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Radian Group Inc. (RDN)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Second Quarter 2024 Radian Group Earnings 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 now like to hand the conference over to your speaker today, Dan Kobell, Head of Investor Relations and Capital Management. Please go ahead.

Dan Kobell

Executive Vice President, Financial Planning & Analysis, Radian Group Inc.

Thank you and welcome to Radian's second quarter 2024 conference call. Our press release, which contains Radian's financial results for the quarter, was issued yesterday evening and is posted to the Investor section of our website at 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 Investor 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 Insurance.

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 2024 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.

Thanks, Dan, and thank you all for joining us today. Last evening, we reported another quarter of excellent financial results for Radian. Our results continue to reflect the economic value of our high quality and growing mortgage insurance portfolio, the resiliency of our company and varied interest rate environments, the strength and quality of our investment portfolio, our strong capital and liquidity positions, and our ongoing strategic focus on managing operating expenses.

I will begin today by sharing a few financial and business highlights. We increased book value per share by 12% year-over-year to $29.66. We grew revenues to $321 million during the quarter, generating net income of $152 million. Our primary mortgage insurance in force, which is the main driver of future earnings for our company, continued to grow to $273 million.

We continue to leverage our proprietary analytics and RADAR Rates platform to identify and capture economic value in the mortgage insurance market, which resulted in $13.9 billion of high quality new insurance written in the second quarter. We benefited again this quarter from positive credit performance in our mortgage insurance portfolio, resulting in a decline in our default rate to 2% at June 30.

In terms of operating expenses, as we discussed last quarter, we've been taking broad and significant actions to improve the operating efficiency and operating leverage across Radian. Sumita will provide an update on how our expense savings efforts are expected to benefit our other operating expenses going forward.

Our primary operating subsidiary, Radian Guaranty, paid its sixth consecutive quarterly ordinary dividend to Radian Group in the amount of $200 million, which was double the amount paid in each of the previous five quarters. Our overall capital and liquidity positions remain strong. We maintained a PMIERs cushion for Radian Guaranty of $2.2 billion, and we increased our Available Holding Company Liquidity to $1.2 billion. Consistent with our use of risk distribution strategies to effectively manage capital and proactively mitigate risk, we entered into a new quota share reinsurance agreement in June for new business written between July 1, 2024 through June 30, 2025 and its attractive cost of capital.

Our return on equity in the second quarter was 13.6%, which reflects our strong financial results, including continuing positive credit performance, offset in part by our current excess capital position. As previously announced in May 2024, our Board of Directors authorized an increase to our existing share repurchase program to $900 million and extended the time period to June 30, 2026. We are pleased that our strong financial position and capital flexibility allow us to deliver excellent financial results, grow our businesses, and serve our customers while opportunistically returning value to our stockholders.

I am also delighted to share that our mortgage conduit business, Radian Mortgage Capital, brought to market its inaugural private label prime jumbo mortgage securitization transaction of approximately $350 million. As I've discussed previously, we view this business as a natural extension of our successful model for aggregating, managing, and distributing mortgage credit risk, and a strategic opportunity to leverage our brand known for quality underwriting for the benefit of capital markets investors. Strategically, we also believe this business provides a growth opportunity by expanding and deepening our relationships with our mortgage lender customers, which has been demonstrated by the strong response from large and small originators. Looking ahead, we expect to become a regular issuer in the non-agency mortgage securitization market.

Turning now to the housing market, recent industry forecasts projected total mortgage origination market for 2024 of approximately $1.7 trillion, which would represent an increase of 12% compared to 2023. Based on the origination forecast, we continue to estimate that the private mortgage insurance market will be approximately $300 billion in 2024, consistent with the prior year. I believe it's worth noting the positive impact that we expect from the continuing higher interest rate environment in terms of increasing our investment portfolio returns and maintaining strong persistency benefiting our insurance in force.

Additionally, the housing market remains supply constrained, which we expect will keep overall home values stable from an HPA perspective. It's also important to note here that most borrowers in our insured portfolio have significant embedded equity in their homes, which helps to mitigate the risk of loss by decreasing both the frequency and severity of paid claims, which are expected to continue to positively impact our default and cure trends. Overall, our outlook for the mortgage insurance business remains positive.

