Radian Group Summary

Date of report: Dec 01, 2020
Stock: Radian Group. (RDN)
Sector: Diversified Financials and Insurance
Subsector: Insurance

P/E ratio for RDN: 9.38
P/E Ratio for Industry: 12.5
Price target: 38.91
Current price: 19.14

Recommendation: Hold

Company Summary

Radian (RDN) is primarily a mortgage insurance company that offers an array of services beyond insurance as well. Some of those being mortgage risk protection, asset management and property valuation. Within their main line of business, they are a major player in private mortgage insurance, and they pride themselves on being one of the most technologically advanced insurance providers out there. Throughout Radian's life they have continuously acquired new firms in order to provide a streamlined client experience, one of the most recent acquisitions being Five Bridges Advisors which brings them up to speed in the big data era. They now have better data analytics, machine learning, and artificial intelligence helping them provide the best service for their clients. This focus on technology is something not many other companies in this industry are doing which gives Radian a key edge for growing in the future. The company has recently benefited from a record of new insurance written (NIW) hitting 25.5 billion in Q2 of 2020 alone. They are projecting that for FY 2020 they will have brought in over 75 billion in NIW. While roughly 40% of this comes from refinancing, they continue to show great resilience by setting new highs even with the uncertainty that Covid-19 has brought.

Industry Outlook

With the mortgage market doing better than it was during the 2008 financial crisis it gives outlook to a good recovery for the private mortgage insurance industry. Although recovery looks good there are still certain factors that need to be taken into consideration such as mortgage delinquencies that are looking to be higher than normal as more people default on loans providing a level of risk to insurance companies that is unprecedented. With Covid-19 still being around and jobless claims continuing to be greater than average it brings another risk which is the potential decline of new insurance written for the industry, but Radian has shown extreme strength in this area thus proving they are taking the right steps to counteract the perceived risks. On the flip side home prices have rose 7.8 percent since October 2019 showing that there is a greater demand than supply all over the US and many being first time home buyers, they will require mortgage insurance which will drive the industry to grow even more in the coming years.

Cash Flow History and Forecast

(Numbers in thousands)								
Date: (end of quarter)	12/31/17 (A)	12/31/18 (A)	12/31/19 (A)	12/31/20 (E)	12/31/21 (E)	12/31/22 (E)	12/31/23 (E)	12/31/24 (E)
Revenues:								
Net premiums earned	$ 932,773	$ 1,014,007	$ 1,145,349	$ 1,171,692	$ 1,198,641	$ 1,226,210	$ 1,254,413	$ 1,283,264
Service revenue	$ 155,103	$ 144,972	$ 154,596	$ 158,152	$ 161,789	$ 165,510	$ 169,317	$ 173,211
Net investment income	$ 127,248	$ 152,475	$ 171,796	$ 175,747	$ 179,789	$ 183,925	$ 188,155	$ 192,482
Net gains (losses) on investments and other financial instrument	$ 3,621	$ (42,476)	$ 51,719	$ 52,909	$ 54,125	$ 55,370	$ 56,644	$ 57,947
Other income	$ 2,886	$ 4,028	$ 3,495	$ 3,575	$ 3,658	$ 3,742	$ 3,828	$ 3,916
Total revenues	**$ 1,221,631.00**	**$ 1,273,006.00**	**$ 1,526,955.00**	**$ 1,562,074.97**	**$ 1,598,002.69**	**$ 1,634,756.75**	**$ 1,672,356.16**	**$ 1,710,820.35**
Expenses:								
Provision for losses	$ 135,154	$ 104,641	$ 132,031	$ 123,942	$ 120,205	$ 125,393	$ 123,180	$ 122,926
Policy acquisition costs	$ 24,277	$ 25,265	$ 25,314	$ 24,952	$ 25,177	$ 25,148	$ 25,092	$ 25,139
Cost of services	$ 104,599	$ 98,124	$ 108,324	$ 103,682	$ 103,377	$ 105,128	$ 104,062	$ 104,189
Other operating expenses	$ 267,321	$ 280,818	$ 306,129	$ 284,756	$ 290,568	$ 293,818	$ 289,714	$ 291,366
Restructuring and other exit costs	$ 17,268	$ 6,053	$ -	$ -	$ -	$ -	$ -	$ -
Interest expense	$ 62,761	$ 61,490	$ 56,310	$ 60,187	$ 59,329	$ 58,609	$ 59,375	$ 59,104
Loss on extinguishment of debt	$ 51,469	$ -	$ 22,738	$ -	$ -	$ -	$ -	$ -
Impairment of goodwill	$ 184,374	$ -	$ 4,828	$ -	$ -	$ -	$ -	$ -
Amortization and impairment of other acquired intangible assets	$ 27,671	$ 12,429	$ 22,288	$ 20,796	$ 18,504	$ 20,529	$ 19,943	$ 19,659
Total expenses	**$ 874,894.00**	**$ 588,820.00**	**$ 677,962.00**	**$ 618,315.33**	**$ 617,159.44**	**$ 628,623.59**	**$ 621,366.12**	**$ 622,383.05**
Pretax income	$ 346,737	$ 684,186	$ 848,993	$ 943,760	$ 980,843	$ 1,006,133	$ 1,050,990	$ 1,088,437
Income tax provision	$ 225,649	$ 78,175	$ 176,684	$ 160,169	$ 138,343	$ 158,399	$ 152,304	$ 149,682
Net Income	**$ 121,088.00**	**$ 606,011.00**	**$ 672,309.00**	**$ 783,590.30**	**$ 842,500.47**	**$ 847,734.45**	**$ 898,686.43**	**$ 938,755.60**

