# Essent Group Ltd (ESNT)

Seidman Investment Portfolio Organization

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*Equity Research Report: Essent Group Ltd. (ESNT)*

Rating: Buy

## Overview:

- **Description**—Looking into one of the fiercest companies in the mortgage insurance industry based in Pembroke Parish, Bermuda, Essent Group Ltd., has more than what meets the eyes. Led by a talented and very experienced management team, having a strategic and efficient business model, and outpacing all their competition.
- **Company Profile**—Since 2008, Essent Group Ltd., have scaled into one of the leading competitors in the field of mortgage insurance in the United States. Essent Group Ltd built a strategic business model that has built a name for them in these past years.
- **Management Team**—A highly strategic and sophisticated team with extraordinary expertise in the industry, Essent Group Ltd has a management team that will continue the strategic expansion of the company.
- **Recent News**—A company that tends to be featured a healthy amount of coverage, Essent Group Ltd still has not been fully discovered despite their rapid years of growth and expansion.
- **SWOT Analysis**—Evaluating Essent Group's strengths, weaknesses, opportunities, and threats is crucial for forming an appropriate opinion for the company and for the sector.
- **Competitors**—Comparing Essent Group Ltd to its competitors in the sector highlights its performance and what key features are similar among the companies.
- **Growth Analysis**—Companies such as Essent Group Ltd are here to stay, established for over 13 years, since 2008, providing and utilizing a very exclusive and high-end technology to efficiently service their customers from big clients to small clients as well will contribute to their vast amount of growth in future years.
- **Valuation**—Using a method of discounted cash flow analysis will show us a clearer image of the outlook of how profitable the business will become in the future.
- **Equity Rating**—After examining Essent Group's fundamentals, market conditions, competition, and the future that is lays ahead for the industry, Essent Group Ltd. has received a rating as a Buy.

## Equity Research Report

April 5, 2021

*Small Cap Value*


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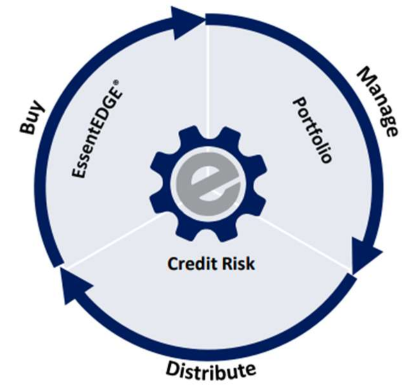
## Company Profile

Essent Group LTD is a holding company that went public in 2013. Essent Group is headquartered in Bermuda and their U.S. insurance business is headquartered in Radnor, Pennsylvania. They also operate additional underwriting and service centers in Winston-Salem, North Carolina, and Irvine, California. Essent Group serves the U.S. housing finance industry by offering mortgage insurance and reinsurance to support homeownership. Essentially, they provide credit protection to lenders and mortgage investors by covering the portion of the unpaid principal balance of a mortgage and certain related expenses in the event of a default.




Private mortgage insurance helps extend affordable homeownership by facilitating the sale of low down payment loans into the secondary market. The GSEs, which are U.S. Federal government-sponsored enterprises, purchase residential mortgages from banks and other lenders and guarantee mortgage-backed securities that are offered to investors in the secondary market. Private mortgage insurance satisfies the GSE's credit protection requirements for low down payment loans, supporting a robust secondary-mortgage market in the United States.

Their primary U.S. mortgage insurance subsidiary, Essent Guaranty Inc., received its certificate of authority from the Pennsylvania Insurance Department in July 2009. They subsequently acquired their mortgage insurance platform from a former private mortgage insurance industry participant and, in 2010, became the first private mortgage insurer to be approved since 1995 by Fannie Mae and Freddie Mac, which we refer to collectively as the GSEs.

The financial strength ratings of Essent Guaranty are A3 with a stable outlook by Moody's Investors Service, BBB+ with a negative outlook by S&P, and A (excellent) with a stable outlook A.M. Best.