Finally, as you've heard me say before, our business model is proven and our company is built to withstand economic cycles. This has been significantly strengthened by the PMIERs capital framework, dynamic risk-based pricing, and the distribution of risk into the capital and reinsurance markets. We believe this is recognized on both sides of the political aisle and that we are well-positioned to fulfill our important role in the housing finance system.

Sumita will now cover the details of our financial and capital positions.

Sumita Pandit

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

Thank you, Rick, and good afternoon to you all. I'm pleased to provide additional details about our second quarter results, which reflect another strong quarter of performance producing net income of $152 million or $0.98 per diluted share, in line with the prior quarter. Adjusted diluted net operating income per share was slightly higher than the GAAP metric at $0.99 for the second quarter, compared to $1.03 for the previous quarter. We generated a 13.6% annualized return on equity in the second quarter, which helped to grow our book value per share 12% year-over-year to $29.66. This book value per share growth is in addition to our regular stockholder dividends, which were $37 million during the quarter, reflecting our quarterly dividend of $0.245 per share. We also repurchased $50 million of shares during the second quarter.

Turning now to the detailed drivers of our results. Our revenues continued to be strong in the second quarter. We generated $321 million of total revenues during the quarter, compared to $319 million in the first quarter and $290 million in the second quarter of 2023.

Slides 10 through 12 in our presentation include details on our mortgage insurance in force portfolio, as well as other key factors impacting our net premiums earned. Our primary mortgage insurance in force continued to grow, reaching $273 billion as of the end of the second quarter, and generating $235 million in net premiums earned in the quarter. We wrote $13.9 billion of new insurance written in the second quarter of 2024, an increase from $11.5 billion written in the prior quarter. This contributed positively to the growth of our insurance in force. The persistency rate of our existing insurance in force also remained high at 84% in the second quarter, based on the trailing 12 months compared to 83% a year ago.

As of the end of the second quarter, 74% of our insurance in force had a mortgage rate of 6% or less. Given current mortgage interest rates, which meaningfully exceed these levels, these policies are less likely to cancel due to refinancing in the near term. We continue to expect our persistency rates to remain strong given current mortgage rates and the overall economic outlook.

As shown on slide 12, the in force portfolio premium yield for our mortgage insurance portfolio remained stable in the quarter at 38.2 basis points. With strong persistency rates and the current positive industry pricing environment, we expect our in force portfolio premium yield to continue to remain stable for the remainder of the year. The total net yield of our insured portfolio can fluctuate from period to period due to other factors, such as changes in our risk distribution programs and profit commissions earned.

Our net investment income was $74 million in the second quarter. The increase in our net investment income has been driven by increases over the past year in both the size and average yield of our investment portfolio, as well as an increase in income from our mortgage loans held for sale within Radian Mortgage Capital. The $74 million of net investment income this quarter includes $5 million related to mortgage loans held for sale within Radian Mortgage Capital. Excluding that impact, net investment income grew 9% year-over-year. As we continue to reinvest cash flows in the current rate environment, we expect our average investment portfolio yield to continue to increase. Our unrealized net loss on investments reflected in stockholders equity was $377 million at quarter end. We expect that our strong liquidity and cash flow position will provide us with the ability to hold these securities to recovery of the unrealized losses, which would equate to $2.50 that is expected to accrete back into our book value per share over time.

I will now move on to our provision for losses. Credit trends continue to be extremely positive. Similar to previous quarters, our defaults continue to cure at rates greater than our previous expectations, resulting in releases of prior period results that in recent years have significantly offset reserves established for new defaults. Our favorable loss experience continues to be driven primarily by the significant embedded homeowner equity, resulting from the strong home price appreciation experienced in recent years.

On Slide 16, we provide trends for our primary default inventory. Total default declined to approximately 20,000 loans at quarter end, resulting in a portfolio default rate of 2%, a decline from 2.1% in the prior quarter.

