

Presented by  
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Rocky Mountain Chapter

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### Who is Essent?

- ▶ Essent Group Ltd. is a Bermuda-domiciled private mortgage insurance and reinsurance company (IPO: 2013; NYSE: ESNT)
  - Holding company
- ▶ Thru its subsidiaries, ESNT provides private mortgage insurance and reinsurance for mortgages secured by residential properties located in US
- ▶ As of December 31, 2018 (FYE18), Essent had approximately \$137.7 billion of insurance in force
- ▶ Customers consist of originators of residential mortgage loans, e.g., mortgage banks, credit unions, banks, other lenders

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### Who is Essent?

- ▶ Operation centers in: Radnor, PA; Winston-Salem, NC; Irvine, CA
- ▶ Recently named to Fortune's 2019 List of 100 Fastest-Growing Companies (8/19)
- ▶ Total Insurance In Force (IIF) of \$153.3B a/o June 30, 2019
- ▶ Combined risk-to-capital ratio of 13.6 to 1\*

\*The combined risk-to-capital ratio equals the net risk in force of Essent Guaranty and Essent Guaranty of PA, Inc. divided by the combined statutory capital of these U.S. insurance companies.

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Who is Essent Guaranty, Inc.?

- ▶ Primary U.S. mortgage insurance subsidiary (PA, 2009)
- ▶ Offers private mortgage insurance for single-family mortgage loans in the U.S.
- ▶ Essent Guaranty, Inc. is rated:
  - A (Excellent) by A.M. Best
  - BBB+ by S&P
  - Baa1 by Moody's
- ▶ Licensed to write coverage in all 50 states and the District of Columbia and is approved by Fannie Mae and Freddie Mac

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Who is Essent Reinsurance (a/k/a Essent Re)?

- ▶ Offers mortgage-related insurance and reinsurance
- ▶ Essent Re is rated:
  - A (Excellent) by A.M. Best
  - BBB+ by S&P
- ▶ Essent Re also reinsures 25% of Essent Guaranty's Government-Sponsored Enterprises (GSE) eligible mortgage insurance

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US Mortgage Market

- ▶ US residential mortgage market is one of the largest in the world
  - Over \$10.8 trillion of debt outstanding as of September 30, 2018
- ▶ Includes a range of private and government-sponsored participants
- ▶ Private participants: mortgage banks, mortgage brokers, commercial, regional and investment banks, savings institutions, credit unions, REITs, mortgage insurers and other financial institutions

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US Mortgage Market

- ▶ Public participants:
  - Government agencies - Federal Housing Administration (FHA), the Veterans Administration (VA), the U.S. Department of Agriculture Rural Development program and the Government National Mortgage Association (Ginnie Mae)
  - Government-Sponsored Enterprises (GSEs) such as Fannie Mae and Freddie Mac.

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### US Mortgage Market

- ▶ US residential mortgage market = both primary and secondary markets
- ▶ Primary market: lenders originating home loans to borrowers:
  - Loans made to support home purchases
  - Loans made to refinance existing mortgages
- ▶ Secondary market: institutions buying and selling mortgages in the form of whole loans or securitized assets, such as mortgage-backed securities
  - GSEs are the largest participant in secondary market

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### Why Are GSEs Important?

- ▶ GSEs buy residential mortgages from banks and other primary lenders as part of their government mandate to provide liquidity and stability in the U.S. housing finance system
  - GSEs held or guaranteed \$4.8 T, or 44%, of total US residential mortgage debt outstanding a/o 9/30/18
- ▶ GSE charters generally prohibit the GSEs from purchasing a low down payment loan unless:
  - that loan is insured by a GSE-approved mortgage insurer;
  - the mortgage seller retains at least a 10% participation in the loan; or
  - the seller agrees to repurchase or replace the loan in the event of a default

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### Private Mortgage Insurance

- ▶ Private mortgage insurance (PMI) = preferred method to meet this GSE charter requirement – therefore GSE's drive private mortgage insurance
- ▶ PMI is arranged by lenders (but paid by borrowers) to protect them if borrowers stop making loan payments
- ▶ PMI plays a critical role in the U.S. housing finance system:
  - Covers a portion of the unpaid principal balance of a mortgage and certain related expenses in the event of a default
  - Provides private capital to mitigate mortgage credit risk, allowing lenders to make additional mortgage financing available to prospective homeowners