## Management Team

*Mark A. Casale - Chairman, President & Chief Executive Officer*

Mark A. Casale is the founder of Essent and has served as Chief Executive Officer and as a member of the board of directors since 2008. Additionally, he serves as the Chairman of the Board of Directors with a background of more than 25 years of financial services management experience holding senior management positions at Radian Group, Inc., including president of its mortgage insurance subsidiary. Furthermore, he held various management positions with Advanta Corp., including servicing as its senior vice president of corporate finance services. Received a BS in accounting from St. Joseph's University and an MBA in finance from New York University.

*Vijay Bhasin - Senior Vice President, Chief Risk Officer*

Vijay Bhasin has served as Senior Vice President and Chief Risk Officer since 2009. Additionally, he has expertise in the mortgage finance industry holding multiple senior management positions specializing in mortgage risk, modeling, and analytics. Historically, he has served as a managing director at Bank of America, held several management positions including vice president for credit and prepayment modeling at Freddie Mac, research positions with Fannie Mae, and the Board of Governors of the Federal Reserve System. Received a BS in mechanical engineering from the

National Institute of Technology, India, an MBA in finance and marketing from Southern Illinois University, and a Ph.D. in Finance from Indiana University.

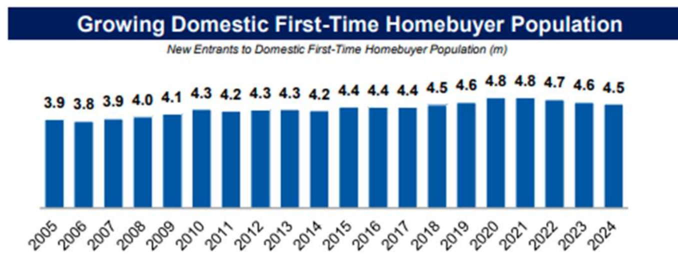
*Lawrence E. McAlee - Senior Vice President & Chief Financial Officer*

Lawrence E. McAlee has served as Senior Vice President and Chief Financial Officer since 2009. Furthermore, he holds over 25 years of experience in the areas of finance, accounting, controls, and risk management. Specifically, by holding several senior management positions including general auditor and chief enterprise risk management officer at Sovereign Bancorp, Inc., and he was a partner with Arthur Andersen LLP. Received a BS in accounting from St. Joseph's University and is a certified public accountant.

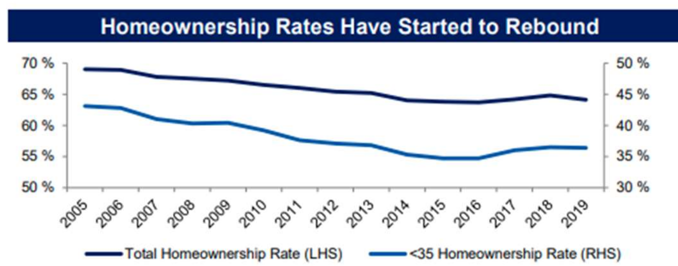
## Recent News

### Essent Group Ltd. CEO Participates at the MKM Partners Virtual Conference

Essent Group Ltd., CEO, Mark Casale reflects on the strong demand for their services especially during the covid era which lays a strong foundation building on the company's fundamentals. Mark Casale highlighted how the company will follow the macro trends of the real estate market and how the real estate market will be booming since people want to move into bigger houses and more suburban areas due to the new style of the work ethic of hybrid flexibility. Furthermore, Mark Casale commented that Essent Group's primary focus is to continue working on its risk management and having satisfying balance sheets for investors to observe over.




