a total cost of $50 million.

As of the end of the third quarter, our current share repurchase authorization that expires in January 2025 had $230 million remaining. Our results for this quarter once again highlight the strength and resiliency of our company despite the uncertainties in the current macroeconomic economy.

I will now turn the call back over to Rick.

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

Thank you, Sumita. Before we open the call to your questions, I want to highlight that we are pleased with our results and remain focused on executing our strategic plans. We are driving operational excellence across our businesses and aligning our overall expense structure and resources to reflect the market environment.

Our growing $270 billion mortgage insurance portfolio is highly valuable and is expected to deliver significant earnings going forward. We continue to strategically manage capital by maintaining strong Holding Company liquidity and PMIERs cushion, expecting to continue to pay ordinary dividends from Radian Guaranty to Radian Group, and opportunistically repurchasing shares including $50 million of common stock in the quarter.

I know many of you are familiar with our annual fundraiser for the MBA Opens Doors Foundation, an incredible organization that shares our mission of affordable homeownership by helping families with critically ill or injured children to remain in their homes while their children are in treatment.

We launched this year's campaign during the MBA annual convention in our hometown of Philadelphia. I wanted to thank all who have contributed to this outstanding cause. We will be fundraising through November 17. So, visit radianopensdoors.com, if you would like to learn more. And finally, I want to recognize our team for helping to drive our strong results and for the outstanding work they do every day.

And now, operator, we would be happy to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question comes from Bose George with KBW. Your line is open.

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

Q

Hey, everyone. Good morning. Good afternoon. Sorry. Actually, I wanted to ask about the expense reductions. As you guys noted, it's moving in the right direction really well. Just when you think about it going forward, I know you reiterated the guidance for the full year, but on a quarterly basis, could we see the OpEx remain closer to what you guys did this quarter or will that kind of bounce around little bit still?

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

A

Yeah. Thanks, Bose, for the question. I think we had given guidance for our full year. We've not traditionally given a quarterly guidance. So, I think last year, if you look at our 2022 total expenses, which includes cost of services and other operating expenses, we were at about $464 million. I think the guidance we had given at the beginning of the year was $380 million to $400 million for 2023.

And I think what we are reiterating is that we expect to be at the top end of that range from a expense savings perspective. I think going forward, we would continue to have a similar run rate for each quarter, but we've not given a specific quarterly guidance as of now.

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

Q

Okay. Great. That's helpful. Thanks. And then, actually, just switching to homegenius. To the extent that rates kind of remain in the range they are in now, any updated thoughts about when that gets closer to breakeven?

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

A

Yeah. Good afternoon, Bose, and appreciate the question. Look. As we've discussed, the environment, not just for homegenius, certain of the businesses, but the entire mortgage industry and real estate industry has been challenging, continues to be challenging. And I think our team has done a very good job of focusing on expenses.

And if I kind of walk through some of the different components of it, I think sometimes, it's helpful that we think about the capacity, addressing capacity in both our real estate services, which is our REO, SFR, and valuation business, and our title business that, since with a significant decline in volumes, we've been addressing expenses throughout the year to drive that down closer to profitability. Actually, our real estate services business is profitable kind of through the cycle, has a great operating leverage to it. The title business has been a little bit more challenging as we've gone through the year. I think we've made great progress on that.

The other part of the expense, spend, if you will, is really our investment in our data and analytics and technology platform around our digital real estate platform. And that investment is really being made from a thoughtful and considered way in terms of how we see the opportunity to create value through that platform.

And so, where I would summarize today is that our team is highly focused on managing the expenses and kind of moving the business towards profitability. We're going to continue to kind of manage our title and real estate services business towards that profitable contribution as we go into 2024. And we're going to continue to invest in the digital technology platform because we see value.

And just a quick comment, the recent MBA conference where we rolled out our digital real estate platform to lenders, we're discussing that with literally tens of other types of lenders and corporations getting great feedback on positioning our platform as their customer journey for kind of a digital real estate experience. And so, feedback is good. I think our investment is going to be well-served. And so, but we're just being very balanced about kind of current investment against the opportunity we see.

I will say this. I just want to highlight one other thing. I think, as you know, because you're as close to this market as anybody, the next two quarters for the mortgage industry and real estate industry are going to be very challenging from a volume point of view. And we're anticipating that and understand kind of those challenges that both our customers are going to have.

And just as we manage our businesses through this environment, I think volumes are going to be seasonally low, but both our title business and our real estate services business are well-positioned kind of, as this – as the market starts to bounce back even to a small degree. So, but very focused on expenses, very conscious of the value we believe we're creating, and trying to be very thoughtful about as we navigate through this environment.

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

Q

Okay. Great. Thanks. Thanks for that detail.

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

A

Yes. Thank you.

Operator: [Operator Instructions] The next question comes from Mihir Bhatia with Bank of America. Your line is open.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Hi. Good afternoon. Thank you for taking my question. Maybe I'll just start with pricing question. Maybe just – we've been – just wanted to check in what's the pricing environment like that you are seeing? Did you see any signs of increased price competition between the MIs this quarter? What have you been doing on the pricing side? Any update there?

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

A

Hey, Mihir. It's Derek. So, in terms of the pricing environment, it continues to be rational and disciplined. And we saw fairly normal pricing fluctuations really throughout the quarter. This included what we estimate was a small decrease in market clearing levels in the latter half of the quarter, but important to keep in mind that that's really within the bounds of what I'd call a normalized kind of competitive environment.

