FINANCIALS EQUITY RESEARCH

BTIG

New Residential Investment Corp

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Strong 3Q19 Results; Sequential Increase in BV Proves Value of Hedging Strategy – Ditech Acquisition to Add Value Going Forward

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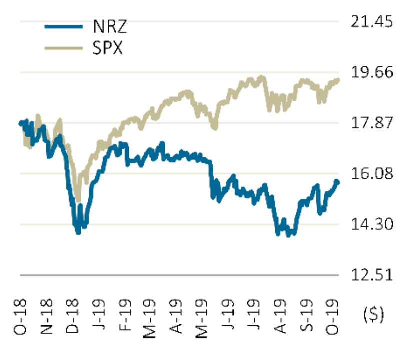
NRZ	$15.77
12 month target	$18.00

Buy	
52 week range	$13.91 - $17.95
Market Cap (M)	$6,552

WHAT YOU SHOULD KNOW: This morning before the market open, New Residential (NRZ) reported strong 3Q19 earnings. Notably, book value per share increased to $16.26, above our estimate of $16.19, driven by hedging gains during the period. On the operating side, NRZ increased MSR UPB to $593B from $576B in 2Q19 and continued to execute on the company's call right strategy by calling $1.3B UPB. NRZ's ability to protect book value in a volatile and falling rate environment is a positive development that should alleviate concerns about the company's interest rate sensitivity. The acquisition of $1.2B of assets from Ditech was closed in early 4Q19 and should drive incremental operating earnings and cash flow generation going forward. At a 12.8% dividend yield and a discount to book value, we believe NRZ shares continue to be undervalued.

- Core Earnings per diluted share was $0.50,below our $0.54 estimate. Call rights contributed approximately $0.02 during 3Q19. As NRZ begins to receive the benefit of the Ditech assets, we believe Core Earnings should improve. We believe the company's ability to successfully hedge out the portfolio is a positive development that should eliminate one of the largest overhangs on the company's stock, in our view.
- **Ditech Acquisition –** NRZ closed the acquisition of ~$1.2B assets, which included $62B of MSR UPB: $35B of FNMA, $22B of GNMA and $5B of MH/PLS. And it closed on other assets that include a $2.2B recovery portfolio and $418M of servicer advance par value. NRZ financed the acquisition with $200M of cash on hand and financing facilities and expects to generate ROEs of 20%+ on the transaction. During 4Q19, NRZ will likely realize a gain of $30M to $40M on the acquired Ditech assets because they were acquired at a discounted valuation.
- **Originations –** NRZ originated $5.7B in 3Q19, up 200% YoY and $11.8B YTD, up 123% YoY and expects to originate $22B in FY19, up ~206% compared to 2018. As we have previously noted, additional origination volume provides an internal source of recapture and reduces NRZ's cost to acquire/create MSRs. Management is targeting ~$40B of origination volume during FY20 led by additional volume from recently acquired Ditech. This additional volume should further increase internal replenishment, reduce replenishment costs and reduce the interest rate sensitivity of the MSR portfolio.
- **Shellpoint –** Subserviced UPB increased to $184B, up 100% YoY with $62B subserviced for 3rd parties and $122B subserviced for NRZ. Management is targeting FY20 servicing UPB of ~$200B, an increase of approximately $115B. The increase in subservicing for NRZ allows the company to control its own destiny by reducing counterparty risk and shifting additional profitability that had been paid to 3rd party subservicers internally.
- **Growth in ancillary revenue –** Going forward, NRZ intends to continue growing its ancillary services revenues and offerings as a way to capture a larger portion of the MSR economics and to grow earnings.

Price Performance



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

NRZ's MSR portfolio is more seasoned than the industry average with a weighted average loan age (WALA) of 82 months vs. 52 months for the industry and an average loan balance of $159K vs. $182K for the industry. This additional seasoning and a higher concentration of Non-Agency MSRs reduces interest rate sensitivity – management estimates 24% of NRZ's portfolio is currently refinanceable compared to 54% for the industry. Approximately 75% of MSRs on NRZ's balance sheet have already seen this level or lower mortgage rates over the past 3 years and have not refinanced, which supports a lower CPR and by extension lower sensitivity to falling interest rates.

