

Equity Research

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Financials

Mr. Cooper Group Inc.

COOP's Acquisition of IBM's Seterus Creates Upside Potential Above 7% FY19 Servicing UPB Growth

Mr. Cooper Group (COOP) last evening announced the acquisition of IBM's (IBM, Not Rated) Seterus mortgage servicing platform which is expected to close in 1Q19. The transaction will add \$24B of GSE MSR's and a contract to subservice an additional \$24B of mortgages. While the company did not adjust their previous guidance in conjunction with the announcement, we believe the additional UPB puts the company in a position to beat previous FY19 servicing UPB growth targets.

- ▶ The \$48B of UPB represents over 50% of the UPB the company estimated it must add to achieve the 7% FY19 UPB growth putting COOP in a position to exceed its previous goal.
- ▶ Combined with our FY19 originations estimate of \$27.8B, we believe the company has \$75.8B of the \$90B needed to achieve 7% FY19 growth.
- ▶ This transaction provides further support to our belief that COOP will continue to leverage its scaled platform and low-cost structure to acquire smaller mortgage servicers and increase its servicing UPB.
- ▶ **We reiterate our Buy rating on COOP and price target of \$21** based on 7.5X our FY19E adjusted earnings per share estimate of \$2.86. We believe the additional growth visibility going into FY19 combined with COOP's discount valuation provide an attractive entry point to take advantage of a company with upside earnings optionality.
- ▶ The transaction adds over 300,000 new clients onto COOP's servicing platform which had 3.2M customers at 3Q18. COOP will have the ability to tap into those customers and cross-sell its other products.
- ▶ **Valuation:** Our \$21 price target for COOP is based on 7.5X our FY19E adjusted earnings per share estimate of \$2.86.

COOP **\$12.00**

12 month target \$21.00

BUY

52 week range \$9.00 - \$19.80

Market Cap (m) \$1,104

Price Performance



Source: IDC

Estimates

	1Q17 A	2Q17 A	3Q17 A	4Q17 A	FY17 A	1Q18 A	2Q18 A	3Q18 A	4Q18 E	FY18 E	FY19 E
Sales	427	380	406	438	1,651	588	444	506	479	2,017	2,190
Net Income (Adj.)	29	42	43	43	157	43	52	54	53	202	264
Diluted EPS (Adj.)	0.32	0.46	0.47	0.47	1.71	0.47	0.57	0.59	0.57	2.19	2.86
Tangible BVPS	17.26	17.01	17.15	17.64	17.64	19.40	20.05	21.56	22.02	22.02	24.21

Source: BTIG Estimates and Company Documents (\$ in millions, except per share amount)

- ▶ Our FY19E adjusted earnings per share estimate remains unchanged as we await additional detail from the company during the 4Q18 earning report.
- ▶ We currently model 6.2 bps of adjusted servicing margin in FY19 which is below the 6.5 bps the company achieve in 3Q18 – a seasonally weak quarter and the 6.5 bps the company needs to achieve in 4Q18 – a seasonally strong quarter to meet its 6.0+ bps guidance. For every 0.1 bps of additional servicing margin the company is able to add above our 6.2 bps estimate, our FY19E adjusted earnings per share would increase by \$0.06.
- ▶ We believe the Seterus transaction materially derisks the company's UPB growth guidance and puts the company in a position to exceed the original 7% goal outlined last quarter. Combining the \$4.8B of UPB acquired and our \$27.8B origination estimate, COOP should have visibility into \$75.8B or 84.2% of the UPB needs to achieve 7% UPB growth in FY19.
- ▶ Additionally, we point to the \$52B of UPB the company added via MSR/Subservicing bulk transactions in FY18pgalpgal, another source of upside optionality going forward. We do not give the company credit for any bulk acquisitions in our FY19.

