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Radian Group Inc. (RDN)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, welcome to the Radian Group First Quarter 2019 Earnings Call. At this point, all the participant lines are in a listen-only mode. There will be an opportunity for your questions and instructions will be given at that time. [Operator Instructions] As a reminder, today's call is being recorded.

I'll turn the conference now to Ms. Emily Riley, Senior Vice President of Investor Relations. Please go ahead.

Emily Riley

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

Thank you, and welcome to Radian's first 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.

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. I am pleased to report another excellent quarter for our company. These results are driven by the fundamental strength of our business model, fueled primarily by the outstanding results in our mortgage insurance business. We look forward to discussing our first quarter performance during the call today and sharing a more in-depth overview of our business during our Investor Day here in Philadelphia on May 7, which will also be webcast live and available for replay at radian.biz.

Now, turning to our results and our strong financial performance, net income for the first quarter grew to $171 million and diluted net income per share increased 50% year-over-year to $0.78. Adjusted pre-tax operating income grew to $202 million and adjusted diluted net operating income per share was $0.73, representing a 24% increase year-over-year. Book value per share grew 24% year-over-year and return on equity was 19%, while adjusted net operating return on equity was 17.7% for the first quarter.

With regard to our mortgage insurance business, we grew our primary insurance in force 10% year-over-year to $224 billion. This marks the fifth consecutive quarter of 10% year-over-year growth for our portfolio. Given the size of our portfolio, this level of growth has been a strong statement about the strength and value of our mortgage insurance business.

Our mortgage insurance portfolio, which is one of the largest in the industry, is the primary driver of future earnings for our company. It is important to note that the projected economic value of this portfolio is not reflected in the current period financial statements, nor is it reflected in our reported book value. But it is expected to be recognized over time. Importantly, the value of this portfolio provides us with significant strategic financial flexibility. We'll talk more about economic value during our Investor Day.

The $10.9 billion of NIW we wrote in the first quarter combined with the favorable persistency is what drove the growth in our insurance in force portfolio. As we look ahead this year, overall housing market trends are positive. Interest rates remain at historically low levels, and employment trends are positive. This combined with increased housing supply and continued moderation of home price appreciation is expected to lead to growth in purchase originations, particularly for first-time homebuyers who represent more than 30% of home sales.

While new business volume for the first quarter of the year was tempered by typical seasonal patterns, we're encouraged by these positive market trends and our strong pipeline for new mortgage insurance business. We expect to write new MI business in 2019 that is in line with the record-breaking levels we have achieved over the past few years and in excess of $50 billion.

I've said before that this is a great time to be in the mortgage insurance business. The business fundamentals are incredibly 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. In fact, in the first quarter, the number of defaulted loans in our portfolio dropped to a low we haven't seen in 20 years, and the percentage of cures reached 26.7%, the highest level in more than a decade.

Demand for our Private Mortgage Insurance products remains strong. The origination market continues to be dominated by purchased loans, which is a positive trend for our mortgage insurance industry, given that purchased loans are three to five times more likely to have MI versus a refinance loan. During this past quarter, purchased loans accounted for 92% of our NIW.

Turning to pricing and the competitive environment, in January, we introduced RADAR Rates broadly to the market as another MI pricing option available for doing business with Radian. As we expected, the transition for customers has been seamless, and today, the majority of our mortgage insurance volume is coming through RADAR Rates.

The overall increased granularity allows us to more dynamically shape the risk profile of our MI portfolio and ultimately the economic value of the business we write. We believe that the combination of flexible pricing options, excellent customer service and outstanding relationships is the right market strategy to both address our customer needs and provide an attractive risk adjusted return for Radian.

Now, moving to our Services segment, we continue to make progress across our mortgage, real estate and title services business. Consistent with the first quarter of 2018, we expected to see a decline in revenue in the first quarter of 2019. Although Services revenues in the first quarter were lower than we expected, the decline from the fourth quarter was largely related to a slow start to the year for the overall mortgage and real estate market, the timing of onboarding of several new clients and the investment in our core products and services, and the integration of recent acquisitions.

We remain confident in our strategy, the market opportunity for our services, the value of our customer relationships and the team we have in place to grow revenues and build value. We look forward to providing a deeper dive at our Investor Day next week as to why we are excited about the opportunities developing across this segment.

In terms of capital management, as I mentioned last quarter, we believe there are a number of strategic benefits from leveraging and regularly assessing both the capital – accessing both the capital and reinsurance markets to distribute risk, including increased financial flexibility, a reduction of our overall cost of capital, enhanced capital efficiency and, most importantly, the opportunity to reduce portfolio and financial volatility through economic cycles.

Consistent with this objective, we closed our second mortgage insurance linked notes transaction in the second quarter in the amount of $562 million related to our 2018 monthly premium book. Combined with our first ILN transaction in the fourth quarter of last year and our existing quota share reinsurance programs, these transactions have significantly reduced the risk profile of our company.

