PARTICIPANTS

Corporate Participants

Richard G. Thornberry – Chief Executive Officer & Director, Radian Group Inc.
J. Franklin Hall – Chief Financial Officer & Executive Vice President, Radian Group Inc.

Other Participants

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

MANAGEMENT DISCUSSION SECTION

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

So, okay. Good morning. Let's get the next session started. Next up, we have Radian Group. Radian is one of the largest mortgage insurance companies in the country. The company wrote over $50 billion of new insurance written in 2016. Currently has around $186 billion of insurance in force. They have a $3.5 billion market cap.

Attending from Radian is the CEO, Rick Thornberry, to my left; CFO, Frank Hall, to his left; and Emily Riley, the Head of IR, in the audience.

So, let me kick off with a few questions, and we're using a fireside chat format. So, we'll open it up to the audience as well. So, let me start with a welcome to Rick Thornberry, who joined Radian earlier this year. It's a pleasure to have you here today for your first conference with us as Radian's CEO. So, before we begin, would you like to make a few comments?

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

Well, thank you, Bose. And Frank and I are very happy to be here, and we appreciate KBW asking us to join. So, I've been at Radian now for just under three months and had the opportunity to really kind of go through the business in significant detail, but I joined the company in – with the thought and the understanding that it was a great team with a great mortgage insurance, distribution franchise, a broad set of products and services, along with a strong capital base and solid profitability.

So, when you kind of look at the mix of what I came into, I was kind of fortunate to get a good hand of, as I've spent time with the company over the past few months, I've been pleased to have the opportunity to meet with many, many employees and our customers and regulators and outside counterparties and really discover how Radian is viewed outside of the company as well as inside. And I've been very pleased, very excited about the opportunity.

So, I think, as we go forward, looking at how we can leverage our mortgage credit risk expertise and our broad base of mortgage and real estate services, I think, presents a very interesting opportunity for us to serve our customers' needs, our mortgage insurance customer, our services customers' needs based on what they're going to need in the future. So, I'm excited. It's been a fun 12 weeks, and I look forward to the next 12 [indiscernible] (02:20)

QUESTION AND ANSWER SECTION

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Thanks. So, let me start with sort of some bigger picture questions on the industry. In terms of market share, it looked like there was a modest shift in new insurance written away from Arch last quarter. Can you discuss market share trends, how you think they're playing out mainly with opportunities arising from – with the Arch/UG merger?

<A – Rick Thornberry – Radian Group Inc.>: Yeah. So, I think we did see a little bit of a shift in the first quarter. It's a little too early to tell at this point, kind of, how it will all play out. I think our position in the marketplace where we have a very strong, dominant market position with very strong customer relationships. So, I think the combination of our relationships, from a sales perspective, our service delivery and kind of our approach to business gives us the opportunity to seize opportunities where they may exist.

So, whether it's a merger or other incidents and occurrences in the market, I think our team is well positioned to leverage our credit risk expertise and also leverage some of our broader set of services to grow market share on our terms, our pricing, our products. And so, we're trying to remain very disciplined about how we grow share and how we approach the market, but I think we're well positioned to take advantage of those opportunities.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Great. And actually, just switching to Genworth. Can you give us thoughts about potential market share shifts there, either if the merge – the acquisition by China Oceanwide goes through or [ph] if it doesn't, sort of, (03:54) scenarios about how that could play out?

<A – Rick Thornberry – Radian Group Inc.>: Yeah. So, probably, it's hard to speculate as to how that deal will play out, and I guess time will tell. But again, I would say we are well positioned to capitalize on those opportunities in our sales team, which is really divided between both a kind of a new account, kind of a business development function and an account management group. Both those groups and combination I think position us well to both have new relationships where the opportunity exists but, even as important, to deepen relationships where opportunities exist from a disruption in the marketplace, say, like a Genworth transaction.

So, we're going to remain very aggressive, very focused on doing the right business based on our returns, based on our profile of products that we want to do and compete aggressively. I think we're well positioned to do that.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. Let me just dig into margins a little bit. That was obviously a big topic around earnings last quarter. You reported a margin after reinsurance of 48 basis points. You guided to a 45 basis points to 47 basis points range going forward. Can you remind us what your average premium is on NIW and then just some of the drivers that takes you from the 48 basis points to the guided range?

