BTIG

Equity Research
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Financials

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Industry Report

Financials

At Year's Midway Point, Three Financials Stocks Look Particularly Attractive for 2H18: AMBC, FDC, MTG

As we look across the Financials stocks within our coverage universe at the midpoint of the year, we would highlight three stocks as particularly attractive ahead of 2H18 given compelling valuations and potential catalysts: Ambac Financial Group (AMBC, Buy, $26 PT), First Data Corporation (FDC, Buy, $27 PT) and MGIC Investment Corporation (MTG, Buy, $18 PT).

Ambac Financial Group

- Last week featured two significant events that we believe bode well for shares of AMBC during 2H18: the company's announcement on June 25 that it had reached agreement with holders of approximately 89% of the Auction Market Preferred Shares (AMPS) housed at its operating subsidiary to repurchase their shares at a modest premium to their trading value but a sizeable discount to par, and the New York Court of Appeals ruling that brought to a close the summary judgment phase of the company's representation and warranty (R&W) litigation against Bank of America (BAC, Not Rated).

- The AMPS agreement was positive for AMBC inasmuch as it enabled the company to capture a $217mm discount while removing a restriction to the future upstreaming of capital from its operating subsidiary to its holding company to the benefit of shareholders. However, we also believe the deal, in which management moved to take out a lower-priority issue in AMBC's capital structure, signaled their expectation of the realization of positive catalysts in the coming months. Management understood that if they had waited until after those catalysts were realized to address the AMPS, they likely would have had to pay a much higher price to repurchase them.

- While one potential catalyst for AMBC would be the emergence of clarity around the treatment of the COFINA senior sales tax bonds in Puerto Rico's debt restructuring as those bonds represent over 40% of the company's net insured exposure to the island's debt, another catalyst would be a settlement of the BAC R&W litigation that would provide the company with cash it could use to continue its deleveraging and free up cash flow that is currently dedicated to debt service. In several prior R&W cases it was at the conclusion of the summary judgment phase that negotiations either began or became more serious, with settlements typically announced soon thereafter.

- If this pattern holds, then a settlement of the AMBC-BAC litigation could be announced sooner rather than later, making AMBC shares a timely play.

First Data Corporation

- While several of the growth/momentum stocks in the fintech space have come under some pressure during the recent market swoon, one stock that has been relatively resilient has been FDC, which has held most of the gains from a surge of more than 46% that began in late April. That rally was sparked by FDC's 1Q18 earnings/adjusted EBITDA beat-and-raise and then provided confirmation by the company's Investor Conference on June 12 in which management provided a roadmap to a consistent mid-single digit revenue CAGR supported by its high-growth businesses.

- Our bullishness on FDC is underpinned in part by the simple mechanics of deleveraging, as we believe the company is poised to reduce its net leverage ratio from 5.8x at March 31 to 5.0x at YE18 thanks to its ample free cash flow. Shares of FDC, which trade at 10.7x consensus FY19E EV/EBITDA, should benefit from multiple expansion as the company's net leverage decreases, increasing the value of its equity, and it demonstrates its ability to sustain revenue growth in the mid-single digits, in our view. FDC trades at a discount of more than 35% to publicly traded merchant acquirers WorldPay (WP, Not Rated), Global Payments (GPN, Not Rated) and TSYS (TSS, Not Rated), a gap that we believe is set to shrink as the company executes on its plans.

- FDC during its Investor Conference provided medium-term (2019-2021) guidance for a revenue CAGR in the mid-single digits. We view this revenue guidance as relatively easy to achieve and likely conservative in light of our expectations with regard to contributions from the company's high-growth products and services. These products and services, which represent about 40% of FDC's revenue, are growing at more than 10% per annum. As such, the remainder of FDC's business units would need to post a revenue CAGR of only ~2% for it to deliver on its medium-term guidance.

- Lead flow has proven to be an important indicator of future performance for FDC's JV alliances with bank partners Bank of America (BAC, Not Rated), Wells Fargo (WFC, Not Rated) and PNC (PNC, Not Rated), and the company after multiple negative quarters saw that metric begin to improve during 4Q18. Management has noted that they have historically seen a lag of six to nine months between an improvement in JV lead flow and a corresponding benefit to revenues contributed by the alliances. This bodes well for the JVs' outlook for 2H18, as does the fact that the alliances are set to lap some easier comparisons during those quarters, in our view.

