FINANCIALS EQUITY RESEARCH

BTIG

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

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We Continue to Believe the Market is Mispricing COOP's Cash Flow Potential, Updating Our Model & Recapture Estimates; Reiterate Buy

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WHAT YOU SHOULD KNOW: Improving operating performance across all segments puts COOP in a position to generate significant cash flow during 2H19 and FY20. We believe investors should continue to focus on the company's ability to generate cash flow from the business as expense savings from project Titan and the stabilization of Assurant Mortgage Solutions (AMS) combined with minimal bulk MSR purchases will prove the platform's cash flow generation through a challenging interest rate environment, in our view.

- **Originations and Servicing –** During July and August, COOP funded $7.7B in volumes at pretax operating margins over 1% supporting strong performance during 3Q19. Management recently noted that they expected the originations segment to more than replenish runoff and would sell off a portion of originated MSRs, an additional source of cash. CPR averaged 17% during July and August, slightly above original expectations. We are adjusting our model to reflect a 17% CPR for 3Q19 which triggers a $26M increase in amortization expense compared to 2Q19. We believe the improved margins during 3Q will likely offset the additional amortization caused by higher-than-expected CPRs during 3Q19.
- **Updating estimates –** We are updating our 3Q19 pretax income per share estimate to $0.68 and our cash flow estimate to $78M. For FY20 we estimate pretax income per share of $2.45 and cash flow of $242M. Based on our FY20E cash flow, COOP shares trade at a 27% free cash flow yield. We estimate the value of recapture would increase MSR fair value and tangible book value by $380M or $3.17 per share on a tax-effected basis and $4.17 if the DTA is excluded from TBV.
- **Xome –** AMS crossed the breakeven point during July, sooner than the original year-end estimate. Additionally, the company is forecasting Xome at a $50M pretax income run rate in FY20.
- **Calling $100M of 6.5% senior notes –** The call is supported by strong operating performance and cash flow generation. We view this as a positive development highlighting the company's confidence in strong cash flow generation. We model leverage falling to 4.6X, below the company's 5.0X target during 3Q19 due to strong EBITDA and reduced debt.
- **Valuation:** Our $21 price target is based on 8.5X our FY20E Adj. earnings per share estimate of $2.45. Our $21 PT equates to an 13.2% cash flow yield and 1.06X our FY20E TBV.

COMPANY DATA	
Closing Price:	$9.69
Price Target:	$21.00
Market Cap ($M):	880.06
Shares Out (M):	90.8
Avg Daily Vol - 3 Months (M):	0.48
Dividend/Yield:	$0.00/0.0%

REVISIONS	Previous	Current
Rating	Buy	Buy
Price Target	$21.00	$21.00
FY19E EPS	$2.86	$2.57
FY20E EPS	$2.44	$2.45
FY19E Rev. (M)	$1,741.49	$1,729.82

Diluted EPS (Adjusted)			
FY Dec	2018A	2019E	2020E
Q1	0.00	0.40	0.56
Q2	0.00	0.98	0.61
Q3	0.00	0.68	0.64
Q4	0.00	0.51	0.65
Calendar EPS	**0.00**	**2.57**	**2.45**
Calendar P/E	-	3.8x	4.0x

REVENUE ($M)			
FY Dec	2018A	2019E	2020E
Q1	588.00	250.00	532.14
Q2	444.00	399.00	571.72
Q3	506.00	560.37	570.08
Q4	252.00	520.45	557.52
FY	**1,790.00**	**1,729.82**	**2,231.45**

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

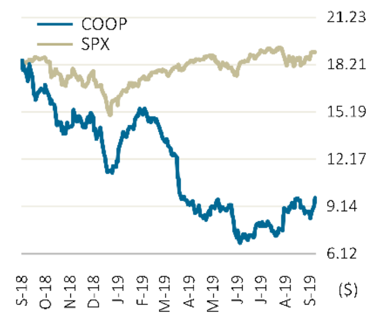
Investment Thesis

We believe Mr. Cooper Group shares are mispriced and do not reflect the platforms ability to generate cash flow going forward. Once COOP is able to complete project Titan and stabilize AMS, cash flow generation should improve materially driving shareholder value.