Exhibit 1: Servicing UPB Growth Guidance Walk

\$ in Billions	2018	2019
Beginning UPB	508	535
Principal Reductions/Transfers	-88	-75
+ Originations and flow from existing partners	64	90
+ MSR/Subservicing bulk	52	0
+ Pacific Union Financial	0	25
Ending UPB	535	575

Source: BTIG Estimates and Company Documents

Income Statement

COOP - Operating Model	Dec-15	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21
\$ millions	2015A	2016A	1Q17A	2Q17A	3Q17A	4Q17A	2017A	1Q18A	2Q18A	3Q18A	4Q18E	2018E	1Q19E	2Q19E	3Q19E	4Q19E	2019E	1Q20E	2Q20E	3Q20E	4Q20E	2020E	2021E
Total revenues	1,989	1,933	427	380	406	438	1,651	588	444	506	479	2,017	494	564	575	558	2,190	570	594	599	581	2,344	2,426
Total expenses	1,688	1,663	372	369	368	366	1,475	364	339	517	385	1,605	394	458	464	441	1,758	453	475	478	457	1,863	1,922
Interest income	351	426	139	139	157	162	597	145	140	138	131	554	131	133	135	130	528	127	127	126	122	502	459
Interest expense	-604	-665	-190	-186	-181	-174	-731	-171	-164	-175	-171	-681	-170	-173	-175	-171	-688	-167	-167	-167	-163	-664	-623
Other expense	8	-2	-1	7	-2	-1	3	8	-2	6	0	12	0	0	0	0	0	0	0	0	0	0	0
Total other expenses	-246	-241	-52	-40	-26	-13	-131	-18	-26	-31	-40	-115	-39	-40	-40	-41	-160	-40	-40	-41	-41	-162	-164
Pretax income (expense)	55	29	3	-29	12	59	45	206	79	-42	54	297	60	65	70	76	272	78	79	80	83	320	340
Income tax expense	-11	-13	-1	10	-5	-17	-13	-46	-21	998	-13	918	-15	-16	-17	-18	-65	-19	-19	-19	-20	-77	-82
Noncontrolling interest	4	-3	0	1	0	0	1	0	0	9	0	9	0	0	0	0	0	0	0	0	0	0	0
Net income (loss)	40	19	2	-20	7	42	31	160	58	947	41	1,206	46	50	53	58	207	59	60	61	63	243	259
Basic EPS - GAAP	\$0.44	\$0.21	\$0.02	-\$0.22	\$0.08	\$0.46	\$0.34	\$1.76	\$0.64	\$10.43	\$0.46	\$13.28	\$0.51	\$0.55	\$0.58	\$0.63	\$2.27	\$0.65	\$0.65	\$0.67	\$0.69	\$2.66	\$2.82
Diluted EPS - GAAP	\$0.43	\$0.21	\$0.02	-\$0.22	\$0.08	\$0.46	\$0.34	\$1.74	\$0.63	\$10.29	\$0.45	\$13.11	\$0.50	\$0.54	\$0.57	\$0.63	\$2.24	\$0.64	\$0.64	\$0.66	\$0.68	\$2.63	\$2.78
Adjusted EPS - Pro Forma	\$1.36	\$1.79	\$0.32	\$0.46	\$0.47	\$0.47	\$1.71	\$0.47	\$0.57	\$0.59	\$0.57	\$2.19	\$0.64	\$0.69	\$0.73	\$0.80	\$2.86	\$0.82	\$0.82	\$0.84	\$0.87	\$3.35	\$3.55
Common shares	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	91	92	91	92
Diluted shares - Pro Forma	92	92	92	92	92	92	92	92	92	92	92	92	92	92	92	92	92	92	93	93	93	93	93
Pretax income (expense)	55	29	3	-29	12	59	45	206	79	-42	54	297	60	65	70	76	272	78	79	80	83	320	340
Mark-to-market	113	192	38	90	48	0	176	-152	-19	-49	0	-220	0	0	0	0	0	0	0	0	0	0	0
Adjustments	28	43	6	6	7	8	27	3	9	148	0	160	0	0	0	0	0	0	0	0	0	0	0
Adjusted pretax income (loss)	196	264	47	67	67	67	248	57	69	57	54	237	60	65	70	76	272	78	79	80	83	320	340
Income tax expense	-71	-99	-18	-25	-24	-24	-91	-14	-17	-3	-2	-36	-2	-2	-2	-2	-8	-2	-2	-2	-3	-10	-10
Adjusted net income (loss)	125	165	29	42	43	43	157	43	52	54	53	202	59	64	68	74	264	75	76	78	81	310	330
Adjusted EPS	\$1.36	\$1.79	\$0.32	\$0.46	\$0.47	\$0.47	\$1.71	\$0.47	\$0.57	\$0.59	\$0.57	\$2.19	\$0.64	\$0.69	\$0.73	\$0.80	\$2.86	\$0.82	\$0.82	\$0.84	\$0.87	\$3.35	\$3.55