- Management said they expected the JVs' performance during 2H18 would be better than their performance during 1H18, and they added that the company's other growth drivers would continue to more than offset the softness within that channel. We expect the JVs' revenues to increase slightly during 2H18 and for the alliances to be much less of a concern to investors going forward than they have been since they began to struggle in late 2016.

MGIC Investment Corporation

- Shares of MTG have declined by 32% since January 22, a drop driven primarily by uncertainty around U.S. government policy regarding mortgage insurance and concerns about pricing pressure. However, with shares of MTG now trading at 1.24x the company's book value as of March 31, such uncertainty is more than baked into its valuation, in our view.

- Moreover, we believe the concerns that have weighed on MTG are likely to abate in the coming months and that changes in leadership in agencies overseeing the U.S. housing market should give investors reason to once again believe that the government will cede more of the mortgage insurance space to the private insurers.

- In particular, the return in May of Brian Montgomery as Federal Housing Administration (FHA) commissioner, a role he held from 2005 to 2009, has been welcomed by MTG and its private mortgage insurer (PMI) peers as they view him as friendly to their interests. At the same time, the end of the term of Mel Watt as director of the Federal Housing Finance Agency (FHFA) in January 2019 is viewed as a clear positive for the PMIs as he has been seen as an impediment to any shift of U.S. mortgage insurance market share from the government to the insurers.

- The selloff in shares of MTG was sparked on March 12 by the launch of a pilot program launched by Freddie Mac (FMCC, Not Rated) and Arch Capital Group (ACGL, Not Rated) involving a deal structure that works in place of lender-paid single-premium mortgage insurance. While the launch of the pilot led to concerns about its impact on the PMIs' volumes and pricing, the program does not appear to have gained significant traction such that investors' initial fears about it appear to have been unwarranted. Management during MTG's 1Q18 conference call on April 18 said they had not seen any material impact on their business from the FMCC-ACGL pilot program and they reiterated their forecast for the company to generate $50bn in new insurance written (NIW) during 2018 that they had provided in January.

- MTG's stock price had been boosted by the enactment of U.S. tax reform that had led investors to expect its ROE to rise from the mid-teens to the high-teens or low-20s. However, in the face of competitors passing along some of the tax reform windfall to customers in the form of lower pricing, MTG on April 9 announced across-the-board premium rate cuts that shifted all of the benefits from U.S. tax reform to its customers. While these cuts should move MTG's ROE back to where it had been prior to the enactment of tax reform, some observers suggested that additional pricing pressure would be forthcoming and the company's shares traded down to levels more than 33% below where they had been exchanged prior to the tax changes.

- We have heard nothing to support the notion that the PMIs are looking to implement premium rate cuts beyond those already announced, and we believe the firms in the space appreciate that such behavior would be self-defeating. Moreover, we believe the new Private Mortgage Insurer Eligibility Requirements – the so-called "PMIERS 2.0" will be supportive of MTG continuing to post a mid-teens ROE.

- MTG CEO Pat Sinks said during the April 18 call that if investors liked the returns the company had enjoyed on December 31 then they would like the returns it is generating today. The difference is that investors can now purchase the company's shares at a price that is 24% lower than it had been at YE17.