### Essent Group Ltd. Announces Amended and Extended $625 Million Credit Facility



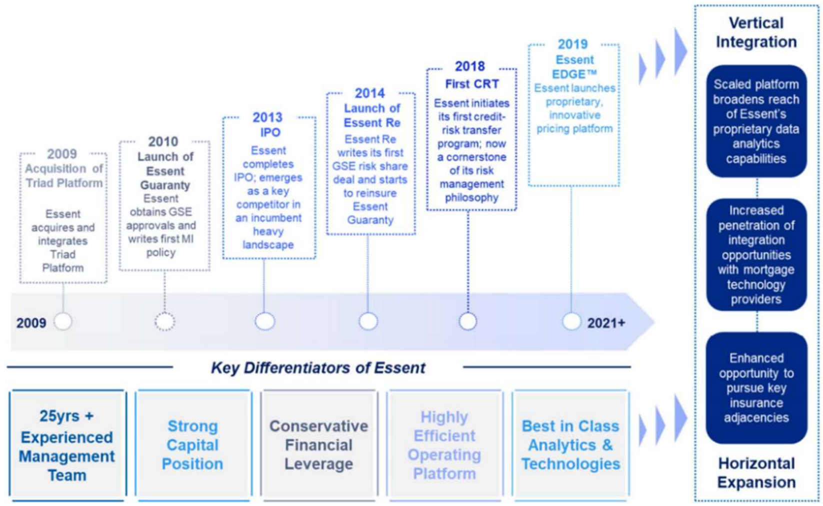

Essent Group Ltd. announced that it has amended its credit facility to increase the total facility from $500 million to $625 million. This increase provides an increase in the revolving credit facility from $275 million to $300 million, the issuance of an additional $100 million non-amortizing term load, the revolving credit facility and term loans maturing concurrently in October 2023, and finally an opinion to increase the credit facility to $775 million. The proceeds of the additional term loan issued, as well as cash at the holding company, were used to pay down all amounts drawn under the revolving credit facility.

### Essent Group Ltd. Announces Closing of $399.2 Million Reinsurance Transaction and Related Mortgage Insurance-Linked Notes

Essent Group Ltd. announced that an owned subsidiary, Essent Guaranty, Inc. has obtained #399.2 million in fully collateralized excess of loss reinsurance coverage on mortgage insurance policies that were written in September 2019 to July 2020. These policies were written by Radnor Re 2020-2 Ltd. which is a newly formed Bermuda special purpose insurer. Radner Re 2020-2 Ltd. has funded its reinsurance obligations through an issuance of five classes of mortgage insurance-linked notes. These notes have 10-year legal maturities included with eligible third party capital market investors in an unregistered private offering.

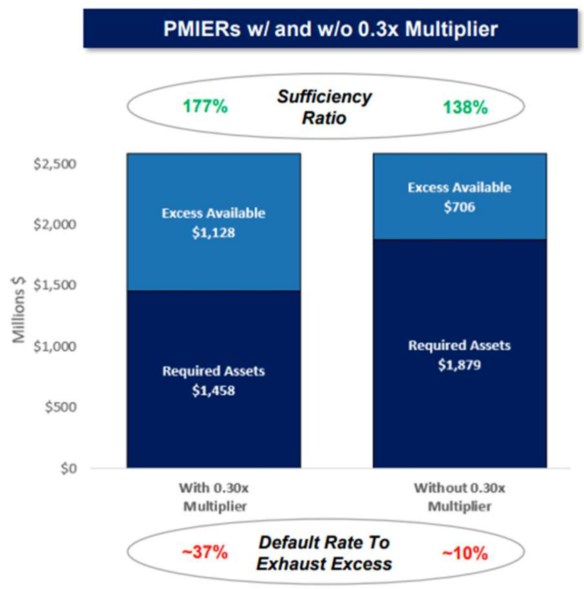
## SWOT Analysis

### Strengths




- **Buy, Manage & Distribute Business Model:** Utilizing the EssentEDGE pricing engine allows to efficiently evaluate loan-level credit and borrower attributes in calculating an mortgage insurance rate. Monitoring includes leverage underwriting standards to adjust new business flows, shape portfolio risk profile, and robust internal risk analytics and quality assurance. Credit risk transfer allows to mitigate return volatility during down cycles, manage the housing cycle with the stronger franchise. The strong business model allows clear sailing through certain business cycles which give investors clarity and assurance.