<A – Frank Hall – Radian Group Inc.>: Sure, Bose. And as you alluded to net premiums, I'll speak in terms of gross, so before reinsurance. What we're seeing there, Bose, is a combination on the portfolio yield of different price structure, different mix of new business coming on with NIW, and then we have the runoff of over vintages coming off. So, the combination of those two things are creating that downward pressure on our portfolio yields that we guided to. So, we've guided to a 48 basis point to 50 basis point gross portfolio yield. And that really will depend upon both mix of what's coming on and what's coming off.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: The – and in terms of the cancellation of singles, the impact, can you just talk about what that – the contribution in the first quarter, and is that a fairly sort of normalized number when you think about the margin?

<A – Frank Hall – Radian Group Inc.>: Yeah. I think I mentioned in the earnings call, it really is tough to predict. But the level that we saw in the first quarter, I think, would be indicative of a lower refinanced activity environment. And so, if you want to use that as a baseline, I think we've shared with the public that that seems to be a pretty good baseline to work from.

It was 3 basis points on the yield for the quarter and – but I think the thing that is sometimes lost in looking at that 3 basis point loss is what the long-term value creation of higher persistency is on the monthly premium business that we have. So, it's a short-term pain but long-term benefit, and that benefit is much greater than the incremental change that we saw quarter-over-quarter. That will start to come through in future quarters. But the overall impact on a net basis is actually positive for the organization overall.

<A – Rick Thornberry – Radian Group Inc.>: From an intrinsic value perspective. So, I think one of the things I've learned very quickly through this business is that there are differences in the accounting aspect in this business. So, we try to manage this business as effectively as we can from an intrinsic value as well. And I think, as you look at any business in a rising rate environment, there's going to be different metrics that we need to focus on. So, as Frank said, the singles' offset by the extension and the duration of our monthly portfolio is a very important factor in looking at our company.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: And then, [ph] one more (07:45) in the margin, just the cost of the reinsurance, is that kind of a good number going forward?

<A – Frank Hall – Radian Group Inc.>: It is, yes.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. And let's actually switch over to pricing. Can you just give us an update on any changes in the market you've seen? And how would you sort of characterize a general pricing environment versus six months ago or a year ago?

<A – Rick Thornberry – Radian Group Inc.>: I would say pricing is generally stable today. Across the industry, we hear there's always noise and there's competition around the edges. But I would say, in general, we've seen a fairly stable pricing environment. And again, I don't have the history with it. But probably, going back over to last year, I think it's been relatively stable, I think. As we go forward, our objective is to be – remain very disciplined about pricing, to focus our pricing around our returns, expectations, our – the relationship value we have with customers, and we make sure we stay within the regulatory framework that exists.

This business is different than many others. We have to sit within a state – national state framework from an insurance regulatory point of view and file rate cards regardless of whether we depict – regardless of how we price our products, our rate cards are very public and transparent. So, we remain disciplined, follow the regulatory requirements of our pricing. And from an industry point of view, we think there are – there is generally stabilization with a little bit of noise around the edges so...

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. And then, just in terms of the ROEs that you're doing, can you remind us where run rate [ph] ROEs are on (09:25) new business and then just how the reinsurance kind of plays into that as well?

<A – Frank Hall – Radian Group Inc.>: Sure. That's right. So, the returns on capital, the required capital, [indiscernible] (09:33) capital that we have on the business is, call it, mid-teens, 16% to 17%. And that is, on a levered basis, inclusive of reinsurance. So, we've been operating at that level for some time and, again, think that's a good number to use going forward.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. Actually, just switching over to the expense side. Can you remind us what expense ratio you're targeting? Also, in the first quarter, there was, I guess, a little bit of noise around some expenses related to [ph] retirement. (10:06) Can you just kind of go through the pieces there?

<A – Frank Hall – Radian Group Inc.>: Sure. So, we reported, on a GAAP basis, an expense ratio of roughly 27%; previous quarter, roughly 23%. We expect that number on a long-term basis to be in the low-20s. On a GAAP basis, we've shared with the public previously some of the moving parts that may be unique to Radian, and we tried to be very transparent about disclosing those items. Mostly, they're timing-related items. But there are some things that are specific to a technology upgrade process that we've been going through for several years, so we try to call that out separately as well.

But on a long-term basis, we are looking to see that in the low-20s and are confident that we can get there. Some of the other one-time items that – I shouldn't say one-time items, but the items that occurred in the first quarter and will have some residual effects throughout the year are related to our prior CEO's retirement, but those aren't expected to recur on a long-term basis.