In April, we received approval from the Pennsylvania Insurance Department for another return of capital from Radian Guaranty to Radian Group of $375 million. This combined with the $450 million return last year has significantly improved our financial flexibility. It is also important to note that we have an interest in operating expense sharing agreement in place for the operating company that reimburse Radian Group, which provides the benefit of minimizing incremental cash needs at the holding company. Frank will provide additional insights into our capital management strategy.

Finally, we also increased and extended our share repurchase program in the first quarter. Frank will provide details about our most recent share repurchases. We are pleased that our strong financial position has afforded us the opportunity to return value to stockholders, and we expect to continue to use repurchases within the context of our overall capital strategy in an opportunistic manner. This strategy designed to enhance an already strong capital structure and further demonstrate our commitment to effectively managing capital for our stockholders.

Turning to the regulatory and legislative landscape, we are pleased to see Mark Calabria sworn in as the next Director of FHFA. We believe Director Calabria's deep understanding of the mortgage finance system and, in particular, his support for increasing the role of private capital will be invaluable in promoting a more robust housing market that provides borrowers with access to affordable low down payment mortgage credit, while also protecting taxpayers from undue mortgage credit risk.

More recently, we were happy to see the appointment of Adolfo Marzol as Director Calabria's Principal Advisor. Marzol has more than 30 years of private sector experience in mortgage finance, including Private Mortgage Insurance. We look forward to working with Director Calabria and his team.

More broadly, dialogue regarding potential reform of the housing finance system continues, including the President's recent executive memorandum requesting plans on reform as well as recent legislative proposals and related congressional hearings. While it remains difficult to handicap the likelihood form and timing of potential reform, there continues to be an overwhelming consensus for an increased role of private capital solutions. Given the reform nature of our industry with strong and consistent capital standards, new master policies and high operational standards, we are confident that Private Mortgage Insurance will remain a critical component of any new housing finance system.

Turning briefly to the FHA, we believe that our industry continues to gain share from the FHA on higher FICO business and then it remains unlikely that FHA will reduce its pricing as their focus appears to be on modernizing their internal systems and increasing their risk oversight in various areas.

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 $171 million or $0.78 per diluted share for the first quarter of 2019, as compared to $0.64 per diluted share in the fourth quarter of 2018, and $0.52 per diluted share in the first quarter of 2018, a percentage increase of 22% and 50%, respectively. Adjusted diluted net operating income was $0.73 per share in the first quarter of 2019, an increase of 4% from the fourth quarter of 2018, and an increase of 24% 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 $10.9 billion during the quarter compared to $12.7 billion last quarter and $11.7 billion in the first quarter of 2018. While total NIW decreased 7% compared to the first quarter of 2018, this decline was primarily in single premium NIW, as our monthly premium NIW was down only 1% year-over-year.

Direct monthly and other recurring premium policies represented 83% of our NIW this quarter, consistent with the fourth quarter 2018 and an increase from 79% for the same quarter a year ago. Borrower-paid single premium policies represented 13% of our NIW this quarter, while lender-paid single premium policies declined to 4% of our volume this quarter. This is in contrast to a year ago when approximately 75% of our single premium NIW was lender-paid.

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. This is because they are subject to automatic cancellation under the Homeowners Protection Act creating shorter expected lives, and for this reason, the capital requirements for borrower-paid singles is lower as well. In total, borrower-paid policies represented 95% of our new business for the first quarter.

The new business we are writing today continues to consist of loans that are expected to produce excellent risk-adjusted returns. Primary insurance in force increased to $223.7 billion at the end of the quarter, our fifth consecutive quarter with year-over-year insurance in force growth of 10%. It is important to note that monthly insurance in force increased 12% year-over-year and has grown by over $30 billion over the past two years. As Rick mentioned, the in force portfolio is the primary source of our future earned premiums and, as such, is expected to generate future earnings that are not reflected in the current period financial statements, nor reflected in our reported book value. Persistency trends remain positive and our 12-month persistency rate increased to 83.4% in the first quarter of 2019 compared to 83.1% in the fourth quarter of 2018. Our quarterly annualized persistency was 85.4% this quarter, in line with the prior quarter and an increase from 84.3% in the first quarter of 2018.

Our direct in force premium yield was 48.6 basis points this quarter compared to 49 basis points last quarter and 48.7 basis points in the first quarter of 2018 as seen on slide 10. Net premium yield declined slightly from 47.4 basis points in the prior quarter to 47 basis points this quarter which includes the full impact of ceded premium associated with our 2018 combined insurance-linked note and excess of loss reinsurance transaction of approximately 0.5 basis points. The second quarter 2019 insurance-linked note transaction is expected to impact our future net premium yields by approximately 0.8 basis points with the increase due to the larger amount of risk distributed in the second transaction relative to the first.

While this reduction in premium yield of 1.3 basis points due to the ILN/XOL transactions is equivalent to approximately 2.7% of the first quarter net premium yield. The ILN have the effect of reducing PMIERs minimum required assets by almost 30%, a very favorable tradeoff for the risk ceded. Net mortgage insurance premiums earned were $263.5 million in the first quarter of 2019 compared to $261.7 million in the fourth quarter of 2018 and $242.6 million in the first quarter of 2018. This 9% increase from the first quarter of 2018 was primarily attributable to our insurance in force growth.