- **PMIERs Sufficiency Ratio:** Essent Guaranty, Inc. has a private mortgage insurer eligibility requirement (PMIER) asset amount of $1.5 billion and an excess asset amount of $1.1 billion, yielding a PMIERs sufficiency ratio of 177%, with the 0.3x factor applied to the PMIERs asset requirements for defaulted loans. Excluding the 0.3x factor, the PMIERs required asset amount would increase to $1.9 billion, resulting in a PMIERs excess of $706 million and a sufficiency ratio of 138%.




### Weaknesses

- **Loan Forbearance & Delinquencies:** The mortgage insurance industry has experienced an increase in mortgage defaults which also impacted the financial performance of 2020. The constant rise in defaults and forbearance is very threatening against a mortgage insurance company.

### Opportunities

- **Growing Domestic First-Time Homebuyer Population:** Over the next several years, on an annual basis, approximately 4-5 million millennials will reach the average age of a first-time home buyer which is 32 years old. The millennial generation of roughly 80 million will drive housing's longer-term prospects and first-time buyer activity.

- **Homeownership Rates Have Started to Rebound:** Outlook on affordability is favorable as mortgage rates continue to be at historically low labels. Homeownership rates have been increasing recently which is very beneficial for all mortgage companies including Essent Group.

- **Industry NIW Continues to grow:** Demographic and macroeconomic trends which have been showing growth by new insurance written (NIW) consistently annually supported the growth over the past decade. Growth has been focused on higher credit quality business.

Threats

- **Housing Crisis Speculation:** There is a lot of market-wide speculation that there will be a potential 2021 to 2022 real estate market crash. There is a possibility that this will potentially happen due to looking at the home values compared to the 2007 values and we can see that in 2020/2021 they have finally surpassed 2007 levels. Additionally, Urban Institute analysts have set that for the next two decades homeownership rate is set to decline 62.1%. This poses a great threat against all mortgage lender companies and banks.

- **Consumer Financial Protection Bureau Regulation:** Potential investigations or lawsuits from the Consumer Financial Protection Bureau will be very negative PR against the company also simple regulations such as how much you must hold in reserves can negatively affect business and lending. It negatively affects the lending business due to higher reserves results in less money to lend out and take on even more potential deals with clients.

## Competitors

| | Price | Market cap | P/E | PEG | Free Cash Flow |
|---|---|---|---|---|---|
| ESNT | $47.51 | 5.2B | 11.76 | 0.89 | 518.60 |
| TFSL | $20.50 | 5.8B | 70.65 | 3.39 | 118.59 |
| NYCB | $12.73 | 5.9B | 14.54 | 0.82 | 334.20 |
| PFSI | $67.50 | 4.6B | 3.18 | 0.04 | 2407.41 |

| | EPS | Efficiency Ratio | Delinquency Ratio | Divident Yield | Institutional Ownership |
|---|---|---|---|---|---|
| ESNT | 3.88 | 49.64% | 3.93% | 1.51% | 96.96% |
| TFSL | 0.3 | 65.65% | 2.70% | 5.32% | 9.90% |
| NYCB | 1.02 | 49.38% | 8.07% | 5.56% | 59.82% |
| PFSI | 20.92 | 57.34% | 7.20% | 1.30% | 72.99% |

Understanding these numbers makes us understand why Essent Group stands out among its competitors. To begin with, the market cap comparison Essent Group rides in the middle of the pack which is a good thing because they are keeping up with their competition battling for a market share of the industry. With the similarities in market capitalization, ESNT's PEG ratio is the highest among competitors except for TFSL. This shows that they outperform companies of similar sizes in the industry. Also, this PEG is very reasonable considering the rest of the market. Not only does this PEG demonstrate growth throughout the competition, but it is also not unreasonably high like the PEG for TFSL. Very high PEG ratios may seem great on the outside but are unsustainable in the long run.