As shown on slide 17, our cure trends have been very consistent and positive in recent periods, with approximately 90% of defaults curing within four quarters and 97% curing within eight quarters meaningfully exceeding our initial expectations. Cure rates in the second quarter exhibited typical seasonal trends and compare favorably to similar periods from prior years. The number of new defaults reported to us by servicers was approximately 11,100 in the second quarter of 2024, a decline of 6% from the previous quarter. We continue to maintain our default to claim roll rate assumption for new defaults at 8%, which resulted in $48 million of loss provision for new defaults reported during the quarter. Positive reserve development on prior period defaults of $50 million more than offset this provision for new defaults, resulting in a net benefit of $2 million in our mortgage insurance provision for losses in the second quarter.

Moving on to our other business lines. As a reminder, last quarter, we implemented a change to streamline our segment reporting and summarize the activities for several of our business lines into All Other. Total revenues in All Other were $40 million in the second quarter, an increase compared to $34 million in the prior quarter. The adjusted pre-tax operating loss for all other was $6 million this quarter, or $1.4 million before corporate expense allocations.

Now, turning on to our other expenses. For the second quarter, our other operating expenses totaled $92 million, an increase compared to $83 million recognized in the first quarter. Expenses in the second quarter included the impact of our annual share-based incentive grants, as well as an increase in severance and related expenses. As

Rick noted, we have taken significant actions to improve our efficiency and operating leverage across Radian. As a result of these actions, compared to our expense run rate, which was $348 million for the full year 2023, we expect an improvement in 2024, and to see the full benefit of a run rate reduction of $20 million to $25 million in annual operating expense, beginning in 2025 based on current operations. While we continue to actively manage our operating expenses and seek opportunities for additional efficiencies, it is important to note that expenses can fluctuate from quarter to quarter due to changes in line items such as variable incentive compensation and investments in strategic growth initiatives.

Moving on to our capital, available liquidity, and related strategic actions. The financial position of our primary operating subsidiary, Radian Guaranty, remains strong. Radian Guaranty paid a $200 million ordinary dividend to Radian Group this quarter, an increase from the $100 million ordinary dividend that Radian Guaranty has paid for each of the last five quarters. The PMIERs cushion remains stable at $2.2 billion even after this higher dividend. At the beginning of the year, we provided guidance that we expected Radian Guaranty to pay $400 million to $500 million of ordinary dividends to Radian Group for the full year 2024. Radian Guaranty continues to generate strong earnings and release contingency reserves in material amounts. As a result, Radian Guaranty has already paid $300 million of ordinary dividends in just the first half of the year.

I will briefly walk you through the mechanics of the ordinary dividend capacity at Radian Guaranty, which is also highlighted in slide 21 of our investor presentation. Ordinary dividends from Radian Guaranty are paid from its statutory unassigned funds. Given Radian Guaranty's strong PMIERs position, we've been able to maximize our ordinary dividends paid in recent quarters, closely mirroring the previous quarter's ending unassigned funds balance subject to other statutory limitations. We expect to continue to maximize our ordinary distributions from Radian Guaranty in future periods as well.

For the second quarter, the ending unassigned funds balance for Radian Guaranty was $186 million, providing us capacity to pay our dividend of approximately $185 million to Radian Group in the third quarter of this year, with another dividend expected in the fourth quarter. Statutory unassigned funds and therefore future ordinary distributions will continue to be driven by Radian Guaranty's ongoing earnings, as well as the contingency reserve release schedule shown on Slide 22.

As Rick mentioned earlier, in June 2024, Radian Guaranty entered into a quota share reinsurance agreement with a panel of third party reinsurance providers, consistent with our use of risk distribution strategies to effectively manage capital and proactively mitigate risk. Under this 2024 QSR Agreement, we expect to see 25% of new insurance written between July 1, 2024 and June 30, 2025 subject to certain conditions.

