

Equity Research

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Financials

MGIC Investment Corporation

With MTG in 'Falling Knife' Territory, 4Q15 Report an Opportunity for Mgmt to Rekindle Enthusiasm

While shares of MGIC Investment Corporation (MTG, Buy, \$12 PT) had already been reeling during 2H15, they took another leg lower in the new year amidst concerns about the U.S. housing market that were capped off by a disappointing 2016 existing-home sales outlook from the typically bullish National Association of Realtors (NAR).

MTG

12 month target

\$7.69

\$12.00

BUY

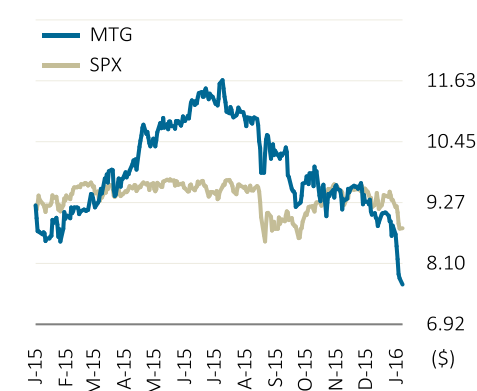
52 week range

\$7.69 - \$11.64

Market Cap (m)

\$3,377

Price Performance



Source: IDC

- ▶ So while MTG, which has lost more than a third of its market capitalization since July 2015, may appear to be a falling knife in the classic sense of that term, we still see ample reasons to grab it. And insofar as the decline has been driven by specific investor concerns, we view the company's upcoming 4Q15 report as a golden opportunity for management to address - and perhaps dismiss - such concerns, and to perhaps revive the enthusiasm that sent the stock vertical in 1H15.
- ▶ MTG, which has declined by almost 13% since the beginning of the year and by 33.9% since July 14, now trades at 1.21x the company's book value as of September 30, a level that is less than half the level at which the shares traded prior to the financial crisis.
- ▶ MTG is scheduled to report its 4Q15 results on Thursday, January 21 before the market open with a conference call scheduled for that day at 10am ET. We estimate that the company will report 4Q15 earnings per share of \$0.25 versus the consensus estimate of \$0.29. We note that the first quarter is typically a seasonally stronger quarter for MTG in terms of claim rate.
- ▶ **Valuation:** Our \$12 price target for MTG is based on 11.5x our 2017E earnings per share of \$1.01.

Estimates

	1Q14 A	2Q14 A	3Q14 A	4Q14 A	FY14 A	1Q15 A	2Q15 A	3Q15 A	4Q15 E	FY15 E	FY16 E
Net Income (Adj.)	133	114	823	118	1,187	90	100	92	95	376	435
Diluted EPS (Adj.)	0.15	0.11	0.17	0.17	0.61	0.32	0.28	0.29	0.25	1.14	0.89
BVPS (Ex-AOCI)	2.53	2.82	4.59	4.84	4.84	5.02	5.23	5.42	5.62	5.62	6.52

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

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Among the questions that we believe MTG management should address during the conference call are the following:

Mike Zimmerman, MTG's Vice President of Investor Relations, during the company's 3Q15 conference call said it expected the purchase market to grow in the 5%-8% range in 2016. The NAR this week released its estimate for a 1-2% increase in existing home sales for 2016, with Chief Economist Lawrence Yun citing rising mortgage rates, home prices still outpacing wages and "shaky" global economic conditions as headwinds. **Has MTG management reset its expectations for 2016 since it last offered guidance, on December 9?**

MTG CEO Patrick Sink during the company's 3Q15 conference call stated that the company had "positive momentum" with Fannie Mae and Freddie Mac with regard to increased risk sharing, a notion that was reiterated by the Federal Housing Finance Agency (FHFA) in the 2016 Scorecard it released on December 17. Sink added that such discussions had been in the second and, in some cases, third round between the company and the agency. **What is the current status of MTG's discussions with the FHFA regarding increased risk sharing?**

MTG management during the company's 3Q15 conference call stated that its discounting in the lender-paid mortgage insurance segment was the lowest among the industry's seven participants and that it nevertheless grew its market share by approximately 20bps during the quarter. **Has MTG demonstrated similar resilience in terms of market share in the face of competitive pressure during 4Q15? Has management seen increased competitive pressures emerge in the borrower-paid mortgage insurance space during the quarter given reports of a competitor's pilot program with such an intention in the space?**

After Edward DeMarco as interim head of the FHFA pushed to reduce the role of the U.S. government in the mortgage insurance industry, President Obama appointed to the role Mel Watt, who slowed that transition. **To what extent does MTG believe its future growth through 2021 will be tied to a Republican being elected President in 2016 and appointing a more private mortgage insurance-friendly head of the FHFA?**

MTG has stated that its estimate of normalized loss ratio was in the 20% context on a normalized basis. **Insofar as that estimate has been based on the environment in which the books were written, has the recent volatility changed management's outlook?**