Diluted shares - Pro Forma	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.1	92.2	92.3	92.4	92.2	92.5	92.5	92.6	92.7	92.6	93.0
Servicing Metrics:																							
Adj. Pretax Income	118	210	66	55	65	78	264	68	72	81	87	308	86	83	87	95	351	95	90	92	101	378	387
Adj. Servicing Profitability (bps)	3.0	5.2	5.6	4.5	5.0	5.8	5.2	5.4	5.8	6.5	6.6	6.1	6.4	6.0	6.0	6.6	6.2	6.5	6.1	6.2	6.8	6.4	6.4
UPB - end of period (\$B)	398	473	470	498	533	508	508	500	498	514	540	540	544	570	575	578	578	585	589	593	597	597	610
UPB - average (\$B)	396	406	470	494	521	536	505	504	497	500	527	507	542	557	572	576	562	581	587	591	595	588	604
Originations Metrics:																							
Adj. Pretax Income	210	222	27	56	46	34	163	24	33	33	24	114	26	32	32	29	120	30	35	35	30	130	132
Total originations	18,405	20,470	3,805	4,200	4,930	4,796	17,731	4,862	5,440	5,027	4,808	20,137	4,984	8,005	8,027	6,808	27,824	7,123	8,165	8,188	6,944	30,420	31,029
Gain on sale margin	3.62%	3.60%	3.71%	3.76%	3.04%	2.96%	3.33%	2.63%	2.44%	2.61%	2.45%	2.53%	2.40%	2.30%	2.30%	2.30%	2.32%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%
Xome Metrics:																							
Adj. Pretax Income	79	77	13	12	12	13	50	14	13	11	10	48	13	14	15	17	58	17	17	17	18	69	77
Assurant margins										-3.4%	-0.9%	-1.9%	1.6%	4.1%	6.6%	9.1%	5.5%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
COOP field services onboarding (% of \$80M annualized)										0.0%	0.0%	0.0%	15.0%	30.0%	45.0%	60.0%	60.0%	70.0%	80.0%	90.0%	100.0%	100.0%	100.0%
Corporate & Other Metrics:																							
Adj. Pretax Income	-211	-245	-59	-56	-56	-58	-229	-49	-49	-68	-67	-233	-64	-64	-64	-65	-257	-64	-63	-64	-65	-256	-255
Consolidated Metrics:																							
Return on equity	7.7%	10.4%	6.9%	10.0%	10.3%	10.1%	9.3%	9.5%	10.9%	10.7%	10.1%	10.4%	11.0%	11.6%	12.1%	12.8%	11.9%	12.8%	12.6%	12.6%	12.8%	12.7%	12.2%
Tangible book value per share	18.14	17.21	17.26	17.01	17.15	17.64	17.64	19.40	20.05	21.56	22.02	22.02	22.51	23.03	23.59	24.21	24.21	24.82	25.46	26.10	26.77	26.77	29.48
GAAP tax rate	20.0%	44.8%	33.3%	34.5%	41.7%	24.0%	28.9%	22.3%	26.6%	2376.2%	24.0%	-308.7%	24%	24%	24%	24%	24.0%	24%	24%	24%	24%	24.0%	24.0%

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MR. COOPER GROUP INC. (COOP, Buy, \$21.00 PT; Current Price: \$12.00; Analyst: Giuliano.Anderes)

Appendix: Analyst Certification and Other Important Disclosures

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Mr. Cooper Group Inc. (COOP, Buy, \$21.00 PT)

Valuation: Our \$21 price target for COOP is based on 7.5X our FY19E adjusted earnings per share estimate of \$2.86.

Risks: Risks to our rating include: regulatory risks, the company's ability to access the capital markets for servicing and originations activities, the ability to refinance corporate debt, the ability to fund future growth, interest rate risk and economic risks.

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