Upcoming Catalysts

- 3Q19 earnings report.
- Deleveraging and/or capital return.
- Completing project Titan.
- Stabilizing Assurant Mortgage Solutions (AMS)

Price Performance



Source: IDC

Base Case Assumptions

- The company stabilizes Assurant Mortgage Solutions (AMS) returning the business to profitability in FY20.
- Expenses related to project Titan ramp down materially in FY20.
- COOP deleverages to 5.2X by the end of FY20 and does not return capital.
- Owned MSR portfolio remains stable through the end of FY21.

Company Description

Mr. Cooper Group provides quality servicing, origination and transaction-based services related principally to single-family residences throughout the United States with operations under its primary brands: Mr. Cooper® and Xome®. Mr. Cooper is one of the largest home loan servicers in the country focused on delivering a variety of servicing and lending products, services and technologies. Xome provides technology and data enhanced solutions to homebuyers, home sellers, real estate agents and mortgage companies.

Upside Scenario

- If interest rates increase, COOP would recognize positive mark-to-market adjustments on the company's MSR assets which would result in a higher tangible book value.
- Additional cost savings beyond management's current expectations could drive higher profitability.

Downside Scenario

- If interest rates fall, COOP would recognize negative mark-to-market adjustments on the company's MSR assets which would result in a lower tangible book value.
- If mortgage default rates increase, COOP's cost to service loans would increase, decreasing the company's profitability.

Updating Estimates

Updated recapture value assumptions – During 2Q19, COOP provided additional disclosure noting the company includes $145M into excess spread liability (ESL) fair value for the estimated cost of sharing recapture with capital partners. Due to different accounting guidance applied to ESL vs. MSR fair value, ESL liability on the company's balance sheet is held at a higher value than the company's MSRs which do not include the benefit recapture value. We believe this is an important disclosure because COOP is the only public company that has a significant amount of ESL on their balance sheet.

The company holds MSRs on the asset side of the balance sheet on a gross basis, including the FV of the cash flows derived from the excess spread sold to partners without the benefit of recapture assumptions. This has the impact of inequitably increasing the mark on the same exact cash flow stream on the liability side of the balance sheet compared to the asset side which is held at a lower value.

We estimate the MSR FV is understated by approximately $380M if we account for the MSRs on the same basis as ESL. The $145M of recapture value included into ESL implies the ESL ex-recapture is marked up by approximately 10.9%; applying an equivalent premium to the $3,479M of MSR FV, we arrive at $380M.

This would increase tangible book value by $3.17 or 19.9% to $19.12 assuming the benefit would be taxed at 24%. On a pretax basis, this would increase TBV by $4.17 because it would trigger a non-cash tax expense of $91M or $1.00 per share and would trigger an equivalent reduction in COOP's deferred tax asset.

These assumptions do not include the cash flow COOP would be able to generate on recapture originations that have historically been cash flow positive for the company. During 2Q19, COOP reported a DTC margin of over 200 bps compared to an MSR capitalization of 149 bps which implies the company realized cash flow of approximately 51 bps after backing out the capitalization. If this was included, it would further increase our $380M recapture value estimate.

Corporate initiatives – Over the past few months, COOP has begun discussing additional corporate actions that the company estimates will result in an additional $50M of cost savings above and beyond Titan which is expected to reduce expenses by $30M during FY20. Under former ownership and control, Mr. Cooper's predecessor, Nationstar Mortgage Holdings was acquisitive, buying several companies and bulk MSR portfolios which resulted in a 40% MSR UPB CAGR over a 13-year period.