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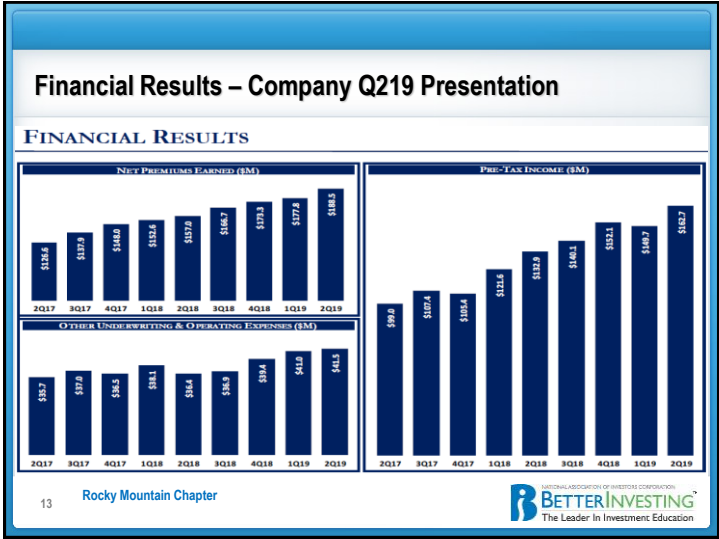
### Who Are the Private Mortgage Insurers?

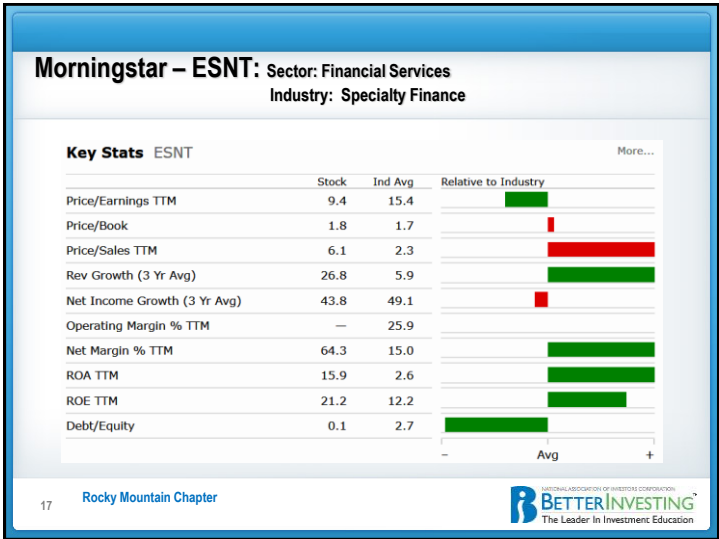
- ▶ Essent Guaranty Group (ESNT)
- ▶ Arch Mortgage Insurance Company (which also acquired United Guaranty Corporation in 2016)
- ▶ Genworth Financial, Inc. (GNW)
- ▶ Mortgage Guaranty Insurance Corporation (MGIC)
- ▶ National Mortgage Insurance Corporation (NMIH)
- ▶ Radian Guaranty Inc. (RDN)

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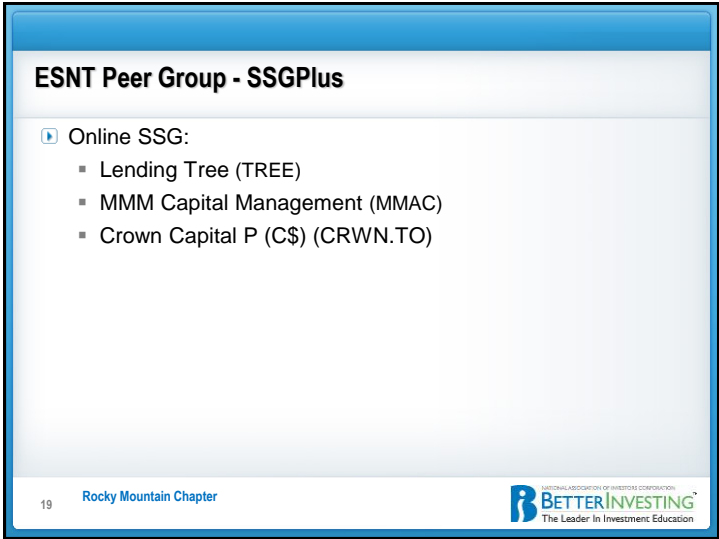