<A – Rick Thornberry – Radian Group Inc.>: And, Bose, I would just add one thing to that. As I come in new to the company, I think an important element of our go-forward path is to continue and look for ways to improve our operational effectiveness. And it's important not only from a financial point of view. But I think, when you're in the business that we plan that it's important from a competitive differentiation perspective, I think it's important also to drive increased profitability, improved margins, higher returns for our shareholders. So, the expense side of the equation, as Frank has focused on since his joining on the firm will continue, and we'll continue to look for ways to become more operationally effective.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. Let's switch over to credit. You guys have shown loss ratios peaking on books – 2011-2012 books at sort of 7% to 8%. Actually, first, when you give your sort of – you modeled your ROE, does that assume kind of the 20% loss ratio and are these in – so these are sort of essentially incremental returns as long as that persists?

<A – Frank Hall – Radian Group Inc.>: That's correct. So, when we make our pricing decisions and give our estimates of return, it does assume a through-the-cycle loss estimate of roughly 20%. So, we – but to your point, we had experienced loss ratios much less than that.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: And so, in terms of your thought process, do you think that could persist for a while? I mean, clearly, the box – the credit box is so much tighter than it was in the past? So, what sort of gets us from here back to 20% or to a more normalized number?

<A – Frank Hall – Radian Group Inc.>: That's a good question. I think it really is just experience and seeing how the credit plays out over time. But through the cycle, we haven't experienced anything that would provide enough evidence for us to change those estimates of a 20% through-the-cycle assumption.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. And then, can you just remind us what your default-to-claim rate assumption was in the first quarter, and then just [ph] what that is (13:16) going to normalize?

<A – Frank Hall – Radian Group Inc.>: Sure. So, the default-to-claim rate, we reduced from 12% down to 11.5%. And we have guided that we would not expect to see more than another 50 basis points during the current year.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. Then, let me ask one on capital, and then I can open it up. The – can you just talk about when capital return could be a bigger part of the story and then just how you see excess capital which is clearly building as your earnings are high?

<A – Frank Hall – Radian Group Inc.>: Sure. So, the capital access, if you will, that we have, the PMIERs cushion at the operating company is roughly $300 million or 8%. If you couple that with the holding company liquidity that we have, it's roughly an 18% cushion.

So, as we think about long term, the capital building in the subsidiary, that cushion needs to grow quite a bit more before we start having the conversations about approaching the state regulators for a special dividend to dividend that up to the parent company. But our primary focus and our first priority for capital in the operating company is to support the very profitable business that we can produce organically.

So, that's probably a few years away as far as – now, we're obviously having some of those conversations in anticipation of that event internally. But the way the models are working, it will be 18, 24 or more months out.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. If I can just one more on capital. The PMIERs 2.0 that's coming out, any expectations for that to be much different for that? Is there – like, do you hold capital sort of contingent to what you see over there?

<A – Frank Hall – Radian Group Inc.>: The cushion, when PMIERs was first effective, we talked about how much of a cushion and for what. That certainly is one of the elements of the unknown that we contemplate when targeting a cushion. The GSE certainly have the ability to update it. I think the original PMIERs suggested that will be on a two-year cycle. I don't know that it's going to be on a two-year cycle. What's important for us, though, is that we have adequate time to review the proposed changes and prepare ourselves for whatever they may be.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Is there any indication of when they could come out, or is that still kind of up in the air?

<A – Frank Hall – Radian Group Inc.>: There is no clear indication at this point.

<A – Rick Thornberry – Radian Group Inc.>: Yeah. I think we're – we obviously have close communications with both GSEs and monitor it closely. But I think there's a general understanding that, as Frank said, we'll have adequate time to review and respond and comment, of course, through that process and make any adjustments. And I would suspect there will be adjustments. How those will play out? Too early to tell.

<A – Frank Hall – Radian Group Inc.>: Yeah.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Okay. Great. So, let me just check if there are questions from the audience.

<Q>: Yeah. Just going back to the market share for a second. Is it really just kind of the big lenders that you see when their [indiscernible] (16:26) that's where you can really see the market share shift? Or are there small and mid-sized lenders out there that [indiscernible] (16:33) as well?