As a result of the rollup history, COOP has the potential to eliminate significant costs ranging from excess staff that had been in place to integrate part transactions and is no longer needed for the business to operate on an organic basis, duplicative technology expenses and consulting expenses.

Updated cash flow estimates – COOP generated $93M of discretionary steady state cash flow, 82% above the $51M generated in 1Q19 – the material increase was driven by significant originations volume and margin increases from increased refinance activity. During 2Q19, COOP further refined the company's presentation of discretionary steady state cash flow representing the company's cash flow while sustaining the current net MSR balance. The updated presentation used cash flow from operations as a basis as opposed to the previous presentation that used Adjusted EBITDA. We believe this presentation is more precise and is a better way to display and forecast cash flow since it accounts for a couple items left out of the previous methodology. For example: excess spread financing and changes in working capital.

Our new cash flow estimate for 3Q19 is $78M and our FY20 estimate if $242M. We believe the market underappreciated COOP's ability to generate cash and the pace at which the company will be able to retire debt and reduce leverage. Shares of COOP trade at a 27% free cash flow yield based on our FY20 estimates.

Consolidated leverage – Due to the strong originations results in 2Q19, Adjusted EBITDA increased to a record $178M and had the impact of reducing COOP's leverage ratio by 1.2X to 5.2X sequentially. This accelerated COOP's goal of achieving a target leverage ratio of <5.0X. Going into this quarter, we had estimated COOP would reach 5.2X in 4Q20, six quarters later that the company was able to achieve.

Due to the updated originations guidance, our 3Q19 Adj. EBITDA estimate is $142M. Combined with calling $100M in 6.5% senior notes, our 3Q19 leverage ratio declines by an additional 0.6X sequentially to 4.6X. We believe it is important to note that this is below management's target leverage ratio below 5.0X.

Servicing

Due to the increased CPR of 17% during July and August, we assume the 17% CPR will continue during September. As a result, we are increasing our forecasted CPR to 17% for the quarter which should add approximately $10M of additional MSR amortization relative to prior guidance. Our net amortization expense increased to $114M an increase of $26M over 2Q19.

Due to the increased refinance activity, the company had originally expected CPRs to increase to about 14% to 15% resulting in an additional $15M to $20M of MSR amortization net of excess spread accretion next quarter.

We believe it is important to note that MSR lines increased by $150M in 2Q19 pointing to lending bank's increased confidence in the company's financial stability and performance.

Project Titan Update – Pointing to the initial performance of project Titan investments, COOP noted that conversion from inbound lead to loan lock increased to 9.5% in June 2019 from 6.4% in January 2019 supported by the launch of the Home Advisor program. As of the end of 2Q19, the Home Advisor initiative was only 30% rolled out and has the potential to continue improving conversion rates in future periods as COOP expands to 300 home advisors by year-end.

A part of the Home Advisor initiative includes licensing servicing employees as loan officers. In the past, the servicing and originations platforms were separate and there was some friction in the company's attempt to convert refinance opportunities. Before Home Advisor, a customer calling in with a servicing question would speak with a servicing employee that would offer to put the customer in touch with a loan officer if they thought there was a refinance opportunity, this would lead to the customer being put on hold for a cold handoff to a loan officer or would lead to a callback from a loan officer. With the new Home Advisor program, the servicing employee is also a licensed loan officer and can pitch and close the refinance opportunity with minimal friction and without having to hand off the customer in the process.

Originations

COOP noted that the company funded $7.7B of volume at a pretax operating margin above 100 bps during July and August. At the current run rate, COOP could fund as much as $11.5B of volume during the period. In our model, we assume COOP will fund $10B of volume at a 95 bps pretax operating margin.

Direct to consumer (recapture) originations generated a pretax operating income margin of over 200 bps during 2Q19. As we move further into September, the last month of 3Q, purchase volumes and by extension correspondent volume are likely to fall and the mix of direct to consumer volume should account for a larger share of consolidated volumes. We believe this should support continued strong origination margins for the period which could be a source of upside above our 95 bps estimate.

