

Equity Research

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Financials

MGIC Investment Corporation

Borrower-Paid Premium Cut Negates Tax-Reform Benefit, But Core Thesis Intact; Reiterating Buy

Shares of MGIC Investment Corporation (MTG) were down sharply in early trading this morning after the company announced that it will cut borrower-paid mortgage insurance (BPMI) premiums beginning on June 4 as it essentially ceded virtually all of the benefit from the U.S. tax reform legislation enacted last December to customers. While we had anticipated that MTG and its private mortgage insurance (PMI) peers would share a portion of the tax benefits with customers in the form of lower premium rates, the extent of the sharing exceeded our expectations.

MTG

\$12.82

12 month target

\$18.00

BUY

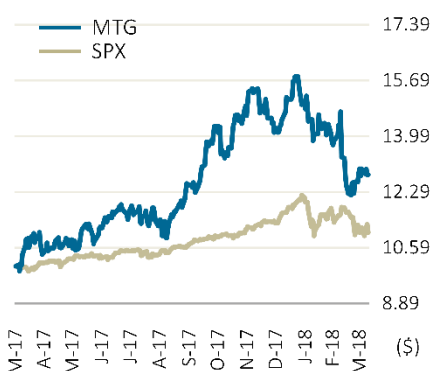
52 week range

\$10.06 - \$15.81

Market Cap (m)

\$4,775

Price Performance



Source: IDC

- ▶ MTG stated that BPMI premium rates on the company's most popular insurance plans would be reduced by an average of 11%. CEO Patrick Sinks said in the company's announcement that while MTG's competitors in recent months have offered lower BPMI premium rates to some of their customers, the company would do so publicly, transparently and across the board to all of its customers.
- ▶ We believe a mitigant to BPMI premium rate cuts for MTG and its PMI peers could be increased share of the U.S. mortgage insurance market relative to the FHA. MTG management estimated that it would now be more competitive in about 10% of the overall U.S. market that has been dominated by the FHA up to this point.
- ▶ **We are reiterating our Buy recommendation on MTG and our price target of \$18** based on 11x our FY19E adjusted EPS of \$1.60. While the company's BPMI premium rate cut means that it will not enjoy the approximately 18% ROE it would have had with the full benefit of tax reform, it nevertheless should generate an ROE in the mid-teens while continuing to grow its book value – the investment thesis that had attracted investors prior to the enactment of the tax changes.
- ▶ As such, we view the sell-off in MTG shares this morning as overdone, and we believe it presents a buying opportunity.
- ▶ **Valuation:** Our price target of \$18 for MTG is based on 11x our 2019E EPS of \$1.60. The multiple we employ is based on comparable company analysis.

Estimates

	1Q17 A	2Q17 A	3Q17 A	4Q17 A	FY17 A	1Q18 E	2Q18 E	3Q18 E	4Q18 E	FY18 E	FY19 E
Net Income (Adj.)	90	119	120	27	356	144	145	148	150	587	613
Diluted EPS (Adj.)	0.31	0.31	0.32	0.43	1.36	0.37	0.37	0.38	0.39	1.51	1.60
BVPS (Ex-AOCI)	6.58	7.59	8.00	8.47	8.47	8.46	8.84	9.24	9.65	9.65	11.46

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

Please Read: Important disclosures and analyst's certification appear in Appendix