<A – Frank Hall – Radian Group Inc.>: Yeah. So, I think when – it's really all of the above. So, the – I don't know if everybody could hear the question. But the question was, do large lenders drive kind of how the market share shifts come? And in part, penetrating those large lenders matters from just a sheer volume point of view. I would say we're – we have great relationships with many of the large lenders and are developing great relationships with the rest of them. But I think, the way I view the market is there's also a lot of ground-level play that has to be won. We have to win the hearts and minds of loan officers in many situations.

So, our combined effort of sourcing new clients from a business development point of view, working from a kind of account management perspective, a separate sales effort to penetrate those clients. And then, what I didn't mention earlier, we have an inside sales team which continue – is very effective, continually makes outbound calls both to the client, the loan officers, very unique in the marketplace. So, we're looking to kind of penetrate opportunities across multiple points of relationship.

And the one thing that everybody should understand is, no, clients are all different. Each client administers their mortgage insurance decisions differently. Some administer those at a sales person level, some administer them at the CEO level – from an allocation. So, depending upon the client, I would say it's safe to say that we're well positioned in how we approach that client and compete for that client. And I think our service delivery and our capabilities could stand on their own. So, large clients matter, but I think you also win it at the ground level as well, too.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: It seems there are questions at the back there.

<Q>: Can you please elaborate on your explanation for how we get to 48 basis points to 50 basis points in terms of singles impact, new business and the [ph] backup? (18:27)

<A – Frank Hall – Radian Group Inc.>: Sure. So, for those who didn't hear, the question was about how we'll get to the premium yields from where we are to the guided 48 basis points to 50 basis points. As I said, the mix of NIW is actually very important that, if you look at what the premium yield is on a monthly business for instance, that's in the high 50s. Single premium is much lower than that, obviously. And so, the mix of that is very important as it relates to what's coming onto the portfolio. But I think what is more important and certainly played out in the first quarter is what's actually coming off the books. And some of the older vintages had much higher premium yields. And as those older vintages come off, that has a drag on it as well.

<Q>: Can you just give us a rough idea as to [indiscernible] (19:21)

<A – Frank Hall – Radian Group Inc.>: Yeah. So, it's higher than 51 basis points as far as what's coming off. We don't give vintage level premium yields.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: The [indiscernible] (19:37)

<Q>: Yeah. Can you talk about [indiscernible] (19:39-19:44)

<A – Rick Thornberry – Radian Group Inc.>: Yeah. So, I can take that. So, I think – so, the question was how does Clayton fit in. Is think you mentioned there's been some disappointments.

So, I think, as I've come into this business, really taking a hard look at what we have today across the Clayton businesses and it's quite a diverse set of products and services that have been accumulated there. And so, as I came into this company, I came in with the idea and the anticipation that not only are we a mortgage insurance company, but we can become more relevant to our customers and have a deeper relationship with them by providing a broader set of products, right?

So, I've spent time going through all our Clayton products, whether it's transaction management, whether it's our valuation products, whether it's our REO management products or our title products, and there's all different levels of those. And I think, as we sit here today, the opportunity is for us to leverage these products to enhance our mortgage insurance relationships. So, as I'm going through this and as I'm learning about what we – what our core competencies are, I'm looking at not how we have transacted in the past, but how we can go forward with those products and how we can leverage those products going forward.

So, as we go forward over the next few months and have discussions about our business and kind of how I see going forward, I think we'll bring into focus kind of our strategic direction around Clayton and the services that we offer through these various products. But it's a high value to us to have those capabilities, and it's all about what we do in the future, right? So, it's – I think there has been struggles in the past, but we're seeing some bright signs in terms of some of the interests from our mortgage insurance customers. But as a guy who has kind of experienced the mortgage banking world for most of my career, the services side for a good part of my career, it's about what do we do with them next? How do we position effectively so that, in total, they'd become relevant to our overall earnings?

And today, obviously, in the first quarter, we had year-over-year growth but they weren't – businesses weren't contributing to our earnings. And so, my focus is, how do we position them so they'd become a relevant part of our earnings contribution and improve value for shareholders?

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: Actually, as part of that, could we see either divesting part of it or adding businesses to sort of complement it?

<A – Frank Hall – Radian Group Inc.>: So, the focus is on what we have today and kind of how it goes forward and what we can do with it. So, I've been – I think this is week 13. There's no shortage of opportunities in the marketplace for acquisitions. You have to see anything that would be accretive or pass the test. So, we're not focused on acquiring our way forward in this business. I think, taking the core capabilities, defining a path forward is our focus. And certainly, if there are high-value, accretive opportunities that make sense in that strategic direction, we'll certainly consider them. But at this point, it's about what we have and how we go forward.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: The – actually, let me just switch to just other growth opportunities in the sort of core business. Can you just talk about the FHA? Just any updates in terms of what you're seeing. Do you see that as a potential opportunity for your sector?

