

NMI Holdings, Inc.

(NMIH, Buy, \$36.00 PT)

Impressive 3Q19 Print: Strong Earnings Beat, Record Origination Volume, 7.3% Q/Q Boost in Book Value; Reiterating Buy and \$36 PT

WHAT YOU SHOULD KNOW: Given the strong origination figures posted by NMI Holdings' (NMIH) private mortgage insurance (PMI) peers thus far in 3Q19 against a favorable backdrop of lower interest rates and a low unemployment rate, it was not surprising that the company also posted very solid results during the quarter. Yet the 3Q19 report that NMIH released today after the market close nevertheless exceeded that raised bar in several respects. As such, we believe that the company's shares, which have traded up by more than 63% this year, will be given fresh fuel by the better-than-expected print.

- NMIH reported 3Q19 adjusted earnings per share of \$0.71, exceeding the consensus estimate of \$0.62 and our estimate of \$0.65. The beat was facilitated by an 11% sequential increase in net premiums earned to \$92.4mm, outpacing the consensus estimate of \$88.5mm and our estimate of \$89.2mm. While pretty much all the metrics the company posted during the quarter were impressive, standing out was its adjusted ROE of 23.7%.
- Originations reached record levels as NMIH posted \$14.1bn in new insurance written (NIW), up from the strong \$12.2bn level it achieved in the prior quarter. The company's insurance in force (IIF) – the primary source of its revenue and earnings – was \$89.7bn as of September 30, up 10% sequentially and 41% versus the prior year period, an increase that occurred despite a decline in annual persistency to 82.4% versus 86.0% in 2Q19. NMIH's book value per share jumped during 3Q19 by 7.3% sequentially to \$12.86.
- Management during NMIH's conference call noted that the company's increased revenue during 3Q19 – \$101.6mm, up 42% year-over-year, and better than the consensus estimate of \$96.7mm and our estimate of \$97.0mm – was due to a combination of new customers added to its platform as well as an increase in wallet share. They said they believed NMIH's adoption of risk-based pricing – it rolled out its pricing engine, Rate GPS, last June – had helped it to get to market faster and thereby drive volumes. Meanwhile, NMIH continued to benefit from benign credit and expense control as seen in the decline in its combined ratio to 38.8% in 3Q19 from 48.1% in the prior year period. The company's expense ratio was down to 36.0% during 3Q19 from 48.1% in 3Q18, and its loss ratio remained low at 2.8% while increasing from 1.7% in the prior year period.
- **We are reiterating our Buy recommendation on NMIH and price target of \$36 based on 10x our FY21E adjusted earnings per share of \$3.60.** We view NMIH shares as inexpensive at 8.3x the consensus FY21E adjusted EPS, especially considering the company's removal of virtually all of its tail risk through the use of insurance linked notes (ILNs) and reinsurance. We believe NMIH's Investor Day, slated for November 21 in New York City, could lend further support to the company's valuation, as it is likely to include a demonstration of its projected resiliency in the face of a potential economic downturn given the positive impact of ILNs and reinsurance.
- **Valuation:** Our \$36 price target for NMIH is based on 10x our FY21E adjusted EPS estimate of \$3.60. The multiple we employ is based on comparable company analysis.



November 6, 2019

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COMPANY DATA	
Closing Price:	\$29.12
Price Target:	\$36.00
Market Cap (\$M):	2,042.39
Shares Out (M):	70.1
Avg Daily Vol - 3 Months (M):	0.27
Dividend/Yield:	\$0.00/0.0%

REVISIONS		
	Previous	Current
Rating	Buy	Buy
Price Target	\$36.00	\$36.00
FY19E EPS	\$2.47	\$2.54
FY20E EPS	\$3.15	\$3.13
FY19E Rev. (M)	\$369.67	\$375.79

Diluted EPS (Adjusted)			
FY Dec	2018A	2019E	2020E
Q1	0.34	0.56	0.75
Q2	0.40	0.59	0.74
Q3	0.46	0.71	0.78
Q4	0.46	0.71	0.85
Calendar EPS	1.67	2.54	3.13
Calendar P/E	17.4x	11.4x	9.3x

REVENUE (\$M)			
FY Dec	2018A	2019E	2020E
Q1	59.55	81.11	104.78
Q2	67.45	91.18	108.60
Q3	71.76	101.59	113.65
Q4	76.26	101.92	117.54
FY	275.03	375.79	444.58

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

Investment Thesis

We believe NMIH is poised to trade higher due in part to the company's early adoption of the use of insurance-linked notes (ILNs) and reinsurance as a means of reducing its exposure to the boom-and-bust cycles that the PMIs have historically faced. NMIH was also the first company in the group to introduce a risk-based pricing engine – Rate GPS – that it rolled out last June, enabling it to actively shape the credit mix of its new production. The positive impacts of these innovations are not yet reflected in NMIH's valuation, in our view.

Upcoming Catalysts

- Additional removal of tail risk through use of ILNs and reinsurance.
- Potential actions by U.S. government to reduce its footprint in the mortgage insurance space, including program enabling NMIH and its private mortgage insurance (PMI) peers to offer deep cover mortgage insurance.
- CFPB's issuance of a workable replacement for the current Qualified Mortgage patch based on borrowers' debt-to-income ratios.
- Investor Day to be held on November 21.