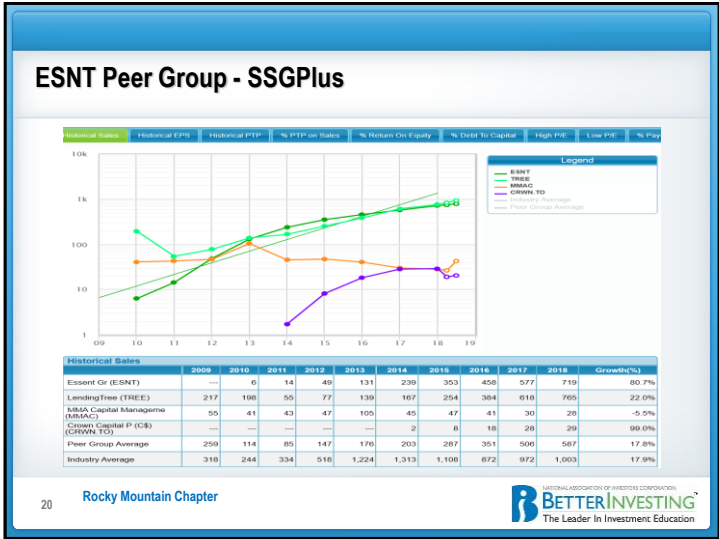
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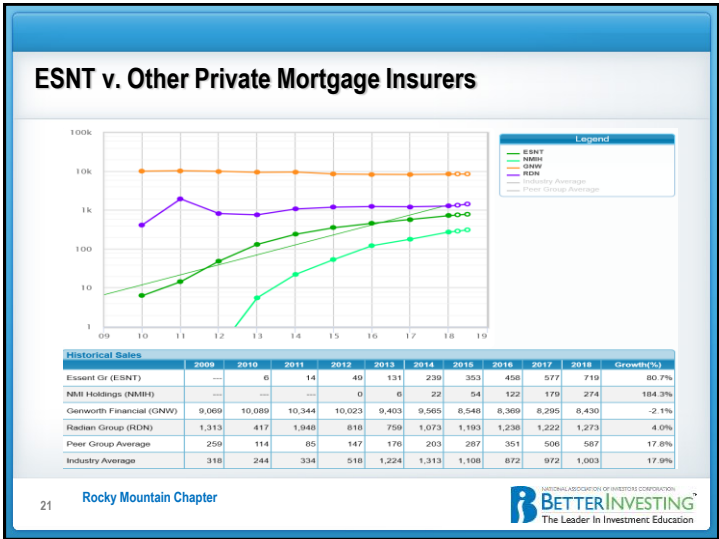
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### Credit (Default) Risk

- ▶ Credit (or default) Risk = Biggest risk for mortgage insurers
  - 80% of total risk is credit risk
  - Combination of poor mortgage loan underwriting standards and home construction excesses could lead to rising mortgage defaults and falling home prices
  - Investors fear some version of this outcome

I know what you are thinking!

Shades of 2007-2008!

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### Subprime Lending Led to 2008 Financial Crisis and Great Recession

- ▶ Banks and brokers sold mortgage backed securities (MBS) to each other and to investors as investments
  - Problem: by 2006, many MBS were backed by questionable mortgages
- ▶ MBS' included subprime loans issued to borrowers with low credit ratings
  - Subprime refers to borrower's credit score, not interest rate on the loan
  - Low interest rates or interest only
  - Usually adjustable rate mortgages (ARMS)
  - Conventional mortgage not offered because lender views the borrower as more likely to default on the loan

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### Subprime Lending Led to 2008 Financial Crisis and Great Recession

- ▶ When the ARMs reset, interest rates went up
- ▶ Borrowers couldn't make the higher interest payments
- ▶ Demand for houses fell, and then housing prices fell too
- ▶ Borrowers defaulted when couldn't sell their homes, or just abandoned their homes

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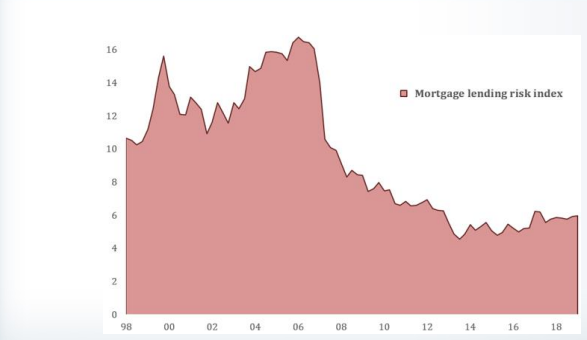
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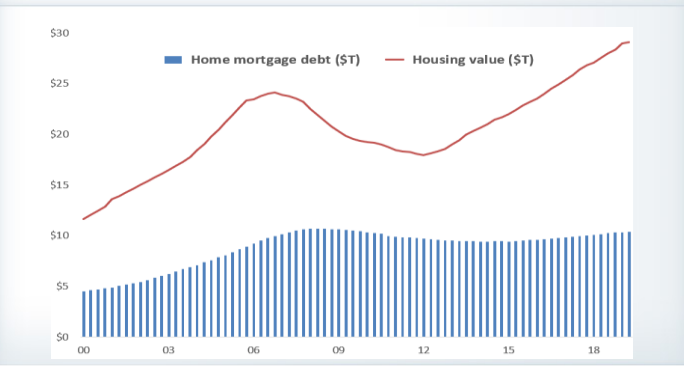
Volume of MBSs from 1996 – 2003