Warehouse lines increased by $485M sequentially during 2Q19 pointing to lending bank's increased confidence in the company's financial stability and performance.

Xome

COOP noted that AMS crossed the breakeven point during July which implies the business will likely have a flat to slightly positive contribution during 3Q19 and a positive contribution to Xome segment results during 4Q19. This supports management's guidance that Xome will generate approximately $50M of pretax income during FY20.

Income Statement

COOP - Operating Model	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	Mar-21	Jun-21	Sep-21	Dec-21	Dec-21
$ millions	*1Q18A*	*2Q18A*	*3Q18A*	*4Q18A*	*2018A*	*1Q19A*	*2Q19A*	*3Q19E*	*4Q19E*	*2019E*	*1Q20E*	*2Q20E*	*3Q20E*	*4Q20E*	*2020E*	*1Q21E*	*2Q21E*	*3Q21E*	*4Q21E*	*2021E*
Total revenues	**588**	**444**	**506**	**252**	**1,790**	**250**	**399**	**560**	**520**	**1,730**	**532**	**572**	**570**	**558**	**2,231**	**536**	**576**	**573**	**560**	**2,244**
Total expenses	364	339	517	432	1,652	443	492	465	447	1,847	439	475	469	456	1,839	434	471	465	452	1,822
Interest income	145	140	138	166	589	134	162	168	155	619	135	130	127	121	513	114	111	107	104	436
Interest expense	-171	-164	-175	-171	-681	-183	-187	-195	-181	-746	-174	-166	-161	-155	-656	-152	-144	-141	-137	-574
Other expense	8	-2	6	7	19	9	1	1	1	12	1	1	1	1	4	1	1	1	1	4
Total other expenses	**-18**	**-26**	**-31**	**2**	**-73**	**-40**	**-24**	**-26**	**-25**	**-115**	**-38**	**-35**	**-34**	**-33**	**-139**	**-37**	**-33**	**-32**	**-32**	**-134**
Pretax income (expense)	**206**	**79**	**-42**	**-178**	**65**	**-233**	**-117**	**69**	**48**	**-232**	**55**	**62**	**67**	**68**	**253**	**65**	**72**	**75**	**76**	**288**
Income tax expense	-46	-21	998	42	973	47	29	-17	-12	48	-13	-15	-16	-16	-61	-16	-17	-18	-18	-69
Noncontrolling interest	0	0	9	0	9	0	-1	0	0	-1	0	0	0	0	0	0	0	0	0	0
Net income (loss)	**160**	**58**	**947**	**-136**	**1,029**	**-186**	**-87**	**53**	**37**	**-183**	**42**	**47**	**51**	**52**	**192**	**49**	**55**	**57**	**58**	**219**
Diluted EPS - GAAP	**$1.76**	**$0.64**	**$10.43**	**-$1.50**	**$11.33**	**-$2.05**	**-$0.96**	**$0.58**	**$0.40**	**-$2.01**	**$0.46**	**$0.52**	**$0.55**	**$0.56**	**$2.09**	**$0.53**	**$0.59**	**$0.61**	**$0.62**	**$2.35**
Adjusted EPS - Diluted						**$0.40**	**$0.98**	**$0.68**	**$0.51**	**$2.57**	**$0.56**	**$0.61**	**$0.64**	**$0.65**	**$2.45**	**$0.61**	**$0.66**	**$0.68**	**$0.68**	**$2.64**
Common shares	90.8	90.8	90.8	90.8	90.8	90.8	91.1	91.3	91.5	91.2	91.7	92.0	92.2	92.4	92.1	92.7	92.9	93.1	93.4	93.0
Diluted shares - Pro Forma	92.0	92.0	92.0	90.8	91.7	91.0	91.1	91.3	91.5	91.2	91.7	92.0	92.2	92.4	92.1	92.7	92.9	93.1	93.4	93.0
Pretax income (expense)						**-233**	**-117**	**69**	**48**	**-232**	**55**	**62**	**67**	**68**	**253**	**65**	**72**	**75**	**76**	**288**
