

Equity Research

February 8, 2019

Mark Palmer

(212) 588-6582
mpalmer@btig.com

Giuliano Bologna

(212) 588-6583
gbologna@btig.com

Financials

Essent Group Ltd.

ESNT Posts Strong Earnings Beat Aided by Reduction in Hurricane-Related Loss Reserves; Reiterate Buy

Essent Group (ESNT) this morning released a 4Q18 report that featured a solid earnings beat driven both by the strong growth in insurance in force (IIF) that the company has consistently delivered as well as a \$9.9mm reduction in the \$11.1mm in loss reserves that it established during 4Q17 related to the impact of Hurricanes Harvey and Irma.

- ▶ ESNT reported 4Q18 earnings per share of \$1.31 versus the consensus estimate of \$1.19 and our estimate of \$1.22. The hurricane-related reduction in loss reserves accounted for about \$0.08 of the company's EPS during the quarter.
- ▶ ESNT's IIF – the primary source of its revenues and earnings – grew to \$137.7bn by YE18 as it increased by 5% sequentially and by almost 25% versus the prior year period. New insurance written (NIW) of \$11.4bn during the quarter was up from \$11.2bn in the prior year period.
- ▶ **We are reiterating our Buy recommendation on ESNT and our price target of \$54** based on 10.5x our FY19E earnings per share of \$5.19. We believe the stock is inexpensive at 8x FY19E consensus EPS, particularly in light of the company's continued rapid growth in IIF and its increasingly resilient business model given its use of insurance linked notes (ILNs) and excess of loss (XOL) reinsurance agreements and the launch of its new risk-based pricing engine.
- ▶ ESNT during 4Q18 entered into an XOL reinsurance agreement with a panel of U.S. and global reinsurers that provided \$165.2mm of protection on mortgage insurance policies the company had written during 2017. This was in addition to the \$424mm of ILNs issued in March 2018 on the company's 2017 vintage.
- ▶ **Valuation:** Our \$54 price target for ESNT is based on 10.5x our FY19E earnings per share of \$5.19. We believe the multiple we have assigned is appropriate given the company's growth trajectory.

ESNT **\$40.94**

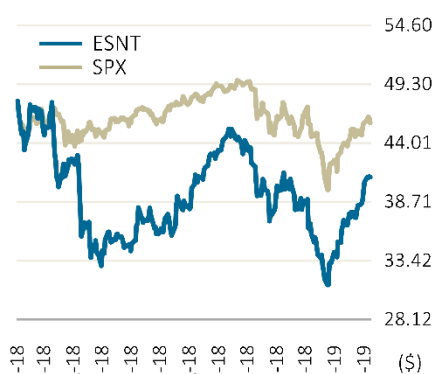
12 month target \$54.00

BUY

52 week range \$31.25 - \$47.66

Market Cap (m) \$3,990

Price Performance



Source: IDC

Estimates

	1Q18 A	2Q18 A	3Q18 A	4Q18 A	FY18 A	1Q19 E	2Q19 E	3Q19 E	4Q19 E	FY19 E	FY20 E
Diluted EPS (Adj.)	1.13	1.14	1.18	1.31	4.77	1.25	1.28	1.32	1.33	5.19	5.70
BVPS (Ex-AOCI)	20.84	21.99	23.18	24.49	24.49	25.74	27.02	28.34	29.68	29.68	35.37
Operating Income	122	133	140	152	547	150	155	160	163	628	700