- ▶ While have been pointing to the potential initiation of capital return as a catalyst for MTG, with the shares now trading well below their January highs we believe the announcement of a share repurchase program would be even more impactful. While we do not expect the company to announce such a program when it reports its 1Q18 results on April 18, but management has stated that the initiation of capital return could come on the heels of the unveiling of the final version of the latest iteration of the Private Mortgage Insurer Eligibility Requirements – the so-called “PMIERS 2.0.” They expect the new requirements to be released by the GSEs prior to the end of June.
- ▶ Shares of PMIs Radian Group (RDN, Buy, \$36 PT), Essent Group (ESNT, Buy, \$54 PT) and NMI Holdings (NMIH, Buy, \$26 PT) also came under pressure after MTG’s announcement. The PMI stocks had been under pressure since the second week of March when news of a pilot program launched by Fannie Mae (FNMA, Not Rated) and Arch Capital Group (ACGL, Not Rated) dubbed IMAGIN emerged.
- ▶ While the program’s actual percentage impact on the PMIs’ new insurance written would be limited to single digits in our view, we believe the severity of the price decline in shares of MTG and its peers in recent weeks was due to concerns that the pilot program would expand from lender-paid single premium mortgage insurance (LPMI) to BPMI. ACGL stated in a white paper issued in late March that such would not be the case.
- ▶ We further observe that by the time the IMAGIN pilot program has been completed, the term of Mel Watt as Director of the Federal Housing Finance Authority (FHFA), the regulator of FMCC, will have expired. Watt, whose term concludes on January 6, 2019, was appointed by President Obama and has been viewed as seeking to preserve, and in some cases expand, the scope of the GSEs and the role of the government in U.S. housing finance.
- ▶ Many observers believe President Trump would be likely to appoint as Watt’s successor a new head who would seek to reduce the role of the U.S. government in housing finance while boosting the role of private-sector alternatives such as the PMIs. One of the candidates whose name has been floated for the role is Mark Calabria, chief economist to Vice President Pence, who is a libertarian advocate of a reduced role for government.
- ▶ We believe Calabria or a candidate of similar ideology would be likely to return to the approach embraced by Ed DeMarco, Watt’s predecessor as head of the FHFA, who had created a plan for protecting taxpayers that called for shifting mortgage risk from the U.S. government to the PMIs.

