

## Equity Research

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## Financials

### Mr. Cooper Group Inc.

#### COOP Shifts Strategy to Increasing Profitability from Growth During Acquisition Integration

Mr. Cooper Group (COOP) this morning before the market open released the company's 4Q18 earnings results and reported adjusted net income of \$0.55 per share slightly above the consensus estimate of \$0.54 and slightly below our estimate of \$0.57. During the quarter, the servicing segment outperformed on profitability and UPB increased to over \$600B in March, 2019.

► **Servicing** – In 4Q18, COOP reported adj. servicing margin of 6.7 bps. Excluding the impact of Project Titan expenses, adj. servicing margin was 7.6 bps compared to our 6.6 bps estimate. The margin improvement materially outperformed our model and should level out as the company works through Titan.

► Servicing UPB increased 7% in FY18 to \$548B, outpacing management's prior \$535B target and our estimate of \$540B. This does not include the impact of the acquisitions of Pacific Union and Seterus which closed during 1Q19 and had approximately \$25B and \$48B of UPB, respectively. And during March, UPB increased above \$600B.

► **Originations** – Reported \$5.4B of originations volume outpacing our estimate of \$4.8B but underperformed on margin reporting \$16M of adjusted pretax income below our \$32M estimate. A significant portion of the margin compression was due to an 8% sequential decrease in higher margin direct to consumer and a 17% increase in significantly lower margin correspondent volume.

► **XOME** – The segment reported \$1M of adjusted pretax income below our \$10M estimate. The largest part of the impact was a larger than expected loss from recently acquired Assurant which was acquired during 3Q18.

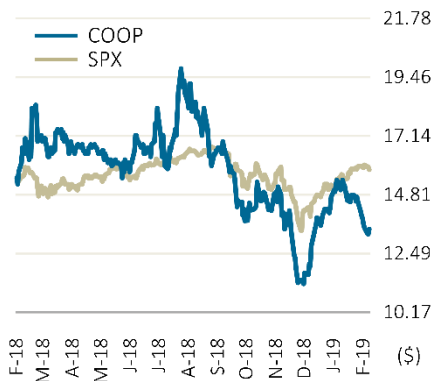
► **Shift in business strategy** – COOP is shifting from growth and M&A to optimizing the company's cost structure and integrating its recent acquisitions: Assurant, Pacific Union and Seterus. Additionally, the company intends to reduce leverage and is evaluating the potential use of derivative hedging going forward

<b>COOP</b>	<b>\$13.46</b>
12 month target	\$21.00

### BUY

52 week range	\$11.30 - \$19.80
Market Cap (m)	\$1,238

#### Price Performance



Source: IDC

Management's decision to shift their focus towards optimization and cost reductions away from growth in the near-term will have an impact on the company's results during FY19.

Going forward, COOP will be in a position to stabilize its earning, increase internal MSR replenishment and reduce the need to acquire MSRs to fuel growth as ~\$10B of originations from Pacific Union increase total originations above \$30B.

Excluding the impact of project Titan expenses and one-time benefits on the reverse servicing portfolio, the segment was able to generate an adjusted pretax margin above 6.5 bps for 2H18. We believe this puts COOP in a position to drive material earnings power from the segment as the company completes Titan and leverages an optimized expense structure to generate increased profitability on a portfolio of over \$600B.

On the XOME side of the business, as COOP turns around Assurant, we believe the earning power of the segment will provide a material contribution to earnings growth in a capital light segment. When COOP acquired Assurant, it was operating at a loss and it reported a pretax operating loss of \$7M during 4Q18 reducing combined segment profitability. The company believes it can achieve break-even in the business by the end of FY19.

**Investment thesis** – We believe COOP has all the right pieces in place and the shift in strategy will yield positive returns putting the company in a position to increase its earnings power and drive shareholder value as the impacts of the transition roll-off during FY19.

We expect management to provide additional guidance throughout FY19 as the company refines its new strategy and Chris Marshall assumes the role of CFO and puts together an updated business strategy and targets for the company.

Our estimates are under review pending the filing of the company's 10K.

## BTIG Covered Companies Mentioned in this Report

MR. COOPER GROUP INC. (COOP, Buy, \$21.00 PT; Current Price: \$13.46; Analyst: Giuliano.Bologna)

## 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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Additional Information Available Upon Request

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