<A – Frank Hall – Radian Group Inc.>: So, we were happy to see the change made by the new administration to eliminate the price reduction. We think that the price reductions did not make sense. We're encouraged by the dialogue related to FHA. But I think, too early to tell. We – FHA competes with the MI business, and we monitor it very carefully.

But I think, as we go forward, we're focused on increasing the understanding and the value of the mortgage insurance product from a borrower perspective relative to an FHA product. And I think we'll stay very close to kind of how the FHA story evolves. But we're encouraged by what we see in here from Washington in terms of thoughts around FHA.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: And then, just a question on M&A. I figured this question used to come up more a few months ago and less recently. But do you think there could be more merger activity either within the industry or from other players, sort of, coming in to purchase?

<A – Frank Hall – Radian Group Inc.>: So, I think, those – either of those options both with across participants or from outside companies like the Arch kind of – more or less, like an Arch deal or a Genworth deal, I guess both of those, those are always possible options. And I think, as we sit here, there are six participants in the mortgage insurance world. I don't think it would be farfetched to see that go to five, or I doubt they will see an increase in the number of participants, right? I think that [ph] play is kind of run. (25:00) So, I think it's – the market is kind of the right size. There's – the industry is healthy. There is enough for the participants to compete effectively on and have strong thriving businesses.

How it plays out? I don't know. But I think our focus is in just continuing to drive our business, compete effectively and push our opportunities ahead regardless of what happens around us. So, I think we're in a good position to compete if there were new entrants to come in and we're – our market position puts us in a point to strike so...

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: I just got a couple on risk sharing, but let me just check quickly if there's anything from the audience. Go ahead.

<Q>: So, if you have higher premium yield vintages, I guess, rolling off and as the headwinds with the overall portfolio of premium yield and so you point out the 48 basis points to 50 basis points, is that factor limited to this year, or is it going to be a consistent headwind for many years to come?

<A – Frank Hall – Radian Group Inc.>: No. I think it's a kind of pricing levels that should be. I mean, we're putting on business – new business that's coming on around the 50 basis points mark. So, if that price stability and the current mix of both product and cycle LTV continues, then, yeah, I think that that's an accurate statement. And that's really what makes it difficult to predict because you have the mix of both products, single premium and monthly premium business. And then, you have the mix of cycle and LTV. And how all of that plays out is really what impacts the new business yields coming on. But yeah, what we're seeing coming on certainly would play into a 48 basis points to 50 basis points range on a somewhat stable basis.

<A – Rick Thornberry – Radian Group Inc.>: And keep in mind, too, that the pre-2009 book of business represents about 11% of our – the portfolio, excluding HARP, I think, is the right way to phrase it so...

<A – Frank Hall – Radian Group Inc.>: That's right.

<A – Rick Thornberry – Radian Group Inc.>: So, it's becoming less and less of a percentage of our overall book as we go forward.

<Q – Bose George – Keefe, Bruyette & Woods, Inc.>: The – actually, just let me touch on – we're almost done. But on risk sharing, there's been a couple of the [indiscernible] (27:23) transactions. Can you just talk about how do you see them? Do you feel like that's a promising first step? Or do you feel like there's quite a ways to go here still?

<A – Frank Hall – Radian Group Inc.>: Yes. So, I think here, the transaction is done by Fannie and Freddie. We have participated on the front-end transactions which are kind of the steps towards deep cover MI but not what the industry is proposed. So, I think we'll see how that plays out. I don't think much is going to happen on the deep cover MI in the near term. But from the front-end flow transactions that we participated in, I mean, we are leveraging our credit risk expertise and our credit risk scale analytics to really participate in those deals. And I think we're learning a great deal from our participation.

Our capital and the premiums associated with those deals are not significant, but we feel it's important to have a seat at the table to understand how those deals transact. And we think this is really kind of the frontend of how the world is going to evolve from a credit risk transfer perspective, and we think it's important given our deep analytic capability around credit risk and our deep core competency around credit risk to be a participant in that and understand that we're walking before we run and not jumping in without learning. So, we're taking it very slowly and participating from having the appropriate level at this point.

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

Great. So, that's all the time we have. Thanks a lot.

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

Thank you.