Income Statement

MGIC - Operating Model	Dec-14	Dec-15	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Dec-19
\$ Millions	2014A	2015A	2016A	1Q17A	2Q17A	3Q17A	4Q17A	2017A	1Q18E	2Q18E	3Q18E	4Q18E	2018E	2019E
Net premiums written	881.96	1,020.28	975.09	236.70	245.83	255.90	259.52	997.96	260.02	262.91	267.84	272.23	1,063.00	1,108.74
Increase in unearned premiums	(37.59)	(124.06)	(49.87)	(7.60)	(14.70)	(18.81)	(22.10)	(63.21)	(20.37)	(20.60)	(20.98)	(21.33)	(83.28)	(82.13)
Net premiums earned	844.37	896.22	925.23	229.10	231.14	237.08	237.43	934.75	239.65	242.31	246.85	250.91	979.72	1,026.61
Investment income	87.65	103.74	110.67	29.48	29.72	30.40	31.28	120.87	32.21	33.18	34.18	35.20	134.77	151.69
Realized investment gains	1.50	27.72	8.93	(0.22)	(0.04)	(0.05)	0.46	0.15	-	-	-	-	-	-
Total other than temporary losses	(0.14)	0.64	-	-	-	-	-	-	-	-	-	-	-	-
Proportion of losses recognized in other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net impairment losses recognized in earnings	(0.14)	0.64	-	-	-	-	-	-	-	-	-	-	-	-
Other revenue	8.42	12.46	17.66	2.42	2.50	2.92	2.34	10.19	2.58	2.60	2.63	2.65	10.46	10.77
Total revenues	941.80	1,040.78	1,062.48	260.78	263.31	270.36	271.50	1,065.95	274.44	278.09	283.66	288.76	1,124.95	1,189.07
Losses incurred	496.08	343.55	240.16	27.62	27.34	29.75	(31.00)	53.71	34.53	36.16	38.13	40.09	148.91	177.92
Change in premium deficiency reserve	(24.71)	(23.75)	-	-	-	-	-	-	-	-	-	-	-	-
Amortization of deferred policy acquisition costs	7.62	-	-	-	-	-	-	-	-	-	-	-	-	-
Underwriting and operating expenses	138.44	164.37	160.41	43.00	41.10	42.87	43.79	170.75	44.88	44.99	45.11	45.22	180.20	182.01
Loss on extinguishment of debt	-	-	90.53	-	0.07	-	-	0.07	-	-	-	-	-	-
Interest expense	69.65	68.93	56.67	16.31	14.20	13.27	13.26	57.04	13.26	13.26	13.26	13.26	53.02	53.02
Total losses and expenses	687.07	553.09	547.77	86.92	82.70	85.89	26.05	281.56	92.66	94.41	96.49	98.56	382.13	412.95
Income (loss) before income taxes	254.72	487.69	514.71	173.86	180.62	184.47	245.46	784.40	181.78	183.69	187.17	190.20	742.82	776.11
Provision for income taxes	2.77	(684.31)	172.20	84.16	61.99	64.44	218.14	428.74	38.17	38.57	39.30	39.94	155.99	162.98
Net income (loss)	251.95	1,172.00	342.52	89.70	118.62	120.03	27.31	355.66	143.60	145.11	147.86	150.26	586.83	613.13
Adjusted EPS	\$0.61	\$1.13	\$0.88	\$0.31	\$0.31	\$0.32	\$0.43	\$1.36	\$0.37	\$0.37	\$0.38	\$0.39	\$1.51	\$1.60
Diluted shares outstanding	413.55	460.85	421.55	402.18	394.47	391.09	372.46	394.77	390.00	389.61	388.64	387.66	388.98	382.84
Tax rate	1.1%	-140.3%	33.5%	48.4%	34.3%	34.9%	88.9%	54.7%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
Book Value per diluted share	2.36	4.78	6.33	6.58	7.59	8.00	8.47	8.47	8.46	8.84	9.24	9.65	9.65	11.46
Average primary IIF	160,350	169,300	177,713	182,750	185,400	189,150	192,950	187,563	196,154	199,763	204,986	209,875	202,695	218,429
Total primary NIW	33,400	43,000	47,900	9,300	12,900	14,100	12,800	49,100	9,998	13,158	14,382	12,928	50,466	51,979
Average premium rate	0.53%	0.53%	0.52%	0.50%	0.50%	0.50%	0.49%	0.50%	0.49%	0.49%	0.48%	0.48%	0.48%	0.47%

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MGIC INVESTMENT CORPORATION (MTG, Buy, \$18.00 PT; Current Price: \$12.82; Analyst: Mark.Palmer)

RADIAN GROUP, INC. (RDN, Buy, \$26.00 PT; Current Price: \$19.14; Analyst: Mark.Palmer)

ESSENT GROUP LTD. (ESNT, Buy, \$54.00 PT; Current Price: \$42.07; Analyst: Mark.Palmer)

NMI HOLDINGS, INC. (NMIH, Buy, \$26.00 PT; Current Price: \$17.70; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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I, Mark Palmer, 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.

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.

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MGIC Investment Corporation (MTG, Buy, \$18.00 PT)

Valuation: Our price target of \$18 for MTG is based on 11x our 2019E EPS of \$1.60. The multiple we employ is based on comparable company analysis.

Risks: The primary risks to our thesis include: Competition with other PMIs could result in lower revenues and/or lower premium yields. Additional moves by the FHA to make its mortgage insurance offering more competitive could adversely impact demand for MTG's product. A downturn in the U.S. economy could result in higher

delinquencies and higher losses on MTG's existing portfolio.

MGIC Investment Corporation (MTG)

(\$)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
09-Mar-15	9.27	12	Mark Palmer	Buy
20-Jul-17	11.91	14	Mark Palmer	Buy
14-Nov-17	14.01	16	Mark Palmer	Buy
20-Dec-17	14.95	18	Mark Palmer	Buy

Other Disclosures

Additional Information Available Upon Request

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