Mark-to-market						293	231	30	23	577	22	22	21	20	85	20	19	19	18	76
Fair value amortization						-25	-26	-30	-23	-104	-22	-22	-21	-20	-85	-20	-19	-19	-18	-76
Merger related costs						20	17	0	0	37	0	0	0	0	0	0	0	0	0	0
Accounting items						-20	0	0	0	-20	0	0	0	0	0	0	0	0	0	0
Intangible amortization						13	13	13	12	51	12	11	11	10	44	10	9	9	8	36
Adjusted pretax income (loss)						**48**	**118**	**82**	**61**	**309**	**67**	**74**	**78**	**79**	**297**	**75**	**81**	**84**	**84**	**324**
Income tax expense						-12	-28	-20	-15	-75	-16	-18	-19	-19	-71	-18	-20	-20	-20	-78
Operating income						**36**	**90**	**62**	**46**	**234**	**51**	**56**	**59**	**60**	**226**	**57**	**62**	**64**	**64**	**246**
Adjusted EPS - Diluted						**$0.40**	**$0.98**	**$0.68**	**$0.51**	**$2.57**	**$0.56**	**$0.61**	**$0.64**	**$0.65**	**$2.45**	**$0.61**	**$0.66**	**$0.68**	**$0.68**	**$2.64**
Tax rate - Adjusted						24.0%	24.0%	24.0%	24.0%	24.2%	24.0%	24.0%	24.0%	24.0%	24.0%	24.2%	24.2%	24.2%	24.2%	24.2%
Consolidated GAAP pretax income	**206**	**79**	**-42**	**-178**	**65**	**-233**	**-117**	**69**	**48**	**-232**	**55**	**62**	**67**	**68**	**253**	**65**	**72**	**75**	**76**	**288**
Mark-to-market	-152	-19	-49	188	-32	293	231	30	23	577	22	22	21	20	85	20	19	19	18	76
Adjustments	3	9	139	29	180	21	26	10	10	67	5	0	0	0	5	0	0	0	0	0
MSR amortization - net	48	48	41	39	176	23	56	75	43	197	38	49	50	40	177	45	55	56	46	201
Capitalized servicing rights	-68	-71	-65	-77	-281	-66	-103	-120	-88	-378	-73	-89	-91	-79	-332	-74	-90	-92	-80	-335
Depreciation and amortization	15	14	22	26	77	21	24	23	22	90	22	21	20	20	83	19	19	18	18	74
Corporate debt expense	35	31	45	54	165	51	53	52	50	205	48	46	45	43	183	42	41	40	39	163
Other	5	5	4	0	14	5	4	4	4	17	4	4	4	4	16	4	4	4	4	16
Adjusted EBITDA	**92**	**96**	**95**	**81**	**364**	**115**	**174**	**142**	**112**	**543**	**121**	**115**	**116**	**117**	**470**	**121**	**120**	**120**	**121**	**483**
Cash taxes						0	0	-2	-1	-4	-2	-2	-2	-2	-8	-2	-2	-2	-2	-9
Corporate debt interest expesnse						-51	-53	-52	-50	-205	-48	-46	-45	-43	-183	-42	-41	-40	-39	-163
CAPEX						-10	-10	-10	-9	-39	-9	-9	-9	-9	-38	-10	-10	-10	-10	-38
Corporate operating cash flow						**54**	**111**	**78**	**52**	**295**	**62**	**57**	**60**	**62**	**242**	**67**	**67**	**68**	**70**	**273**
Tax rate	22.3%	26.6%	2376.2%	23.6%	-1496.9%	20.2%	24.8%	24.0%	24.0%	24.2%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.2%
Book value per share	20.73	21.37	22.88	21.42	21.42	19.39	18.43	18.99	19.38	19.38	19.82	20.31	20.84	21.38	21.38	21.90	22.48	23.08	23.67	23.67
Tangible book value per share	19.78	20.44	21.56	19.88	19.88	16.91	15.96	16.67	17.19	17.19	17.89	18.51	19.16	19.81	19.81	20.44	21.12	21.82	22.51	22.51
Pretax ROTCE						11.5%	31.6%	22.1%	15.7%	19.6%	16.7%	17.6%	18.0%	17.5%	16.2%	16.0%	16.9%	16.8%	16.3%	15.4%