Another key number to look at is the earnings per share (EPS). Essent Group exceeds among their competitors at 3.88 while the next closest is 2.46. This shows that shareholders receive great payouts compared to the rest of the industry. We should also note that a desired earnings per share should be reasonable and yield nice results compared to the competition. Even though PennyMac Financial Services has a much larger earnings per share (20.92), this number is unsustainable and shareholder payouts will drop as a result.

The institutional ownership for most of these companies is at least above 90%, with Essent Group sitting at 96.96% ownership by institutions, which shows high faith in this industry in the future. With the Earnings Per Share of ESNT in mind, we also see that they have a dividend yield to shareholders.  These numbers combined show that the company is conducting business with shareholder profits in mind.  Essent Group wants to make sure people investing in the business receive pleasant returns by not only giving great EPS but paying dividends to investors as well.

Since COVID hurt the mortgage lending industry, we need to look at the efficiency ratio to see how the increase in loan adjustments affects the income of a company.  After computing the efficiency ratio, we notice that ESNT is at the bottom with NYCB.  This means that Essent Group is doing well among competitors when it comes to adjusting loans to accommodate individuals who cannot pay them off.  Essent Group's high-quality loans have decreased the amount of loans adjusted which has freed up more operating income to grow the business or pay more to shareholders.

We also should consider the delinquency ratio among the competitors.  The delinquency ratio refers to the percentage of the loans that are past due.  This indicates the quality of a lending company's portfolio.  We see that Essent Group stands right in the middle of the pack when it comes to delinquent loans.  The 3.93% shows that the company takes on mostly high-quality loans compared to companies like New York Community Bancorp and PennyMac Financial Services.  Even though the delinquency rates are high among all companies compared to the U.S. average (1.96%) they will continue to lower throughout the year.  Since COVID has created large unemployment throughout the United States, many people have been unable to pay off their debts.  Since COVID restrictions are becoming lifted across the country, people can acquire work and pay off their debts.

## Growth Analysis

Since the IPO dating back on November 1, 2013, at $17 a share, Essent Group has gained over 101.29% over these past years since IPO. In the same time, Essent


Group has outperformed all of its competition. When comparing Arch Capital Group (Red) to Essent Group (Blue), Arch Capital Group came the closest by gaining around 88.25%, however, lagging by 13.04% against Essent Group which shows how Essent

Group stays ahead of the pack, outpacing their competition, and will continue their strategic growth against their competition. The next closest competitor NMI Holdings Inc. (Orange) gained around 64.10%, falling short compared against Essent Group by 37.19% which shows that the competition is starting to severely lag behind Essent Group's effective growth strategy. MGIC Investment Corp (Yellow) gained about 52.33% which posts a drag of 48.96% compared to Essent Group. Radian Group Inc. has only shown a 46.60% growth since Essent Group's IPO which results in falling short of Essent Group's growth by 54.69% which shows it has only performed under a half of what Essent Group has grown. Finally, Genworth Financial Inc. has not even grown and actually lost 77.77% since Essent Group's IPO which results in a lag of 179.06%. Overall, Essent Group shows a great return rate, outpacing their competitors, and consistently growing.

The reason we can conclude why Essent Group has been producing such great results is by utilizing their effective business model of Buy, Manage, and Distribute which includes their top-of-the-line EssentEDGE technology which attracts customers due to the convenience of their fast engine to calculate their risk-based price and evaluate loan-level credit and borrower attributes in calculating an MI rate. The transition from their old business model of "Buy and Hold" to "Buy, Manage, and Distribute" has increased their competitive advantage. Additionally, Essent Group is a leading specialty insurance company operating in a large and growing market with a high barrier of entry which makes it extremely difficult for them to have new competitors in the market since it is so expensive to just get up and running. Furthermore, Essent Group has amazing financial strength and flexibility allows them to seize attractive opportunities as the market evolves especially in very volatile times. In addition, the strong capital and liquidity, along with 3rd party reinsurance, enables Essent Group to navigate challenging market environments.