In terms of the current environment, we view it as a strong one to deploy capital. Pricing remains substantially above where it was in 2022. And we continue to see really good value across the credit spectrum. So, as a result, really the way we look at it, the pricing and competitive landscape remain very favorable to our strategic focus, which we talked a lot at our Investor Day about, and that focuses on generating long-term economic value and leveraging our analytics to generate alpha with really a focus on finding the portion of the MI market with what we estimate to be the long-term economic value of the highest order. So, that's really been, what we've been focused on. And so, we think that today's environment offers a really good ability to successfully implement that strategy and deploy capital.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Got it. And then on persistency, I think you mentioned that you expect it to stay high. But I guess the question is, is there room for it to increase any more from where it is or is this pretty much the cyclical peak or historic peak or what have you?

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

A

Yeah. I – it's a great question, Mihir. I mean, we're in very unusual times, rapid rise of rates, a lot of mortgage borrowers, and really very low rates. Historically, we've kind of bought kind of mid-80s was kind of normalized range, kind of the high end of the curve. I would tend to stick there. I think there's a variety of different factors.

I think really the question is kind of also a duration question, right, and kind of how our portfolio extends in duration from a earnings potential point of view. And that kind of comes back to Derek's comment about how we think about economic value and future earnings of the portfolio. And if you remember from our Investor Day, as we kind of gave an illustration of kind of those future earnings, the longer persistency persists, right, is kind of positive towards the long-term earnings profile of our portfolio.

So, I would not necessarily give you confidence that it could go higher. But I do think there's a lot of – Sumita, I think in her prepared remarks, commented about kind of the percent of our portfolio above – below 6%. So, there's a pretty significant movement in mortgage rates required before you see any level of refinance incentive.

Mihir Bhatia Q
Analyst, BofA Securities, Inc.

Got it. And then, just my last question, maybe on the originations backdrop, right. Obviously, Rick, I think even you mentioned that, expecting it to be challenging in the next couple of quarters. And I have two questions related to your business from that, right. One is typically these are the times you start seeing originators stretch and doing things that from a credit perspective, as they're trying to drive volume, that might not be the best from a credit perspective. Are you seeing any evidence of that in the MI business? And then, relatedly, any update on Radian Mortgage Capital? Any uptick in opportunity or something there from what's just from the...

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

Yeah.

Mihir Bhatia Q
Analyst, BofA Securities, Inc.

...tougher risk environment. Thank you.

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

Yeah, Mihir. Thank you for that question. And, Derek, feel free to jump in to add to this. But on the – I would – given what we've come through from a great financial crisis all the way through today, I would say lenders remain extremely disciplined from an underwriting point of view. Obviously, the nature of the market today is a purchase driven market, so we see certain attributes kind of increase, generally, LTVs because of first time homebuyers, DTIs, the general purchase market attributes.

But I'd say from a credit underwriting point of view, we tend to see lenders remaining very disciplined. As you know, Derek and his team have a very detailed and thorough process of monitoring the quality of our originators from a number of different attributes as well as from a servicing point of view. And I would say today, not really seeing those trends do anything other than what we would expect given the type purchase market we're in today.

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

The other thing I would add, we don't see a lot of dispersion, I think, in terms of performance from a manufacturing quality kind of across lenders. The other thing to keep in mind is just from a pricing perspective, given kind of the RADAR Rates platform, we have the ability and we do exercise that to differentiate price based upon performance and where we see any sort of deterioration in terms of performance or manufacturing quality as well.

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

A

Yeah. And the regulatory restrictions that went in place as part of the post-financial crisis have really kind of – do keep – put constraints on certain types of products that I think are meaningful from the markets we operate in.

To your question about Radian Mortgage Capital, it's a great question. It's a timely question. As we've talked about, we've taken over the last couple of years as we've built the platform, gotten it licensed across the country, really put together an extremely talented team, a very lean and mean team, I should say, but they're highly talented and experienced folks.

Derek and I have kept it gated and kind of taken a very measured approach because we thought the market was generally not – it was more or less challenging. I would say, today, we see the opportunity opening and we're kind of exploring that opportunity primarily related to the – kind of the changes that have gone on through the banking with the Basel III, obviously the higher cost of funds.

And then obviously there are some other challenges, I think, to the banking mortgage product around some of the proposed CRA regulations, other things that are kind of impacting and causing banks to rethink their presence in the mortgage business, but most of all, taking away a large part of the portfolio bid for non-agency production. So, we've seen that market begin to rationalize and become interesting and attractive and we just continue to explore the opportunity we see for the platform and the capabilities we have to create the appropriate risk adjusted returns that we would expect from this business.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Okay. Thank you for taking my questions.

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

A

Well, thank you. Appreciate it, Mihir.

Operator: At this time, I show no further questions. I would like to turn the call back to Rick Thornberry for closing remarks.

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

Thank you and thank you, everyone, for your interest in Radian. We enjoy talking about our business each quarter with you. And we look forward to spending time with many of you over the coming days and weeks, kind of further interacting through discussions about the business.

I also want to just take time, as I always try to do is just reiterate the great work our team is doing to serve our customers and find ways to help our customers as they navigate a challenging environment, and also help each other as we all kind of find ourselves in different challenges through life. So, I want to thank our team, and we look forward to the opportunity to talk to all of you as the days ahead come along. So, take care and appreciate your time that you spent with us today.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.