

MARGIN OF SAFETY

BALANCE OF POWER

MANAGEMENT ANALYSIS



STRATEGIC POINTS OF ESSENT/MGIC – US GUARANTEE BUSINESS

22 FEBRUARY 2023

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MACRO ENVIRONMENT

SECTION I



FEDERAL FUNDS RATE TARGET



- 5% seems to be the peak level



Source: Bloomberg

FEDERAL HOME MORTGAGE 30-YEAR FIXED RATE



- Freddie Mac 30 Years rates fixed @ 6.3%



Source: Bloomberg

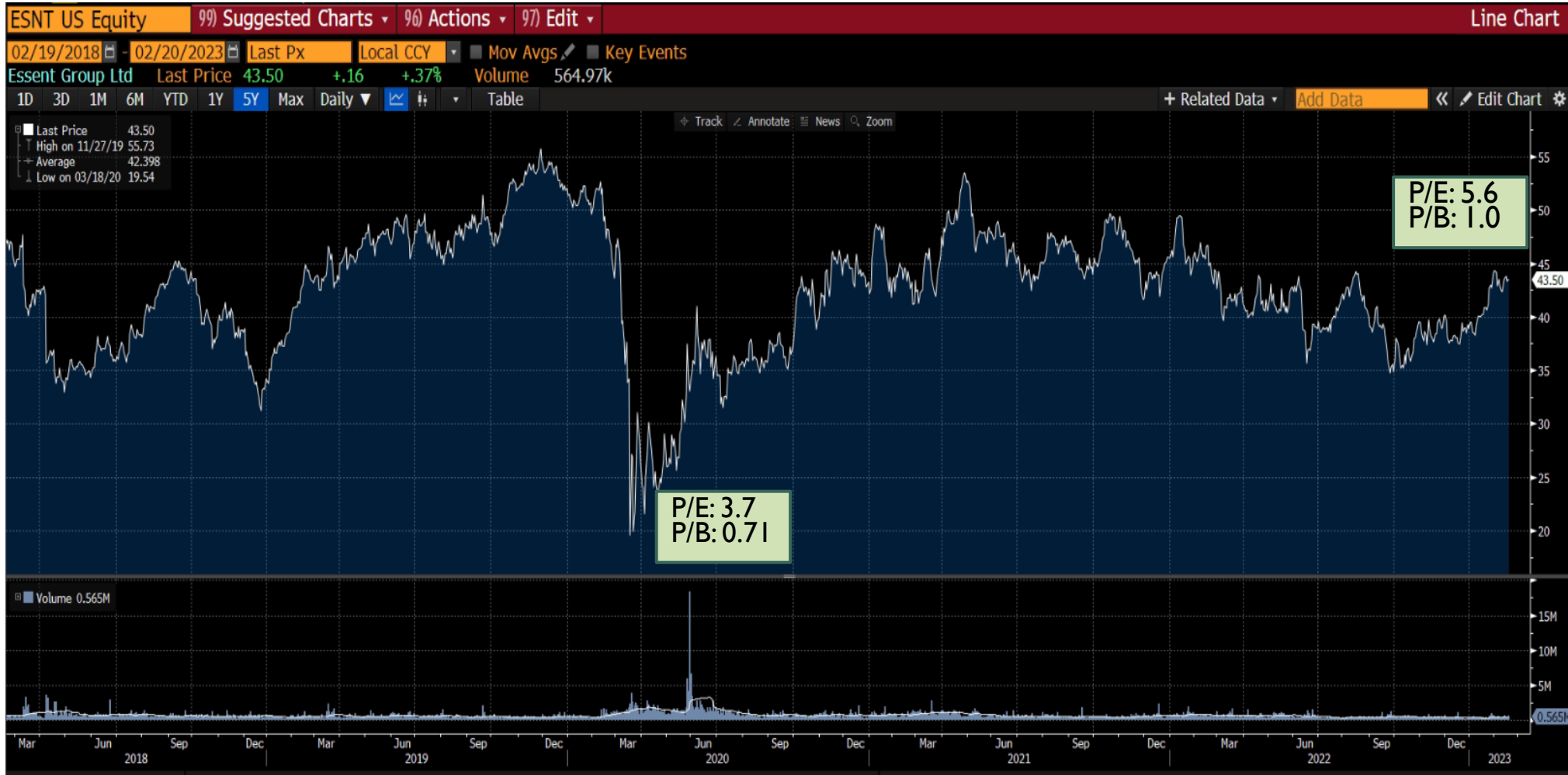


ESSENT

SECTION 2



ESSENT'S SHARE PRICE MOVEMENT



ESSENT'S PERFORMANCE



- FY2022's net income for the year was +21.9% (\$681.8mn → \$831.3mn) ※However, there was an unrealised loss on investment of \$433mn
- FY2022's interest income increased +40.2% from the previous year (\$88.8mn → \$124.4m) equivalent to 12.4% of revenue, 15.0% of net income → recombination of shorter duration investment bonds to drive higher investment yield
- FY2022 New insurance written was \$63.1bn (-25.1% YoY, but 4th highest historically)
- Insurance in force was \$227.1bn (+9.6% YoY) at the end of FY22
- FY2022's ROE was 19.0% (16.8% in FY21) BPS increased +6.9%
- Shareholder's equity/Insurance-in-force = 2.0%
- **Default rate fell from FY21 2.16% → FY22 1.66%**
- Dividend policy is not explicitly stated but appears to be at least 2% DOE
- Investment Portfolio
 - 2022 investment yield improved from 2.0% → 2.6%
 - 2022Q4's annualised yield further increased to 3.0%

ESSENT REVENUE ENGINE



- Essent Reinsurance – Growth Engine