Moving to our holding company, Radian Group. Yesterday, we announced the redemption of our 2024 senior notes in the amount of $450 million payable in September 2024. As described earlier this year, we expect this action will reduce our ongoing interest expense by approximately $20 million annually and reduce our debt to capital ratio to below 20%. Once complete, Radian will have no senior debt maturities due until 2027. Additionally, in the second quarter, we increased our share repurchase program from $300 million to $900 million, and extended the program to June 30, 2026. Within the quarter, we repurchased 1.6 million shares at a total cost of $50 million for an average price of $31.79 per share.

As of the end of the second quarter, our current share repurchase authorization has $667 million remaining. As demonstrated by this prior quarter's repurchase activity and our track record in recent years, we believe that share repurchase provides an attractive option to deploy our excess capital. Our available holding company liquidity increased to approximately $1.2 billion at the end of the second quarter. We also have an undrawn credit facility with borrowing capacity of $275 million, providing us with significant financial flexibility.

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 our results for the second quarter continue to reflect the balance and resiliency of our company, as well as the strength and flexibility of our capital and liquidity positions. We expect the earnings and cash flows generated from our large in force mortgage insurance and investment portfolios to allow us to continue operating from a position of strength and delivering value to our customers, policyholders, and stockholders. We returned $87 million of capital to stockholders during the second quarter and approximately $360 million over the past year in the form of share repurchases and dividends.

I also want to highlight our affordable housing efforts, specifically the MBA's CONVERGENCE Philadelphia that recently recognized its one year anniversary. Radian is a cornerstone partner for this initiative, and the team continues to make progress on bringing together local housing stakeholders to help enable affordable and sustainable homeownership opportunities for historically underserved communities in Philadelphia. And I want to recognize and thank our dedicated and experienced team for the outstanding work they do every day.

As many of you know, this quarter, we transitioned the Investor Relations responsibilities to Dan Kobell, who has been a leader in financial planning and analysis at Radian for the past nine years, and who also has responsibility for investment portfolio management, treasury, and capital management functions. I want to personally thank John Damian for the great work he has done over the past several years leading Investor Relations, as he takes on leadership of the financial planning and analysis function while continuing to lead our corporate development efforts.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Bose George of KBW. Your line is open.

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

Q

Hey, everyone. Good afternoon. I wanted to ask first just about the share count. It went down by less than the buybacks. Is the difference the share grant for the employees or just one of the roll forward of the share count?

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

A

Yes. Hi, Bose. This is Rick. I think Sumita and I can tag [indiscernible] (00:23:13). I think it's all related to probably the LTI program that's offset by the share buybacks.

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

Q

Like in prior quarters, I haven't noticed that. Is that because that occurred last year as well when there were no buybacks, right? So the -and the share count didn't go down. Is that...

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

A

It should be a second quarter.

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

A

Yeah. I think, it usually – you see the impact of that the most in the second quarter. In fact, we referenced that in our prepared remarks that you see the expense higher in Q2, and I think you'll see that impact almost every year in the second quarter.

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

Q

Okay. So, okay, great. Thanks. And then actually switching over just to the conduit, just actually from an accounting standpoint going forward as you securitize, are you going to consolidate these? I mean, will we see this on your balance sheet, or is that sort of a separate vehicle and we don't need to worry about it?

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

A

Yeah. I think it's a really good question. I think we are looking at all of our accounting options as we look at the business. I think we'll be giving you more disclosure on this starting next quarter [indiscernible] (00:24:18). I think that a lot of that depends on how the accounting treatment is driven depending on how much securities are retained in the structure. So, we are in the process of evaluating it, and we will be providing more disclosure to you starting from next quarter.

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

Q

Okay. Great. Thanks.

Operator: Thank you. Our next question comes from Doug Harter of UBS. Your line is open.

Doug Harter
Analyst, UBS Securities LLC

Q

Thanks. Given your comments around the dividend capacity from the operating company, how are you thinking about what is the right amount of liquidity to be holding at the parent company? And kind of how are you thinking about use – kind of uses of that liquidity?

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

A

Yeah. So, I think as we mentioned, there was significant dividends that have been paid out from Radian Guaranty to group already this year. It amounted to about $300 million. And we expect to exceed the initial guidance that we gave you at the beginning of the year, which was $400 million to $500 million from Radian Guaranty to Radian Group.