BTIG Covered Companies Mentioned in this Report

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, $26.00 PT; Current Price: $19.85; Analyst: Mark.Palmer)
FIRST DATA CORPORATION (FDC, Buy, $27.00 PT; Current Price: $20.93; Analyst: Mark.Palmer)
MGIC INVESTMENT CORPORATION (MTG, Buy, $18.00 PT; Current Price: $10.72; 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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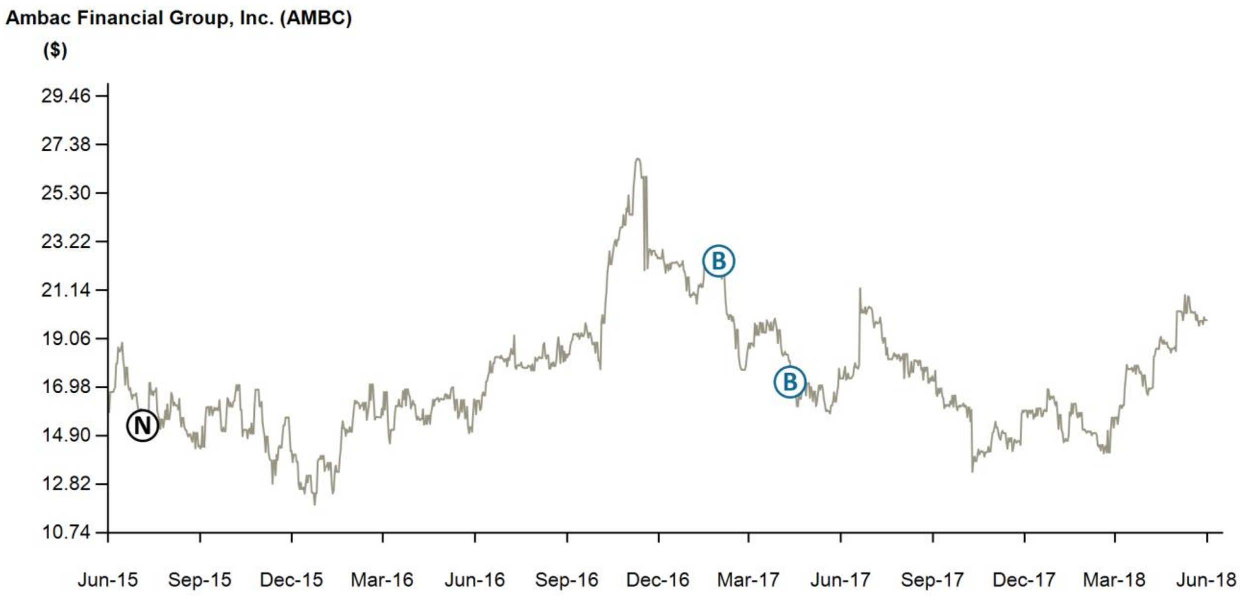
Company Valuation and Risk Disclosures

Ambac Financial Group, Inc. (AMBC, Buy, $26.00 PT)

Valuation: Our $26 price target for AMBC is based on a sum-of-the-parts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY19E.

Risks: The primary risks to achieving our recommendation and price target include the possibility that reserves against losses associated with RMBS and other insured instruments may prove inadequate, that fiscal stress of state and local governments could translate into increased losses, declines in value of investment portfolio could impede Ambac's ability to pay its liabilities and Ambac Assurance Corp. may be unable to exit rehabilitation.



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

Date	Closing Price ($)	Target Price ($)	Analyst	Rating
16-May-13	23.67	31	Mark Palmer	Buy
04-Mar-14	34.49	NA	Mark Palmer	Neutral
01-Mar-17	22.35	28	Mark Palmer	Buy
11-May-17	17.18	26	Mark Palmer	Buy

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 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

First Data Corporation (FDC, Buy, $27.00 PT)

Valuation: Our price target of $27 for FDC is based on 12x our FY19E adjusted EBITDA of $3,555mm. We believe the multiple we employ is appropriate as it represents a modest discount to FDC's faster-growing, less indebted peers in the payments space.

Risks: The primary risks to our thesis include: Competition, significant leverage and interest rate risks, the overhang associated with majority ownership, chargeback liability, security breaches, foreign exchange risks and consolidation of card-issuing banks.

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

Date	Closing Price ($)	Target Price ($)	Analyst	Rating
17-Nov-15	16.88	NA	Mark Palmer	Neutral
10-Feb-16	8.67	13	Mark Palmer	Buy
07-Mar-16	13.27	NA	Mark Palmer	Neutral
01-Aug-16	13.08	15	Mark Palmer	Buy
17-Nov-16	15.48	18	Mark Palmer	Buy
19-Jun-17	18.28	23	Mark Palmer	Buy
14-Jun-18	21.66	27	Mark Palmer	Buy

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Ambac Financial Group, Inc. (AMBC)

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Ambac Financial Group, Inc. (AMBC)

Other Disclosures

Additional Information Available Upon Request

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