Total Services segment revenue decreased to $36 million for the first quarter of 2019 compared to $41.5 million for the fourth quarter of 2018 and increased from $34.2 million from the first quarter of 2018. The decrease in revenue compared to the prior quarter was due to the factors noted by Rick previously including typical seasonality of the Mortgage and Real Estate Services business. Our reported Services adjusted EBITDA was a loss of approximately $900,000 for the first quarter of 2019.

Our investment income this quarter was $44 million, a 4% increase over the prior quarter and a 29% increase over prior year due to both higher rates and higher balances in our investment portfolio. At quarter end, the investment portfolio duration was shortened from 4 years to 3.6 years in anticipation of funding our upcoming 2019 senior debt maturity and potential utilization of the share repurchase authorization. At this time, we have no plans to refinance our 2019 maturity. It is noteworthy that our investment portfolio has grown approximately 17% or just over $800 million since the first quarter of 2018, a sizable increase in our largest on balance sheet earning asset.

Moving now to our loss provision and credit quality. As noted on slide 14, during the first quarter of 2019, we had positive reserve development on prior period defaults of $18.2 million. This positive development was driven primarily by a reduction in assumed claim rate on existing defaults based on observed trends including an increase in cure rates on these defaults as Rick previously mentioned.

The default to claim rate applied to new primary defaults received in the quarter, which reflects recent observed trends, was approximately 8.0% in both the first quarter of 2019 and the fourth quarter of 2018 and approximately 9.0% in the first quarter of 2018. We believe that if observed trends continue, default to claim rates could fall further, although the likelihood and timing of a potential decline is difficult to predict.

The total number of new default decreased by 1% compared to the fourth quarter of 2018, consistent with typical seasonal patterns and increased by 12.4% compared to the first quarter of 2018. Consistent with typical defaults seasonal patterns, the shift in our portfolio composition toward 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 defaults. It is noteworthy, however, that our total default counts has consistently declined to very low levels and currently stands at the 20-year low that Rick mentioned of 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 continue to track to historically low levels.

Now turning to expenses, other operating expenses were $78.8 million in the first quarter of 2019 compared to $77.3 million in the fourth quarter of 2018 and $63.2 million in the first quarter of 2018. The change in expenses year-over-year is primarily driven by $5.7 million of non-operating items, $3.6 million related to businesses acquired in 2018, and an increase of $1.6 million in legal and other professional services.

Moving now to taxes, our overall effective tax rate for the first quarter of 2019 was 20.9% and our expectation for our 2019 annualized effective tax rate before discrete items is approximately the statutory rate of 21%.

Now moving to capital, as Rick mentioned, in April of 2019, we closed on a second insurance-linked note transaction of approximately $562 million. This brings the total ILN issuance by Eagle Re to just under $1 billion and covers origination years of 2017 and 2018 for our monthly premium business. In total, Radian Guaranty has reduced PMIERs capital requirements by over $1.5 billion 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.

As a result of further capital enhancement actions and our continued strong financial performance, in April 2019 following the approval of the Pennsylvania Insurance Department, Radian Guaranty returned $375 million of capital to its parent, Radian Group. This brings the total capital return to Radian Group within the past 12 months to $825 million.

It is important to also note that this return of capital is in addition to the funds received regularly by Radian Group through our longstanding agreements with the operating companies, which provide for the reimbursement of interest and operating expenses of Radian Group. These reimbursements have provided approximately $130 million over the past 12 months. Utilization of this enhanced capital flexibility is expected to include retirement of the next maturity of debt, which occurs in June 2019, of approximately $159 million and, once eliminated, would reduce our debt to capital ratio by approximately 3 percentage points, bringing our debt to total capital to approximately 19% and would be expected to reduce ongoing interest expense by approximately $9 million annually.

Under our expanded share repurchase authorization from January 1, 2019 to April 26 of 2019, the company has repurchased approximately 5.7 million shares at a total cost of $122 million and an average share price of approximately $21.56. After this activity, we have approximately $128 million of our total share repurchase authorization remaining.

PMIERs 2.0 was effective from March 31, 2019. Under PMIERs 2.0, Radian Guaranty had available assets of $3.5 billion and our minimum required assets were $3 billion as of the end of the first quarter 2019. The excess available assets over the minimum required assets of $488 million represents a 16% PMIERs cushion and a $79 million decrease from the prior quarter's $567 million cushion, which was calculated in accordance with PMIERs 1.0. As a reminder, the primary change from PMIERs 1.0 to 2.0 was the change in the available assets definition to exclude the premium benefit of policies written before 2009 of approximately $200 million.

We have also noted on slide 20 our PMIERs 2.0 excess available resources on a consolidated basis of $1.4 billion, which, if fully utilized, represents 48% of our minimum required assets. After consideration of the post quarter end ILN transaction and the $375 million return of capital described above, Radian Guaranty's excess of available assets over its minimum required assets under PMIERs 2.0 would have increased by approximately $187 million or an additional 6% on March 31, 2019, minimum required assets. 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.