If you look at our holding company today, we have about $1.2 billion of HoldCo liquidity. We are going to use about $450 million of that liquidity to pay down our 2024 maturities. We also expect to obviously pay our dividends, which is about $150 million each year. So that should – we have another two quarters of that, that we will pay out. And then there are ongoing, I would say, capital investments that we will continue to make in some of our businesses. I think Rick mentioned RMC as an example of that.

So, I think at the end of the year, you should expect our HoldCo to still have about [ph] $950 million (00:26:10) to a $1 billion of liquidity. It is more than what we really need to run the business. We have said that we are holding some excess liquidity in the HoldCo. Having said that, we will continue to be really disciplined about returning capital back. We returned about $50 million through share repurchases this quarter. We have continued to buy back shares even in Q3. And so, you should expect that we will continue to be disciplined about giving back that capital, both in the form of share repurchases and dividends. But at the end of the year, I would say HoldCo liquidity should be in that [ph] $950 million (00:26:47) to $1 billion range before the share repurchases that I walked you through right now.

Doug Harter
Analyst, UBS Securities LLC

Q

Okay. Thank you very much.

Operator: Thank you. Our next question comes from Soham Bhonsle of BTIG. Your line is open.

Soham Bhonsle
Analyst, BTIG LLC

Q

Hey. Good afternoon. Soham Bhonsle here. Hope you're all doing well. Derek, maybe first one for you on credit. Look. I think the environment remains constructive for mortgage overall, but there does seem to be overall slowing on – in the US consumer if you just look at consumer spend, and unemployment has been ticking up just slightly more recently, right? So maybe just talk about if you're seeing any yellow signs and if you're reflecting any of that in the way that you sort of position the portfolio.

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

A

Sure. I think in terms of yellow sign, what we're seeing initially is really on the much lower end of the credit, kind of outside the space we play in. So, you kind of see some, I would say, pressure in terms of kind of lower credit quality. So we're talking lower FICOs like in the 500 and below 600.

So, it's not a space we play in. We watch that closely. We do expect unemployment to tick up a bit, and for home prices, the rate of appreciation to come down. We're pricing that in. That's factored into all of our scenarios. So, I would say right now playing out as expected and better than what I would have thought a year ago kind of given where we were from a interest rate hiking scenario. So, in terms of playing out from a macro and how it's translated into credit, I would say it's been more positive than I would have expected a year ago.

Soham Bhonsle
Analyst, BTIG LLC

Q

Okay. Great. And then on expenses, Sumita, if you – so this quarter, you saw the increase, of course, from the LTI, the bonuses, and things like that. But as we sort of think of the back half of the year, where should we think about that normalizing, and then – ex-items, and then how should we think about sort of including the $20 million run rate that you sort of mentioned? Thank you.

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

A

Yeah. So I think just going back to where we started, I mean, if I were to remind you of our last year expense initiatives, we had taken out about $77 million of expenses from our operating expenses and cost of services. We've continued to be really disciplined, and we have been looking at other avenues to bring down that cost base further. I think, as I mentioned in my prepared remarks, I think we have continued to take out expenses. And some of that is flowing through our Q2 line item in severance. The $20 million is – $20 million to $25 million run rate reduction that I spoke about is really, I would say,, run rate from 2025. Some of that you may see in the back half of this year.

So, expect the $348 million that we had as the operating expense line item last year to come down a little bit this year and to come down by about $20 million to $25 million by next year. And so for the second half of the year, we have not given a specific number. But I think you can probably estimate it and make an assumption of what that would be like for the second half of the year.

Soham Bhonsle
Analyst, BTIG LLC

Q

Okay. Perfect. Thank you.

Operator: Thank you. I'm showing no further questions at this time. I'd like to turn it back to Rick Thornberry for closing remarks.

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

Thank you. And I appreciate everybody participating and joining us today. And I want to just reemphasize the thanks to our employees as they've been continuing to navigate the marketplace over the last few years and continue to do a great job, but appreciate everybody's interest in Radian. And we look forward to meeting and talking to you all soon. So, thank you and have a great day.

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