- ▶ 1996: total MBS issuances were less than \$500 million
- ▶ 1998: MBS issuances had more than doubled, to more than \$1 trillion
- ▶ 2003: MBS issuances reached an all-time high of nearly \$3.2 trillion

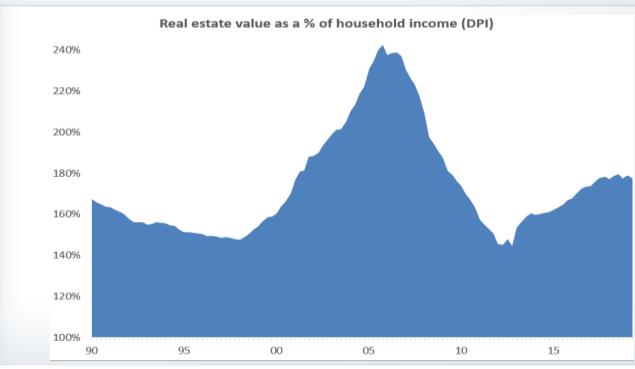
Mortgage Lending Risk Index (Source: Urban Institute)



Home Mortgage Debt v. House Value (Source: Federal Reserve)



Home Values to Household Income (Source: Federal Reserve, Bureau of Economic Analysis)






### SWOT Analysis

**S**trengths – **Internal** factors that may positively influence company performance

**W**eaknesses – **Internal** factors that may negatively influence company performance


**O**pportunities – **External** factors that may positively influence company performance

**T**hreats – **External** factors that may negatively influence company performance



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### Strengths

- ▶ Current low interest rates, with Fed signaling less aggressiveness for 2019
- ▶ All of ESNT’s policies in force were written since May 2010
- ▶ 85% of insurance in force covers borrowers with credit scores of 700 or above
- ▶ Strong financial strength ratings

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### Weaknesses

- ▶ Quicken Loans exceeded 10% of consolidated revenue for FY18 – loss of customer would negatively impact earnings
- ▶ Dependence on third-party servicing of loans that they insure, including
  - Timely submission of premium and monthly insurance in force and default reports
  - Loss mitigation
- ▶ PA law governs payment of dividends – only permitted to pay ordinary dividends without approval of PA insurance commissioner

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### Opportunities

- ▶ Supply of housing in US not enough to meet demand
  - Pickup in housing should lead to higher mortgage loan originations
- ▶ Sizable opportunity: age of the median first-time home buyer is now at 31 years
  - these young adults comprise a large share of the first-time home buyer population and therefore drive demand higher
- ▶ In May 2018, regulations for financial institutions were eased somewhat
  - Mortgage lenders too were given relief from some strict underwriting requirements

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**Threats**

- ▶ Economic weakness leading to higher new defaults and incurred losses
- ▶ Rising interest rates:
  - Cost of borrowing more expensive
  - Reduced demand for new mortgages and refinancings
- ▶ Legislative or regulatory actions which cause changes to the role of the GSE's, their regulations or business practices (e.g., level of coverage, underwriting standards that determine eligibility)
- ▶ Defaults resulting from hurricanes – a/o 12/31/17, there were 2,288 defaults resulting from hurricanes in 2017 (2,150 of those defaults cured in 2018)

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**Adding Judgment – Sales (%)**

- ▶ 12% - Yahoo 2020
- ▶ 16% - Toolkit ACE est. (2 year)
- ▶ 19% - Yahoo 2019
- ▶ 22% - Q219 v. Q218
- ▶ 31% - Five years historical

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**Adding Judgment – EPS (%)**

- ▶ 7% - Zacks 2020
- ▶ 10% - Zacks (3-5 years)
- ▶ 13% - Zacks 2019
- ▶ 22% - Q219 v. Q218
- ▶ 48% - Five years historical

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**Adding Judgment - High P/E**

- ▶ 9 - Current P/E
- ▶ 10 - 52 week high P/E
- ▶ 12 - 3-yr average P/E
- ▶ 30 - Better Investing High P/E

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**Adding Judgment – Low P/E**

- ▶ 6 - 52-week low P/E
- ▶ 7 - 3-year average low P/E
- ▶ 10 - 5-yr average low P/E
- ▶ 20 - Better Investing low P/E

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**Adding Judgment – Low Price (\$)**

- ▶ \$\_\_\_\_ - Forecasted Low Price
- ▶ \$23.60 - Average Low Price for last 5 years
- ▶ \$31.10 – Recent Market Low

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**After this Study, What Are Your Thoughts?**

- ▶ I'm considering adding ESNT to my portfolio
- ▶ Mortgage industry has too much risk for me – I'll pass
- ▶ ESNT doesn't fit my portfolio
- ▶ Will put on my watch list

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**Next Small Talk**

November 12, 2019

7 PM (MDT)

Register at [rmchapter.org](http://rmchapter.org)

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