Holding company liquidity at the end of the first quarter 2019 was $718 million compared to $714 million at the end of the fourth quarter of 2018. The post quarter end return of capital, less the share repurchase activity to-date in the second quarter had a net $284 million positive impact on our holding company cash position before consideration of the upcoming 2019 debt maturity. Considering the net additional $284 million, our holding company cash position is just over $1 billion. We look forward to updating you on our progress as we continue to demonstrate the ability to execute on our capital strategy and we hope to see many of you at our Investor Day next week.

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 grew 49% year-over-year to $171 million. Book value per share increased 24% year-over-year to $17.49. Return on equity was 19% and adjusted ROE was 17.7%. Our $224 billion mortgage insurance portfolio grew 10% year-over-year and is the primary driver of future earnings for Radian. We remain confident in the strategic position and the future value of our Services segment and we are enhancing our risk profile while improving our capital position and financial flexibility. We look forward to providing more details on our future prospects and plans during our Investor Day next week which will also be webcast live and available for replay at radian.biz.

Now, operator, we'd like to open up the call to questions.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] And first from the line of Phil Stefano with Deutsche Bank. Please go ahead.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks and good morning. So now that we have a little bit of time with everyone having a risk-based pricing engine out there, I was hoping you could give us an update on the competitive dynamic. Do you see anyone acting in a surprising fashion or is there anybody doing anything you might think is irrational to try to gain share here?

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

A

Hey, this is Derek. Good question. In terms of that, I think we're in the early innings in terms of – everyone's kind of out there with kind of their versions of pricing engines. I think we see competitors taking different views in terms of, I think, risk appetite where they might be relatively overweigh in kind of certain credit segment. So I think it's kind of early to tell. Again, our focus just continues to be to increase the economic value, looking at it both on a loan level and also on a customer level. We think that's very important too in terms of kind of focusing our volume on customers where we think provide kind of the most economic value to our portfolio.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Okay. And looking at new defaults, it was up low-double digits. In the 10-K, there was a flag that uses the word slightly. I think, Frank, in your prepared remarks, you said slightly as well. It feels like what we saw in the first quarter was a bit more than what, in my mind, slightly would be. Is there anything about new defaults in the first quarter, thinking about the year-over-year that was particularly notable or how should we think about expectations for this as it flows through the rest of the year?

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

A

Yes, this is Derek again. I think in terms of that, I don't think there's anything notable. I think the biggest thing you have to look at is just the change in the book, so more new defaults now are actually coming from the 2009 forward portfolio. It's important to note the absolute level of new defaults from that portfolio is extremely low. But I think it was last quarter where we actually flipped over and a majority of defaults are coming through that, the newer portfolios, and the way to look at that is, every year, we've written more and more business. So as those books of business kind of reach their default seasoning peak, you're going to kind of see kind of a natural push upward in terms of the new defaults. The other positive thing is you see significant credit burnout in the legacy portfolio. So again you tend to see a big kind of decrease year-over-year in terms of that legacy portfolio. So you might see some volatility to quarter-to-quarter, but again I think it's kind of playing out as we would expect.

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

A

Yeah. This is Rick. I think it's also important to highlight that the portfolio grew 10% year-over-year. So the absolute size of the portfolio relative to any kind of default metric, if you will, I think, is important to look at.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Understood. Thank you. One last one, looking at Services, it feels like we're talking about an adjusted adjusted margin, recently being the EBITDA margin excluding the impact of title that was acquired and the restructuring. It feels like that's where the guidance bogey of the 10% to 15% has been. Do you have a feel of what that adjusted adjusted margin looks like in the first quarter?

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

A

Yeah. I don't think we disclosed that – this is Rick again by the way, Phil, so. And thank you for your question. Just in terms of Services, as we noted in the first quarter, we have an expected outcome in terms of revenues declining based upon the factors that I highlighted. And I think we – as we stated, I think in the third quarter of last year, we continue to expect to achieve a run rate of revenues this year in the $175 million to $200 million with a 10% to 15% EBITDA and I think as we go through the course of year, we'll continue to update you on our progress relative to that. But I don't think we – I don't think in the first quarter we've...

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

A

Yeah, it's below that range. But yeah, we didn't call out that number specifically.

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

A

Yeah, but I think it's important to note first off that this is a business I kind of find it important to highlight that when you set it alongside the mortgage insurance business, its relative size is small and so it's a developing and then in some cases somewhat of a – some of the businesses are at different levels of development. But what we can see happening across each of the businesses whether it's mortgage services whether it's real estate services or title services is each one of them kind of setting the growth pattern from a client and product and services mix that provides us – that enables us to see the opportunity going forward. So I think the first quarter although a little bit lower than what we expected, not an unexpected result to see the decline and we see our pipeline's growing and we're optimistic about the opportunities we see in the future. Next week at Investor Day, I think we'll go into a little bit deeper dive around this.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Thanks, Rick. I look forward to the update next week and [ph] uptake (00:34:37) to the optimism side myself. Good luck, guys.

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

A

Thank you.

Operator: Our question is from Douglas Harter with Credit Suisse. Please go ahead.