 - Since the company guarantees a portion of the long above the collateral amount, it performs reinsurance transactions for its own guaranty portfolio while at the same time partake in reinsurance of the loans of other companies’ such as the GSEs
 - ✓ Generated revenue of \$69m through 3rd party reinsurance and 98% of IIF is covered by reinsurance
- Essent Ventures – Growth Engine
 - Seeking both Investment returns and business synergies
 - \$258mn in investment balance generating \$85m in returns (of which \$65m has been realized)
 - Essent Ventures discovered 2 companies that were made into wholly-owned subsidiaries

ESSENT M&A



- Essent Ventures provided the leeway into the Title Insurance Industry
- In the U.S, home transactions are very active, and it is common practice to investigate outstanding debt, history of repairs and defects of the home, and any potential ownership interests
 - Estimated market premiums of \$18-\$25B
 - The industry typically has low loss ratios and is a capital-light business that provides an opportunity to leverage on the strength of Essent's balance sheet.
- Acquired 100% stake in Agents National Title and Boston National (Discovered by Essent Ventures)
 - Insurance is required for mortgage loans and the acquisition provides great synergies
 - Strong synergies in back-office functions and across its insurance businesses
 - The two companies had a purchase price of \$100mn

- Investments have become a way of business development
- Generates strong financial returns