## Valuation

When analyzing Essent Group Ltd. we decided to use a discounted cash flow analysis. We started with this analysis by forecasting the free cash flows for the next 5 years. The present values of those cash flows were then calculated from the discount factors from the required return on the stock. We found our required return by calculating the weighted average cost of capital by utilizing various inputs. We used the 10-year U.S. treasury bond as our risk-free rate (2.40%), an analyst beta estimate of 1.28, and the average yearly return (in periods of 10 years) of the S&P 500 from the early 1930s to present day, which gave us our average market return of 10%. Utilizing these inputs gave us the required return on the stock which we used to calculate the fair value of equity.

| Case | Fair Value | Upside (Downside) % |
|---|---|---|
| Bull | $89.23 | 111.10% |
| Bear | $36.08 | (17.16%) |

As of 3/7/2021

After calculating the fair value of equity, it is key that we make bull and bear cases to comply with different market conditions. When looking at ESNT with a bullish outlook, we used a market growth of 4% when economic conditions are flourishing. The fair value would become $87.11%, or a 98% upside. When analyzing an instance where the stock is experiencing a bearish case, we used a -20% for market growth from average stock declines during a recession. We then come to a fair value of $36.08, or a 31% downside. With the average of these two cases, we get a fair market value of $60.22 dollars or a 27.76% upside. Taking into consideration the recently passed stimulus, increased demand in the housing market, consumer confidence, etc. we believe the stock will fluctuate so the stock price will fall within the range of $60 and $68 dollars. After finding the range, we averaged the two prices and came up with our projected target price of $64 in one year.

## Equity Rating

**For the following reasons Essent Group Ltd. Is Issued a Buy Rating:**

- The company's switch to a more effective business model from "Buy and Hold" to "Buy, Manage & Distribute" was a very sophisticated choice which led a great path away in the short term and in the long term for this company which allows them to effectively use their highly sophisticated engine, EssentEDGE, which allows them to evaluate loan-level credit and borrower attributes in calculating an MI rate which gives them the competitive edge.

- The performance of Essent Group compared to its competitors which was very appealing and truly shows how they perform against the competition. Additionally, since the market is such a high-cost barrier of entry to start a new company, Essent Group does not need to truly worry about any very new competition and continue to keep eating up market share year-over-year against its current competitors.

- Essent Group's position with its current financial strength and flexibility truly gives them an advantage to seize opportunities when necessary as the market evolves. Also, with its strong capital and liquidity, along with partnering with 3rd party reinsurances, enables Essent Group to navigate challenging market environments which is what most investors look for nowadays after recent events in the broader market.

Resources

- Essent Group Ltd Investor Relations
- CapitalIQ
- CNN Money
- Yahoo Finance
- Seeking Alpha
- InvestorsObserver
- Merrill Edge MarketPro
- Mortgage Bankers Association
- Securities and Exchange Commission Database

## Important Disclosures

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Investments have varying degrees of risk. Risks involved with equity securities include the prospect that the value of the stocks may fluctuate in response to specific events to the companies and markets, as well as economic, political, or social events both domestic and international. Foreign securities can involve special risks, including foreign currency risk and the risk of adverse global political, social, or economic environments. Risks are increased for investments made in emerging markets. There may be risk from lack of diversification through concentration in particular sectors and industries. Investments in commodities include risks of market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and other political or financial factors. Fixed-income securities may still involve certain risks, consisting of the credit quality of individual issuers, possible prepayments, economic developments, and yields fluctuations due to changes in interest rates.