Cash Flows:	12/31/17 (A)	12/31/18 (A)	12/31/19 (A)	12/31/20 (E)	12/31/21 (E)	12/31/22 (E)	12/31/23 (E)	12/31/24 (E)
Net Income	$ 121,088.00	$ 606,011.00	$ 672,309.00	$ 783,590.30	$ 842,500.47	$ 847,734.45	$ 898,686.43	$ 938,755.60
Depreciation	$ 36,800.00	$ 33,800.00	$ 26,100.00	$ 32,233.33	$ 30,711.11	$ 29,681.48	$ 30,875.31	$ 30,422.63
FCFE	$ 157,888.00	$ 639,811.00	$ 698,409.00	$ 815,823.63	$ 873,211.58	$ 877,415.94	$ 929,561.74	$ 969,178.23

P/E	9.38
Forward P/E	12.5
ST Growth Rate	2.30%
LT Growth Rate	3.50%
Cost of Equity	11.50%
Target Price	$ 38.91
Recommendation	Hold

For my cash flow forecasting and valuation, I found it difficult to find specific drivers in the private mortgage industry other than home sales, which have been doing great recently but I with the cases of Covid-19 on the rise again I did not want to take an overly positive assumption and decided that a moving average of the previous years would be the best approach as it accounts for the volatility that has happened in the housing market historically. As for the calculations on goodwill, the company had made a big acquisition to their services department which was reflected in 2017 and in 2019 they are holding for sale a company they own called Clayton and the balance reflected is a fair value of the cash flows from the sale when it happens. The company has no major acquisition plans reported and that is why I have forecasted goodwill as zero.

Valuation

Valuation	12/31/20 (E)	12/31/21 (E)	12/31/22 (E)	12/31/23 (E)	12/31/24 (E)	
PV of Cash Flows	$ 731,680.39	$ 702,376.14	$ 632,966.78	$ 601,421.25	$ 562,379.28	Shares Outstanding (in thousands)
Terminal Value	$ 7,275,781.99					191,550
TV Discounted Back	$ 4,221,874.71					
Sum of Cash Flows	$ 7,452,698.55					

Sensitivity Analysis

Sensitivity Analysis		Short Term Growth Rate				
	$ 38.91	1.30%	1.80%	2.30%	2.70%	3.20%
Cost of Equity	10.50%	41.666585	$ 43	44.872909	46.187458	47.856832
	11.00%	38.735344	$ 40	41.676283	42.881773	44.412442
	11.50%	36.195665	$ 38	38.907327	40.018599	41.429444
	12.00%	33.976759	$ 35	36.488709	37.517917	38.824399
	12.50%	32.023669	$ 33	34.360395	35.317605	36.532528