Sam Choe
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. This is actually Sam Choe filling in for Doug. Just looking at the prior period reserve, I mean we've had four quarters of that. I'm just wondering if you could talk about the philosophy around having the comfort to have those during the quarter and how we should think about it going forward.

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

A

Yeah, great question. Sam, this is Frank. I think the way to think about it is when we set our reserves we view it in the context of all available information and we make our assessment for what's appropriate there. I think what we've said and the good news is that the trends continue. What we're seeing from a credit standpoint continues to be, on the [ph] trend (00:35:33) basis, very positive. We caution to not get too far ahead of ourselves in optimism there because it is viewed again each quarter in the context of available information at that time. So, that's how we think about it. What we did guide to is the default to claim rate for new defaults while it's at 8% currently, we do think if these trends continue and I put if in capital letters there, if these trends continue, we do see the potential for it coming down more, but again the timing and magnitude of those steps would be difficult to predict. I don't know Derek if you add anything.

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

A

[indiscernible] (00:36:16). I think as Frank indicated, the positive trends, our cure rate is at very high level, the highest I think we've seen in decades. So as those continue, we'll continue to monitor that. It's difficult to say how low the new default to claim rate could get to I think we're at levels that we probably saw in the early 2000s. So historically, we're at the lowest levels we've, I think, seen.

Sam Choe
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. That's really helpful. So we also saw persistency tick up. What drove that uptick and how do you see that trending this year?

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

A

Sure. In terms of the persistency, what's driving that is just the rate environment. So you had rates go up in the second half of 2018. Now they've come back down. So I think in terms of persistency, it's just kind of continuation in terms of where rates are and also we continue to – the portfolio continues to grow. So as you kind of have kind of newer vintage that go into the portfolio, that also pushes your persistency rate up, one, because usually people in terms of refinancing, if they have refinancing incentives, they don't necessarily refinance right away, and then also, as we see cancellations due to borrowers canceling because of the Homeowners Protection Act. Again, it takes a while for them to – for their LTVs to drop down to a level in which they can actually auto cancel. So kind of all those factors that are kind of driving the persistency.

Sam Choe
Analyst, Credit Suisse Securities (USA) LLC

Q

Awesome. Thank you so much.

Operator: Our next question is from Chris Gamaitoni with Compass Point. Please go ahead.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Good morning, everyone.

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

A

Good morning, Chris.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

I wanted to refocus on capital and I heard you loud and clear on paying down debt. Where do you think now is kind of the right debt to capital ratio to run that long term?

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

A

Chris, that's a great question, and this is Frank. The long-term debt to capital, we said historically, is viewed in the context of our goal to return to investment grade, and we've said historically that we think right around that 20% number is the right place to be. What we're saying now as far as potential future plans here would take us down below that number, and we do think there's just additional financial flexibility that we have with an investment grade rating.

So, that is something that it is certainly toward the top of the list of considerations when we're doing our capital planning. It's hard to peg a number to it specifically, but if you just look at the relative contribution of the next two debt maturities, the June 2019's and the 2020's, the combined impact of those would be roughly 8% lower from where we are right now, which is pretty low. So again not to put a fine point on it or peg it to a particular number, but it is viewed in that context of rating agency consideration. And certainly, other factors that play into that relate to just the broader needs for capital in the business overall, other strategic priorities, et cetera. But sort of on a business as usual basis, that's how we're thinking about it.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

That kind of gets me to my follow-up of with a $1 billion excess liquidity even if you pay down your next three years of debt and [ph] then (00:39:44) refinance any, you kind of have $400 million left. So I guess why not a bigger buyback or what else are the plans for capital for the excess liquidity at the parent.

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

A

Yeah. Again great question and thanks for asking that and I'm sure that will be a popular topic for the rest of the call. But I think it's important to remember that we do have a strong recent history of managing our capital and liquidity both at the operating company and the holding company in a prudent and thoughtful manner. And over the past several years, we've completely restructured our debt. We've delevered from a high of 36% in 2014 to potentially below 20%, increased ratings from the rating agencies, although not yet to our final goal of investment grade, repurchased approximately 15% of our outstanding shares over that time horizon which I think sometimes gets overlooked. We've been very diligent about managing our capital through share repurchase, prudently manage our PMIERs capital position throughout its adoption, and more recently we've utilized the greater risk distribution to facilitate our recent requests for return of capital from Radian Guaranty to Radian Group.

So all that said, we're positioning ourselves for maximum flexibility and the range of options that we have available to us as far as capital management and that we have considered will be focused on creating value for our shareholders and the form timing and execution of those actions, while we won't go into specifics today, are available because of the considerable actions we've taken to position all of our financial resources for maximum flexibility. So, that capital strength and financial flexibility are absolute key ingredients for our strategy. And as you mentioned, some of the potential uses are the remaining $128 million [ph] less than (00:41:35) our current share repurchase authorization, $159 million senior debt maturing in 2019, $234 million senior debt maturing in 2020. And so when you add those up, that is over $0.5 billion. And it is – I'll just remind you it is our practice to announce the specifics of our capital actions as they occur. But I think the takeaway here is that we have demonstrated over time these actions will be taken in a thoughtful and prudent manner.