In Exhibit 1 below, we present MSR replenishment cost savings potential from originating MSRs vs. purchasing them in the open market. As an example, if an MSR cost 125 bps to acquire in the open market and NRZ can originate mortgages at a 50 bps profit margin, including 125 bps of MSR capitalization – the net cost to create an MSR via origination is 75 bps, about 40% cheaper than acquiring that same MSR in the market.

As NRZ continues to ramp up origination volumes on the current NewRez platform and adds additional volume from the recently acquired Ditech originations platform there will be additional opportunities for MSR replenishment cost savings. Management is targeting $22B of volume in FY19 and $40B of volume in FY20. While the margins will likely take some time to come up to industry averages, the potential accretion is important to note. For example, if NRZ was able to originate the $18B of additional volume management expects during in FY20 at a 50 bps margin, that would save ~$90M in annual MSR replenishment costs.

Exhibit 1: MSR replenishment cost savings model (in millions)

	0 bps	10 bps	20 bps	30 bps	40 bps	50 bps	60 bps	70 bps	80 bps
$10B	$0	$10	$20	$30	$40	$50	$60	$70	$80
$12B	$0	$12	$24	$36	$48	$60	$72	$84	$96
$14B	$0	$14	$28	$42	$56	$70	$84	$98	$112
$16B	$0	$16	$32	$48	$64	$80	$96	$112	$128
$18B	$0	$18	$36	$54	$72	$90	$108	$126	$144
$20B	$0	$20	$40	$60	$80	$100	$120	$140	$160
$22B	$0	$22	$44	$66	$88	$110	$132	$154	$176
$24B	$0	$24	$48	$72	$96	$120	$144	$168	$192
$26B	$0	$26	$52	$78	$104	$130	$156	$182	$208
$28B	$0	$28	$56	$84	$112	$140	$168	$196	$224
$30B	$0	$30	$60	$90	$120	$150	$180	$210	$240

Source: BTIG Estimates and Company Reports

Typically, subservicers are able to generate a profit margin of between 2 and 3 bps for subservicing MSRs. In Exhibit 2 below, we present potential profit recapture from shifting subservicing to Shellpoint from 3rd party subservicers. Assuming NRZ can shift $110B onto Shellpoint at an average profit margin of 2.5 bps, the subservicing profit recapture would be $27.5M on an annualized basis.

Exhibit 2: Hypothetical annualized cost savings if NRZ is able to shift subservicing to Shellpoint ($ millions)

	1.0 bps	1.5 bps	2.0 bps	2.5 bps	3.0 bps	3.5 bps	4.0 bps	4.5 bps
$70B	$7.0	$10.5	$14.0	$17.5	$21.0	$24.5	$28.0	$31.5
$80B	$8.0	$12.0	$16.0	$20.0	$24.0	$28.0	$32.0	$36.0
$90B	$9.0	$13.5	$18.0	$22.5	$27.0	$31.5	$36.0	$40.5
$100B	$10.0	$15.0	$20.0	$25.0	$30.0	$35.0	$40.0	$45.0
$110B	$11.0	$16.5	$22.0	$27.5	$33.0	$38.5	$44.0	$49.5
$120B	$12.0	$18.0	$24.0	$30.0	$36.0	$42.0	$48.0	$54.0
$130B	$13.0	$19.5	$26.0	$32.5	$39.0	$45.5	$52.0	$58.5
$140B	$14.0	$21.0	$28.0	$35.0	$42.0	$49.0	$56.0	$63.0
$150B	$15.0	$22.5	$30.0	$37.5	$45.0	$52.5	$60.0	$67.5
$160B	$16.0	$24.0	$32.0	$40.0	$48.0	$56.0	$64.0	$72.0
$170B	$17.0	$25.5	$34.0	$42.5	$51.0	$59.5	$68.0	$76.5

Source: BTIG Estimates and Company Reports

BTIG Covered Companies Mentioned in this Report

NEW RESIDENTIAL INVESTMENT CORP (NRZ, Buy, $18.00 PT; Current Price: $15.77; Analyst: Giuliano.Bologna)

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New Residential Investment Corp (NRZ, Buy, $18.00 PT)

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