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

- ▶ ESNT after those risk-distributing transactions has addressed about 30% of its IIF with ILNs and reinsurance. Management said during this morning's conference call they intended to execute another ILN deal during 1H19 to cover IIF generated during 2018 – the transaction is already in the market –which would bring that figure to about 50%. They said they would continue to pursue additional ILN offerings and reinsurance deals during the next three years with a goal of addressing 100% of the company's IIF.
- ▶ The pricing on ESNT's ILN issuance is attractive in large part because of the quality and strong credit performance of its insured portfolio. Credit remained benign during 4Q18 as the percentage of loans in default declined to 0.66% from 0.96% in the prior year period.
- ▶ Inasmuch as the ILN deals free up a significant amount of capital that can be strategically redeployed, management added that, after ESNT completes its next ILN deal, it would have more clarity with regard to its options for capital deployment including capital return to shareholders. Management said they had not yet decided whether that capital return would take the form of share buybacks or common stock dividends but their comments on today's call indicated that they see dividends as a better option.
- ▶ While Radian (RDN, Buy, \$26 PT) during 2018 reported record new insurance written (NIW) of \$56.5bn, we believe the company's volumes could be meaningfully boosted if the new leadership at the Federal Housing Finance Agency (FHFA) takes action to reduce the U.S. government's footprint in the mortgage insurance space. Interim FHFA Director Joe Otting has said that his agency could take administrative actions to reform the current system even before the Trump Administration's nominee for FHFA Director, Mark Calabria, is confirmed by the Senate. Both Otting and Calabria have expressed support for an increased role for the private sector as a means of protecting taxpayers.
- ▶ With that said, ESNT management believes the company is well positioned to sustain strong growth in IIF during the next few years absent any significant government actions given anticipated positive movement in household formation, particularly as millennials come of age and seek to purchase homes. This trend is especially supportive of ESNT's growth inasmuch as home purchases involve mortgage insurance more than 3x as often as refinancings.
- ▶ Management said they expected ESNT's FY19 NIW to be in line with the \$47.5bn it generated during FY18.

Income Statement

Operating Model - ESNT (\$ millions)	Dec-14 2014A	Dec-15 2015A	Dec-16 2016A	Dec-17 2017A	Mar-18 1Q18A	Jun-18 2Q18A	Sep-18 3Q18A	Dec-18 4Q18A	Dec-18 2018A	Mar-19 1Q19E	Jun-19 2Q19E	Sep-19 3Q19E	Dec-19 4Q19E	Dec-19 2019E	Dec-20 2020E
Net premiums earned	223.23	326.47	422.71	530.13	152.56	156.96	166.68	173.30	649.49	179.11	185.05	191.82	194.82	750.81	828.16
Net investment income	12.29	19.89	27.89	40.23	13.71	15.13	16.65	18.60	64.09	18.83	19.06	19.30	19.54	76.74	80.65
Realized investment gains	0.93	2.55	1.93	2.02	0.20	0.44	0.52	0.16	1.32	-	-	-	-	-	-
Other income	3.03	4.38	5.73	4.14	0.99	1.24	1.15	1.07	4.45	1.08	1.09	1.10	1.11	4.38	4.70
Revenue	239.47	353.29	458.26	576.51	167.46	173.77	185.00	193.12	719.35	199.02	205.21	212.22	215.48	831.93	913.50
Provision for losses and LAE	6.31	11.91	15.53	27.23	5.31	1.81	5.45	(1.00)	11.58	6.60	6.90	7.31	7.61	28.42	32.77
Interest expense	-	-	-	5.18	2.45	2.62	2.50	2.61	10.18	2.61	2.61	2.61	2.61	10.44	10.44
Other underwriting and operating expenses	97.23	112.99	130.85	145.53	38.12	36.43	36.90	39.45	150.90	39.47	40.69	42.08	42.64	164.89	170.76
Losses and expenses	103.54	124.89	146.38	177.94	45.88	40.86	44.85	41.06	172.65	48.69	50.20	52.00	52.86	203.75	213.97
Loss before income taxes	135.93	228.40	311.88	398.57	121.58	132.91	140.15	152.06	546.70	150.33	155.01	160.22	162.61	628.17	699.53
Income tax expense (benefit)	47.43	71.07	89.28	18.82	10.51	21.15	24.14	23.54	79.34	27.06	27.90	28.84	29.27	113.07	125.92
Net income	88.50	157.33	222.61	379.75	111.07	111.76	116.01	128.53	467.36	123.27	127.11	131.38	133.34	515.10	573.62
Diluted EPS	1.01	1.72	2.41	3.09	1.13	1.14	1.18	1.31	4.77	1.25	1.28	1.32	1.33	5.19	5.70
Common shares outstanding	83.99	90.35	90.91	93.33	97.30	97.43	97.44	97.45	97.40	97.94	98.43	98.92	99.41	98.67	100.04
Diluted shares outstanding	87.95	91.74	92.24	95.21	97.95	97.87	98.01	98.07	97.97	98.56	99.05	99.54	100.04	99.30	100.67
Insurance in Force (IIF)	50,763	65,242	83,266	110,464	115,251	122,501	131,250	137,721	137,721	140,358	146,447	153,316	157,287	157,287	174,127
Average IIF	42,770	59,248	75,491	99,229	112,857	118,876	126,876	134,485	126,486	139,039	143,403	149,882	155,302	148,822	166,632
Total primary NIW	24,799	25,928	34,856	43,858	9,336	12,851	13,913	11,409	47,509	9,523	13,108	14,191	11,637	48,459	49,428
Average premium rate	0.56%	0.55%	0.58%	0.56%	0.54%	0.53%	0.53%	0.52%	0.52%	0.51%	0.51%	0.50%	0.50%	0.50%	0.50%
Book value per share	11.04	12.37	14.90	20.16	20.84	21.99	23.18	24.49	24.49	25.74	27.02	28.34	29.68	29.68	35.37
Tax rate	34.89%	31.12%	28.62%	4.72%	8.65%	15.92%	17.22%	15.48%	14.51%	18.00%	18.00%	18.00%	18.00%	18.00%	18.00%