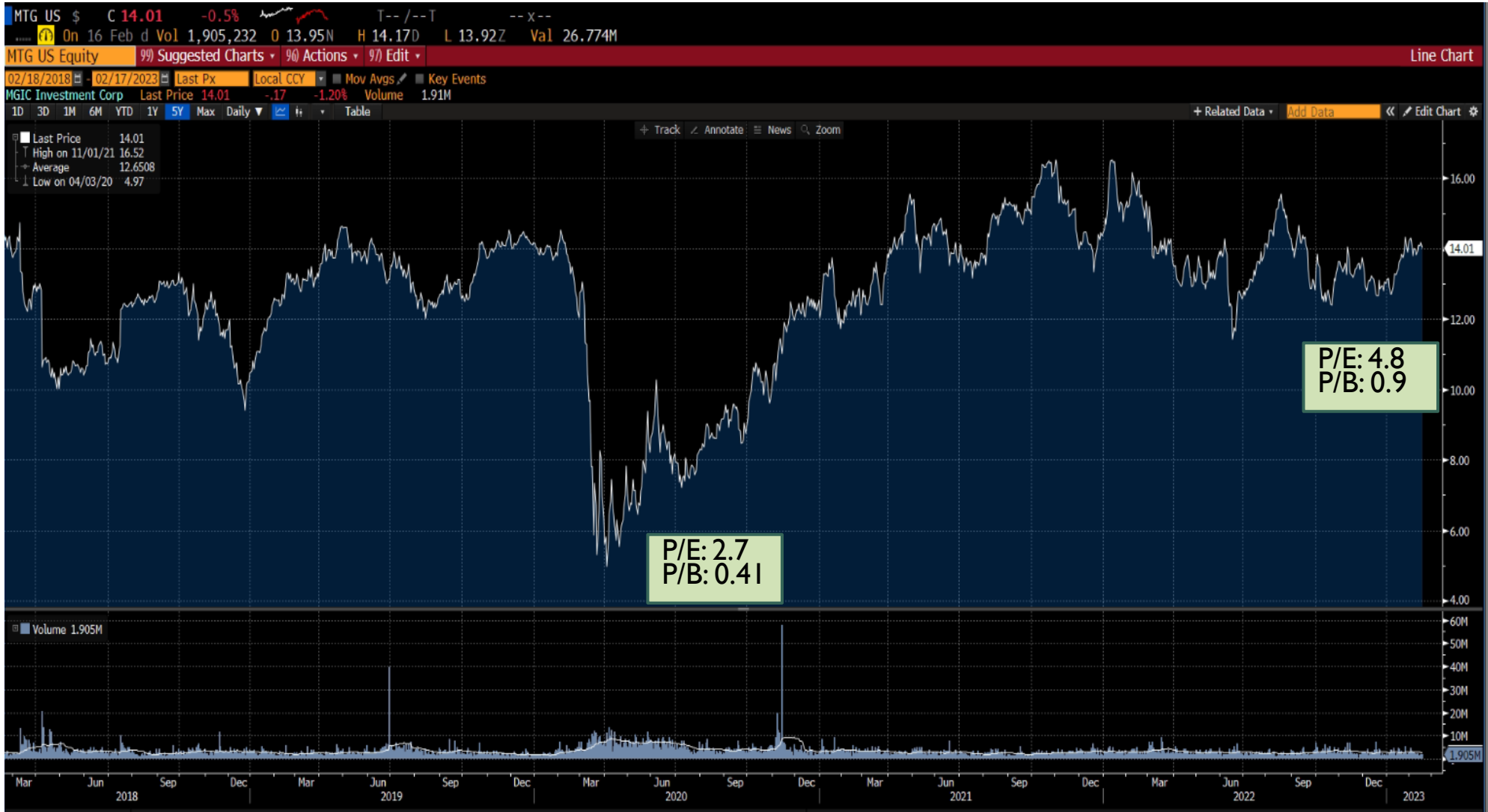


MGIC

SECTION 3



MGIC'S SHARE PRICE MOVEMENT



Source: Bloomberg

MGIC'S PERFORMANCE



- FY2022 net income increased +36.2% YoY (\$634.9mn → \$865.3mn)
- FY2022 interest income increased +7.1% YoY (\$156.4mn → \$167.5mn)
- FY2022's new insurance written was \$76.4bn (-36.4% YoY but remains the 3rd highest historically)
- Insurance in force was \$295.3bn (+7.6% YoY) at the end of FY22
- FY2022's ROE was 18.2% (13.2% in FY21) BPS +4.4% YoY
- Shareholders' equity/Insurance-in-force balance = 1.6%
- **Default rate fell from FY21 2.84% → FY22 2.22%**
- Investment Portfolio
 - 2022's investment yield was 3.0% (compared to 2.5% in FY21)

MGIC'S BALANCE SHEET



- Debt strategy
 - Repaid nearly \$500m of debt throughout the year
 - Long term debt reduced from \$1,146m → \$671m (-42.0% YoY) reducing debt/shareholders' ratio to 12%
 - Reduced \$25mn of annual interest expense
- Share buyback
 - 27.8mn shares were repurchased (worth approximately \$386m) starting with 320mn of shares outstanding at the end of FY21
 - Reduced diluted share count by 11.0%
- Dividend
 - No explicit dividend policy was announced but it appears to be in minimally 2% of DOE
 - Increased dividend for the past 2 years +33% in 2021 and +25% in 2022

KEY TAKEAWAYS



- Both companies achieved record profits in 4Q2022
- Essent aims to create synergies while implementing dynamic investment management strategies
- MGIC dynamically adjusts its balance sheet to take a defensive position and high return on capital
- Default rates have improved in 2022 and the market is relatively stable even with rising interest rates
- However, the stock price seems not fully valued and priced in the intrinsic value of the business → difference in perception of risk by the market?
- Adjusting for unrealised losses in the portfolio, the PER of both companies is in the 10x range

DISCLAIMER



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