Chris Gamaitoni Q
Analyst, Compass Point Research & Trading LLC

Great. Just a nuance clarification. The disclosure in the press release really that says XOL for the reinsurance agreements. Does that include the cost of the ILN or is the ILN separate from that?

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

Are you talking about the first one, it includes it.

Chris Gamaitoni Q
Analyst, Compass Point Research & Trading LLC

So the full costs of both the ILN and the XOL are excluded in that too.

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

Yeah.

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

That's correct.

Chris Gamaitoni Q
Analyst, Compass Point Research & Trading LLC

Okay. Thank you so much.

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

Thank you.

Operator: Next we'll go to Mackenzie Aron with Zelman & Associates. Please go ahead.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Thanks. Good morning. First question just to follow up on that capital conversation. Can you just talk about how you see the need for reinsurance going forward? Is this something that you still intend to use on a regular kind of consistent basis in the context of risk management and then kind of weighing that with the strong capital position you have today?

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

A

Yeah. Great question, Mackenzie. This is Frank. Yes, so we've said previously that we think the risk distribution through the capital markets and the reinsurance markets are both very strong right now. And so we would expect to see further utilization of that on a go forward basis, and we do think that from a risk management standpoint it's a great way to distribute the tail risk in the portfolio.

So, yes, we would expect to see that continue in the future. I do think though it's important to distinguish between the amount of PMIERs capital that is freed, if you will, from the ILN transactions or the risk distribution transactions relative to the returns of capital. It's been somewhat coincidental in our first issuance that the two numbers were similar. I think what you saw in our last transaction was that the return of capital request was less than the PMIERs relief that we received. And part of what drives that is the difference between the statutory capital framework and PMIERs not necessarily being perfectly aligned. So, that's one thing to consider there. So I don't want to mislead anyone to think that a dollar worth of PMIERs capital that's liberated through risk distribution would translate into a dollar of capital coming from Radian Guaranty to Radian Group.

The other thing to consider there too, Mackenzie, is that as we go forward and we are managing two different levels of risk distribution is, one, we're looking at the numbers that we report are on a net minimum required assets basis which contemplate the full impact of the risk distribution that we've made. We're also mindful of the gross minimum required assets as well because we do think that's an important metric to not lose sight of as we do this, even though we are held to the net minimum required assets under PMIERs.

Mackenzie Aron
Analyst, Zelman & Associates

Q

That's helpful. Thank you. And then just lastly on the investment portfolio with it being up so significantly year-over-year, can we expect to see that type of growth continue?

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

A

Mackenzie, I would say probably not, only because of the cash flows that we expect to see on a go forward basis and also some of the uses of capital that I outlined earlier would be a part of it. And also part of that growth had to do with market value adjustments period-over--period, albeit a small amount, but that's a tough amount to predict.

Mackenzie Aron
Analyst, Zelman & Associates

Q

Okay, great. Thank you.

Operator: Our next question is from Jack Micenko with SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

Hi, good morning.

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

A

Good morning, Jack.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

I guess the first one for Derek. Good morning. Your – I understand the directional drivers of persistency, but your persistency rate seems notably higher than some of your peers with maybe similar portfolios. So curious, if you have maybe like a weighted average coupon in the portfolio or if there's something structural in some of the legacy vintages that maybe are accounting for that differential?

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

A

Yeah, I mean, I do have a weighted average coupon in the portfolio. It's a bit above 4.5%, but I don't think that's really relevant to the question, right, because you don't really want to look at the weighted average, it's really the distribution of the coupons in the portfolio, right. So, when you kind of look at that and generally think of borrowers, at least, if it's going to be persistency in terms of refi payoff, they need about 75 basis points to 100 basis points incentive to do that.

So when you kind of look at the portfolio, for the most part, recent vintages don't have an incentive. You kind of see it in the second half of 2018, kind of early 2019, where you have an incentive. So – and then, obviously, some of the earlier vintages, you see a refi incentive, but again, a lot of those have kind of gone through burn out.

So, in terms of that, I do think you need to look at it on a vintage by vintage perspective and then look at essentially kind of what the average coupon was for that particular vintage. So, [ph] heavier weight (00:47:17) in certain vintages, while have a lower refi incentive, that might have an impact. Also, you'll have to look at products as well, right. So, persistency can be impacted by the relative weight of, for instance, lender-paid product versus borrower-paid product. So, that's going to be the other things that's going to potentially drive that as well, if you're trying to figure out variation from company to company.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

Okay, that's helpful. And then one for Frank, the buyback cadence was pretty strong in April relative to sort of the historical run rate. Just curious what the strategy was in really stepping on the gas on the buyback?

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

A

Yeah, great question, and we certainly don't unfortunately offer any details or insights into the specifics of the execution of the program. But you are correct; roughly 12% of the total authorization was repurchased in the first quarter and about 36% in the second quarter. If you think about the variables that are at play there, you certainly have market price as one element of it and then you also have volume limitations at certain points as well. So all of those factors play into what I would call some unpredictability and volatility around the pace of the repurchase program, but good observation.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

Okay, thank you.