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

ESSENT GROUP LTD. (ESNT, Buy, \$54.00 PT; Current Price: \$40.94; Analyst: Mark.Palmer)

RADIAN GROUP, INC. (RDN, Buy, \$26.00 PT; Current Price: \$19.56; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Regulatory Disclosures

Ratings Definitions

BTIG LLC's ("BTIG") ratings, effective June 12, 2017, are defined as follows:

BUY – A security which is expected to produce a positive total return of 15% or greater over the 12 months following the recommendation. The BUY rating may be maintained as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A security which is expected to produce a negative total return of 15% or greater over the next 12 months following the recommendation. The SELL rating may be maintained as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A security which is not expected to appreciate or depreciate meaningfully over the next 12 months.

NOT RATED – A security which is not rated or covered by BTIG.

UNDER REVIEW – Effective immediately, coverage of the following securities is Under Review. Ratings, price targets, disclosures, and estimates for the companies listed below are suspended and should no longer be relied upon.

Distribution of Ratings and Investment Banking Clients

BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. **Stocks under coverage as of the end of the most recent calendar quarter (December 31, 2018): 331**

Distribution of BTIG's Research Recommendations (as of December 31, 2018):

BUY: 59.8%; NEUTRAL: 38.1%; SELL: 2.1%

Distribution of BTIG's Investment Banking Services (as of December 31, 2018):

BUY: 27.3%; NEUTRAL: 11.1%; SELL: 0.0%

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

Company Valuation and Risk Disclosures

Essent Group Ltd. (ESNT, Buy, \$54.00 PT)

Valuation: Our \$54 price target for ESNT is based on 10.5x our FY19E earnings per share of \$5.19. We believe the multiple we have assigned is appropriate given the company's growth trajectory.

Risks: Risks to our recommendation include legislative or regulatory actions or decisions to change the role of the GSEs in the U.S. housing market, actions to decrease or discontinue the use of mortgage insurance or changes in the GSEs' eligibility requirements for mortgage insurers that could reduce ESNT's revenues or adversely affect its profitability and returns; the negative impact on revenues, profitability and returns if ESNT

were to lose a significant customer; the potential adverse impact on ESNT's business prospects and operating results if the Consumer Financial Protection Bureau's final rule defining a qualified mortgage (QM) reduces the size of the origination market or creates incentives to use government-supported mortgage insurance programs; a potential increase in ESNT's losses if a downturn in the U.S. economy or a decline in the value of borrowers' homes from their value at the time their loans close results in more homeowners defaulting.