MTG management has spoken in the past about the possibility of dividends from its insurance-writing subsidiaries to its holding company, which could translate into capital return to shareholders. **What is management's current thinking about such dividends and the potential for share buybacks and a common dividend?**

Income Statement

MGIC - Operating Model	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Dec-17
\$ Millions	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15E	2015E	1Q16E	2Q16E	3Q16E	4Q16E	2016E	2017E
Net premiums written	1,017.83	923.48	881.96	234.46	226.78	317.99	247.69	1,026.91	251.72	257.14	264.23	270.60	1,043.69	1,142.08
Increase in unearned premiums	15.34	19.57	(37.59)	(17.17)	(13.27)	(78.75)	(16.20)	(125.39)	(15.36)	(15.69)	(16.13)	(16.52)	(63.70)	(64.65)
Net premiums earned	1,033.17	943.05	844.37	217.29	213.51	239.23	231.49	901.52	236.36	241.44	248.11	254.08	979.99	1,077.44
Investment income	121.64	80.74	87.65	24.12	25.76	25.94	26.46	102.27	26.99	27.53	28.08	28.64	111.23	120.40
Realized investment gains	197.72	6.06	1.50	26.33	0.17	-	-	26.49	-	-	-	-	-	-
Total other than temporary losses	(2.31)	(0.33)	(0.14)	-	-	0.64	-	0.64	-	-	-	-	-	-
Proportion of losses recognized in other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net impairment losses recognized in earnings	(2.31)	(0.33)	(0.14)	-	-	0.64	-	0.64	-	-	-	-	-	-
Other revenue	28.15	9.91	8.42	2.48	3.70	3.70	3.73	13.61	3.81	3.85	3.89	3.93	15.47	15.94
Total revenues	1,378.36	1,039.44	941.80	270.22	243.13	269.51	261.68	1,044.53	267.15	272.82	280.07	286.64	1,106.69	1,213.77
Losses incurred	2,067.25	838.73	496.08	81.79	90.24	76.46	74.25	322.73	75.81	77.44	79.58	81.50	314.34	332.29
Change in premium deficiency reserve	(61.04)	(25.32)	(24.71)	(6.42)	(17.33)	-	-	(23.75)	(6.48)	(17.51)	-	-	(23.99)	(24.23)
Amortization of deferred policy acquisition costs	7.45	10.64	7.62	-	-	-	-	-	-	-	-	-	-	-
Other underwriting and operating expenses	194.00	181.88	138.44	41.03	37.88	48.44	46.02	173.36	46.14	46.25	46.37	46.48	185.24	187.10
Interest expense	99.34	79.66	69.65	17.36	17.37	17.36	17.36	69.46	17.36	17.36	17.36	17.36	69.45	69.45
Total losses and expenses	2,307.01	1,085.59	687.07	133.75	128.15	142.26	137.63	541.80	132.83	123.55	143.31	145.34	545.03	564.61
Income (loss) before income taxes	(928.64)	(46.15)	254.72	136.46	114.98	127.25	124.05	502.73	134.33	149.27	136.76	141.30	561.65	649.16
Provision for income taxes	(1.57)	3.70	2.77	3.39	1.32	(695.60)	6.20	(684.69)	44.33	49.26	45.13	46.63	185.35	214.22
Net income (loss)	(927.08)	(49.85)	251.95	133.08	113.65	822.85	117.84	1,187.43	90.00	100.01	91.63	94.67	376.31	434.94
Adjusted EPS	(\$4.59)	(\$0.16)	\$0.61	\$0.32	\$0.28	\$0.29	\$0.25	\$1.14	\$0.21	\$0.24	\$0.22	\$0.22	\$0.89	\$1.01
Diluted shares outstanding	201.89	311.75	413.55	468.14	439.15	468.15	468.62	461.01	469.09	469.55	470.02	470.49	469.79	471.67
Tax rate	0.2%	-8.0%	1.1%	2.5%	1.1%	-546.7%	5.0%	-136.2%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%
Book Value per diluted share	0.97	2.20	2.36	2.53	2.82	4.59	4.84	4.84	5.02	5.23	5.42	5.62	5.62	6.52
Average primary IIF	166,537.5	159,425.0	160,350.0	165,500.0	167,450.0	170,700.0	174,706.3	169,589.1	178,383.5	182,220.4	187,251.2	191,758.4	184,903.4	201,390.3
Total primary NIW	24,100.0	29,800.0	33,400.0	9,000.0	11,800.0	12,400.0	10,307.5	43,507.5	8,550.0	10,030.0	11,160.0	9,276.8	39,016.8	40,577.4
Average premium rate	0.62%	0.59%	0.53%	0.53%	0.51%	0.56%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.54%

Source: BTIG Research Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

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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

MGIC Investment Corporation (MTG, Buy)

Valuation: Our price target of \$12 for MTG is based on 11.5X our 2017E EPS of \$1.01

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.

Other Disclosures

Additional Information Available Upon Request

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