Operator: Next, we'll go to Mark DeVries with Barclays. Please go ahead.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah, I've got more questions on capital for you, Frank.

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

A

By the way, Mark, he is not surprised.

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

A

Yeah.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

If I heard you correctly, I think you indicated that if you retire the debt due in June that takes debt to cap to about 18%, which I guess is below where you indicate you think you need to be for an IG rating. I guess the question is, if that's the case, why would you even consider using any of the other remaining, let's say, call it, $850 million of cash to retire any of the other debt as opposed to just rolling it and saving that cash for alternative uses?

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

A

Yeah, Mark, great question. And if I led you to believe that it is a foregone conclusion that we're taking that out, I'll correct it, that is something that we are considering and looking at further delevering. So, that's one of the options that we're looking at. But your points are spot on and all of this will be sort of wrapped up in our discussions with rating agencies and doing really what's the best mix of activities for our shareholders.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. So, I'm assuming the only reason you would contemplate that is if they were telling you, no, we've got a new bogey for you to get to IG, and I guess that would raise the question what's the benefit to the shareholders, when debt is already a pretty marginable part of your capital structure to begin with, of getting your cost down a little bit as opposed to being able to use that for which, theoretically, I think could be much more accretive uses such as buying back stock or even potentially doing some acquisitions?

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

A

Yeah, great question. And I think that's the hard part. First, let me clarify. The rating agencies don't give us a hard and fast target to manage to, so that is really what we just infer from looking at a broad range of inputs in deciding what's appropriate for that. So, I just want to be clear on that point.

But as it relates to the benefits of returning to investment grade, as we've said historically, we think it's valuable from a strategic standpoint primarily as it relates to how counterparties view us or how we're viewed as a counterparty for others. And so it does increase the flexibility that we have, both from a strategic standpoint and also from a financial standpoint. Longer debt maturities are available to us, et cetera, at a lower cost. So all of those things harmonize well with our goals of capital strength and financial flexibility. It does help create an overall profile of Radian that's consistent with strength and flexibility. And so we think it's important to continue to march down that path.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay, great. And then just one last thing, I know you can't be too specific, but the share price is almost 10% higher today than it was – well, actually more than that, you'll be happy to know now that we've opened trading, but more than 10% above where you bought at an average price this past quarter. I guess I'm trying to get a sense of how price sensitive you're going to be, do you still find your stock to be attractive for buybacks at these levels?

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

A

I can only comment, Mark, on what we have done historically here and I think, as you know, we don't give a lot of color around the prices at which we would execute. So the share repurchase price that we have executed on certainly represents a value to us and relative to our intrinsic value. So, I hope that's helpful.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay, fair enough. Thank you.

Operator: Our next question is from Mihir Bhatia with Bank of America Merrill Lynch. Please go ahead.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Hi. Good morning, and thanks for taking my questions. First question, just – actually wanted to just follow-up on that same topic that Mark just asked about. I understand you can't comment on what you're going to do, but maybe you can comment on just, is the new authorization, the parameters, if you will, wider or different than the old authorization because the cadence was certainly – certain acceleration in the cadence of repurchases. So I was curious about that, if the authorization changed the parameters?

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

A

Yeah, Mihir, great question, I appreciate that. It is our historic practice and I'll continue with that, we don't comment on the specifics of the parameters of any authorization or how we execute necessarily on the share repurchase program.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Got it. Okay. And then just one, let me ask you one other question, maybe for Derek. We've been seeing a little bit more lately news of just in certain markets, home prices maybe not appreciating as much. Is there anything like that that you're seeing or is this mostly more like maybe at the high end because of [ph] Salt (00:53:48) and things like that, or – because I think I've seen headlines now actually talking about home prices coming down, and I was just wondering what are you guys looking at thinking about the market as a whole?

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

A

Good question. I think it is I think more concentrated on the higher end. That being said, I think we've seen kind of across the board moderation in terms of home price appreciation. Generally, we see that as a positive, because certainly one of the issues in the market overall is home price appreciation running at 6% to 7%, and wage growth running at less than 3%. It was starting to get certain markets starting to look overvalued.

So now, we're seeing that moderate kind of more in that 4% range, you're seeing wage growth at 3%, but you're starting to see those converge. So that's a positive thing because I think it increases the probability of kind of have a moderation where you don't eventually kind of build up a frothy situation where you have more of a hard landing.

And the other thing I would say with respect to [ph] GO (00:54:43), this is certainly a positive aspect in terms of our rollout of RADAR Rates, because it does give us the ability and we use that ability to price deals on a differentiated basis based upon our relative view of the risk. So that's also an important thing as we move forward in the market as well.

Mihir Bhatia
Analyst, Bank of America Merrill Lynch

Q

Got it. Thank you. Thanks for taking my questions.

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

A

Sure.

Operator: And we'll go to Geoffrey Dunn with Dowling & Partners. Please go ahead.