After Tax ROTCE						8.6%	24.0%	16.8%	12.0%	14.9%	12.7%	13.4%	13.6%	13.3%	12.3%	12.1%	12.8%	12.7%	12.3%	11.7%
LTM Adj. EBITDA						387	465	512	543	543	549	490	465	470	470	469	475	479	483	483
Debt/Adj. EBITDA						6.4x	5.3x	4.6x	4.3x	4.3x	4.1x	4.5x	4.6x	4.4x	4.4x	4.3x	4.2x	4.0x	3.9x	3.9x
Servicing Metrics:																				
Adj. pretax income	68	72	81	100	321	108	107	81	109	405	107	94	95	101	398	101	94	95	101	390
Adj. servicing profitability (bps)	5.39	5.79	6.48	7.61	6.33	7.50	6.69	5.02	6.80	6.48	6.67	5.87	5.92	6.27	6.18	6.25	5.85	5.93	6.28	6.08
UPB - EOP ($B)	500	498	514	548	548	632	643	640	641	641	642	643	643	643	643	642	642	642	641	641
UPB - average ($B)	504	497	500	526	507	576	639	642	641	625	642	643	644	644	643	643	642	643	642	643
Originations Metrics:																				
Adj. pretax income	19	32	32	16	99	45	118	95	37	295	38	47	47	41	174	39	47	48	42	176
Origination volume	5,087	5,543	5,147	5,424	21,201	5,716	9,996	10,036	7,342	33,090	6,983	8,508	8,630	7,510	31,632	7,053	8,593	8,717	7,586	31,948
Production margin	0.37%	0.58%	0.62%	0.29%	0.47%	0.79%	1.18%	0.95%	0.50%	0.89%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%
Xome Metrics:																				
Adj. pretax income	13	10	5	1	29	0	10	13	13	36	14	16	16	15	61	14	17	16	15	62
Adj. pretax income margin	20.0%	16.1%	5.3%	1.0%	8.9%	0.0%	9.3%	12.4%	12.8%	8.8%	13.1%	13.7%	13.6%	12.5%	13.2%	12.5%	13.7%	13.7%	12.6%	13.1%
Corp & Other																				
Adj. pretax income						-60	-80	-71	-69	-279	-67	-64	-62	-60	-254	-61	-60	-59	-58	-238
Unsecured senior notes						2,461	2,462	2,362	2,312	2,312	2,252	2,192	2,132	2,072	2,072	2,022	1,972	1,922	1,872	1,872

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MR. COOPER GROUP INC. (COOP, Buy, $21.00 PT; Current Price: $9.69; Analyst: Giuliano.Bologna)

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

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

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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.

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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 (June 30, 2019): 332**

Distribution of BTIG's Research Recommendations (as of June 30, 2019):
BUY: 62.7%; NEUTRAL: 35.5%; SELL: 1.8%

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BUY: 24.5%; NEUTRAL: 13.6%; SELL: 0.0%

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Company Valuation and Risk Disclosures

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

Valuation: Our $21 price target is based on 8.5X our FY20E Adj. earnings per share estimate of $2.45. Our $21 PT equates to an 13.2% cash flow yield and 1.06X our FY20E TBV.

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.

Other Disclosures

Additional Information Available Upon Request

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