Essent Group Ltd. (ESNT)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
31-Oct-13	21	28	Mark Palmer	Buy
13-Feb-15	24.18	31	Mark Palmer	Buy
04-Nov-16	27.10	32	Mark Palmer	Buy
06-Dec-16	32.81	NA	Mark Palmer	Neutral
12-Sep-17	39.01	44	Mark Palmer	Buy
09-Nov-17	42.22	49	Mark Palmer	Buy
20-Dec-17	46.24	54	Mark Palmer	Buy

Other Disclosures

Additional Information Available Upon Request

General Disclosures

Research reports produced by BTIG LLC ("BTIG") are published for and intended to be distributed solely to BTIG institutional and corporate clients. Recipients of BTIG reports will not be considered clients of BTIG solely because they may have received such BTIG report.

The research analyst(s) responsible for the preparation of this report receives compensation based upon a variety of factors, including the quality and accuracy of research, internal/client feedback, and overall Firm revenues.

BTIG reports are based on public information and BTIG considers the same to be reliable, comprehensive information, but makes no representation or warranty that the reports are accurate or complete. BTIG opinions and information provided in this report are as of the date of the report and may change without notice. An issuer may be classified as "Under Review" or "Research Restricted". In these cases, investors should consider any previous investment recommendation and/or rating to a subject company/issuer to no longer be current and should not be relied upon nor considered a solicitation.

This research report is not an offer to buy or sell or solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. This research report was not drafted specifically for any particular individual or entity and is not a personal recommendation to participate in any particular trading strategy or transaction. Any recipient of this research report should obtain independent advice specific to their personal circumstances before undertaking any investment activity and must make their own independent evaluation of any securities or financial instruments.

Facts, views or opinions presented in this report have not been reviewed by, and may not reflect information known to, employees or other professionals in the "BTIG Group" (BTIG Group includes, but is not limited to, BTIG and its parents, subsidiaries and/or affiliates). BTIG Group employees, including Sales Representatives and Traders, may provide oral or written commentary or advice that may be inconsistent with the opinions and/or views expressed in this research report. BTIG Group employees and/or its affiliates not involved in the preparation of this research report may have investments in securities or derivatives of securities of companies mentioned in this report that are inconsistent with the views discussed in this report.

Investors in securities products bear certain risks in conjunction with those investments. The value of, and income from, any investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors within or beyond the companies control. Recipient of the research reports should be aware that investments in securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in securities should be undertaken only upon consideration of issues relating to the recipient's overall investment portfolio and objectives (such as diversification by asset class, industry or company) as well as time horizon and liquidity needs. Further, past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. There may be time limitations on the exercise of options or other rights in any securities transactions.

Investing in foreign markets and securities, including ADRs, is subject to additional risks such as currency fluctuation, limited information, political instability, economic risk, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. Non-U.S. reporting issuers of foreign securities, however, may not make regular or complete public disclosure relating to their financial condition or the securities that they issue.

The trademarks and service marks contained herein are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability of any damages of any kind relating to such data. The report or any portion hereof may not be reprinted, sold or redistributed without the written consent of BTIG. This report is intended only for use by the recipient. The recipient acknowledges that all research and analysis in this report are the property of BTIG and agrees to limit the use of all publications received from BTIG within his, or her or its, own company or organization. No rights are given for passing on, transmitting, re transmitting or reselling the information provided.

Jurisdiction and Dissemination

BTIG is a U.S. broker-dealer and member of FINRA and SIPC.

BTIG Australia Limited ACN 128 554 601, member of ASIC and ASX; BTIG Hong Kong Limited, an Exchange Participant of SEHK and licensed and regulated by the SFC; BTIG Ltd, member of the LSE, authorized and regulated by the FSA; and BTIG Singapore Pte Ltd, registered and licensed with MAS; are all separate but affiliated entities of BTIG. Unless governing law permits otherwise, you must contact a BTIG entity in your home jurisdiction for further information, or if you want to use our services in effecting a transaction.

Issued and approved for distribution in the UK and EEA by BTIG Ltd. to eligible counterparties and professional clients only. Issued and distributed in Australia to “wholesale clients” only by BTIG Australia Limited. In Singapore and Hong Kong, further information may be obtained from BTIG Singapore Pte Ltd and BTIG Hong Kong Limited, respectively.