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.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Frank, as you think about the prospect for future returns of capital out of Radian Guaranty, how do you contend with the slower growth on surplus? I'm guessing you're down close to $500 million now. So where do you go from here? You get a lot of liquidity at the whole company right now, but how do you think about it between now and 2023 or 2024 when you start getting accelerated surplus growth again?

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

A

Yeah, Geoff, great question, and I think you are hitting on the crux of the constraint or the issue that we are planning around as it relates to future capital returns, which is why I made the point to Mackenzie about trying to disconnect expectations from returns of capital being size similar to the ILN issuances. So your point is spot on, that is what we're managing to in the multiple constraints and our planning exercise. So, we are down to exactly what you said approximately $500 million in statutory surplus and that's down roughly $700 million from a year ago, so due entirely to the returns of capital that we've had there. We have had some decrease in the negative unassigned funds, but your point is exactly right. That is something that we will be mindful of and be managing to and will actually cause lower future potential returns of capital from Radian Guaranty relative to the risk distribution.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Is $500 million the right minimum for both of you as managers as well as the regulators or do you think you can go lower?

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

A

You know, Geoff, I would hate to speculate as to a low point there, that's a level that we're comfortable with. And based on our projections and certainly what we've shared with the regulator, we're comfortable with current levels and what the forward look would present as well.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. And then, Derek, there's been questions about the risk of price competition with respect to the new pricing engines. I wanted to kind of approach from a different angle. What is the risk from evaluating what you think are normalized losses? I mean, the pricing out there seems to be based on, call it, 20%, 25% type of loss ratio, but there's been massive outperformance over the last decade. What's the risk that companies decide it ends up being 15% to 20%? And we just have a revision of the kind of the core assumptions in rates. And I guess along that vein, what is it about today's environment that you think supports the continued view that it – we are seeing outperformance versus normalized?

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

A

Well, I'll kind of take that – a number of questions; I'll kind of take that backwards. But, I mean, the reason you have outperformance now is a couple of things. One is, you have, I think, historically strong underwriting quality, we'd expect that to continue. The other reason you're seeing outperformance is you've seen significant home price appreciation and low unemployment. So, unemployment rate's been going down, home price appreciation being going up. So in that environment, you would expect to see outperformance and you should see outperformance in that environment.

It's tough to speculate what competitors are going to do in terms of kind of their view from a modeling or projection perspective. I don't think I've heard anything publicly. I think when other competitors talk about what they think kind of a through the cycle loss ratio, I think everyone's around that 20% range. I haven't heard anyone take a different view with respect to that.

I think – I also haven't heard anyone changing kind of their return targets. Our blended return targets remain the same. I think that in terms of the positive environment where we've had kind of I would say low loss ratios, that's been something we've been living with for a number of years and we haven't seen, I would say, anyone kind of reset expectations. It would also be odd for them to do it at this point in the cycle considering, kind to the earlier question, if anything you start with the home price appreciation kind of moderate a bit. So again, it'd be speculating. All I can say is from our perspective, we're not changing our view in terms of that or kind of shifting down our projections from it through the cycle loss projection perspective.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you.

Operator: Our final question will come from Bose George with KBW. Please go ahead.

Q

Hey, guys. This is [ph] Tommy (00:59:50) on for Bose. One of your competitors recently did an ILN transaction that covered legacy loans. Do you think that's something that you guys would consider or do you think that the risks there are just pretty minimal at this point?

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

A

Sure. This is Frank. When we do our evaluation of the portfolio and our capital plan and we'd consider a broad range of things, that's certainly something that we consider. Certainly wouldn't want to speculate on what would be or what could be executed in the future. But certainly we've evaluated the entire portfolio and consider a broad range of options.

Q

Okay. And just as you guys continue to tap the ILN market, is there kind of a goal in mind for what percentage of the portfolio you'd eventually like to see reinsured?

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

A

Derek, do you want to take that?

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

A

The way we look at it as opposed to looking at it just from a size of the portfolio perspective, we're looking at it really on a cost of capital and also kind of a tail volatility perspective, right. So, what we really want to do is look at each of the portfolio, if it makes sense to distribute it, we might not be the optimal kind of holder of it from a risk or capital perspective, or we want to essentially, for instance, cut off the tail volatility, that's the way we'd look at it.

And so, even if, for instance, your question on the seasoned portfolio, many of those vintages have benefited, as I indicated earlier, from significant credit burn out. So a lot of that risk is removed. But again, as you think about the ILN structures, you can set the structure to kind of the risk, right. So we would move up and down kind of the attachment and detachment points of those structure to generally optimize it from a capital and risk distribution perspective. So simply looking at is one piece being riskier and less risky, it really depends on the way you structure it and the cost of capital in that structure.

Q

Got it. Thanks, guys.

Operator: And Mr. Thornberry, I'll turn it back to you for any closing comments.

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

All right, thank you. I want to thank each of you for all your excellent questions and appreciate your participation in the call today. Mostly I want to thank our employees and board members and investors who supported Radian as we continue on our mission here. We look forward to seeing you in Philadelphia next week for our Investor Day, should you be able to come. And again, thank you for your time today, and we look forward to talking to you soon. Take care.

Operator: Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.