Base Case Assumptions

- Our price target of \$36 for NMIH is based on 10x our FY21E adjusted earnings per share of \$3.60.
- NMIH continues to execute on its business strategy and further enhances its position in the U.S. PMI space.

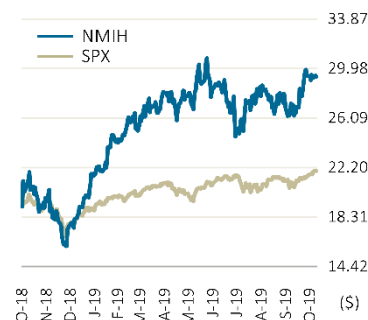
Upside Scenario

- An uptick in U.S. household formation results in increasing demand for NMIH's mortgage insurance, while sustained low unemployment fosters further improvement in the company's credit profile.
- The U.S. government announces plans to allow NMIH and its PMI peers to offer deep-cover mortgage insurance, providing a boost to their volumes of new insurance written (NIW). The stock trades up to \$40.

Downside Scenario

- A U.S. economic slowdown results in significantly reduced demand for NMIH's mortgage insurance while causing deterioration in the company's credit metrics.
- The U.S. government opts to hold back on initiatives that would result in increased market share for NMIH and its PMI peers. The stock trades down to \$20.

Price Performance



Source: IDC

Company Description

NMI Holdings, Inc. (Nasdaq: NMIH) provides private mortgage guaranty insurance through its insurance subsidiaries. NMIH's primary mortgage insurance provides mortgage default protection on individual loans at specified coverage percentages. The company serves national and regional mortgage banks, money-center banks, credit unions, community banks, builder-owned mortgage lenders, Internet-sourced lenders, and other non-bank lenders.

- NMIH during 3Q19 added 23 new customers that management estimated to represent about \$700mm in potential NIW for the company.
- Management said they believed the adjusted ROE of 23.7% that NMIH posted during 3Q19 may have been the highest level achieved by a PMI in that metric during the post-crisis period. They said the achievement of that level was an outcome of the work the company had done across its operations including credit risk management and an improved funding profile.
- Management said the boost that NMIH and its PMI peers had received from an increased penetration of mortgage insurance in refinancings— estimated penetration of 11% during 3Q19 was 2-3x what has been typical – could continue through the end of the year but was likely to end during 1H20 when most of those who could still benefit from refinancing will have taken advantage of the opportunity afforded by lower interest rates. With that said, they were encouraged by the penetration of mortgage insurance in the purchase market which had increased to an estimated 25.5% during 3Q19 from 22.5% in 4Q18.
- Management estimated that the PMI industry would generate \$375mm to \$400mm in NIW in 2019, adding that they expected 2020 to also be a strong year for the industry with the extent of that strength to depend in large part on the level of interest rates.

Income Statement

NMIH - Operating Model	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21
\$ Millions	2013A	2014A	2015A	2016A	2017A	1Q18A	2Q18A	3Q18A	4Q18A	2018A	1Q19A	2Q19A	3Q19A	4Q19E	2019E	1Q20E	2Q20E	3Q20E	4Q20E	2020E	2021E
Net premiums earned	2.1	13.4	45.5	110.5	165.7	54.9	61.6	65.4	69.3	251.2	73.9	83.2	92.4	93.8	343.3	96.4	100.0	104.8	108.4	409.6	458.7
Net investment income	4.8	5.6	7.2	13.8	16.3	4.6	5.7	6.3	7.0	23.5	7.4	7.6	7.9	8.1	31.0	8.4	8.6	8.9	9.1	35.0	39.4
Net realized investment gains	0.2	0.2	0.8	(0.7)	0.2	-	0.1	(0.0)	0.0	0.1	(0.2)	(0.1)	0.1	-	(0.2)	-	-	-	-	-	-
Other revenues	(1.5)	3.0	1.9	0.3	0.5	0.1	0.0	0.1	0.0	0.2	0.0	0.4	1.2	-	1.7	-	-	-	-	-	-
Total revenues	5.6	22.2	55.5	123.8	182.7	59.6	67.5	71.8	76.3	275.0	81.1	91.2	101.6	101.9	375.8	104.8	108.6	113.6	117.5	444.6	498.1
Insurance claims and claims expense	-	0.1	0.7	2.4	5.3	1.6	0.6	1.1	2.1	5.5	2.7	2.9	2.6	3.5	11.7	3.7	3.9	4.2	4.5	16.4	19.2
Amortization of deferred policy acquisition costs	0.0	0.4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Underwriting and operating expenses	60.7	73.0	80.6	93.2	107.0	28.5	29.0	30.4	29.4	117.2	30.8	32.5	33.2	30.6	127.2	31.8	33.5	34.2	31.5	131.0	134.9
Total expenses	60.7	73.5	81.2	95.6	112.3	30.0	29.7	31.5	31.5	122.7	33.6	35.5	35.8	34.0	138.9	35.5	37.5	38.5	36.0	147.4	154.1
Gain (loss) from change in fair value of warrant liability	(1.5)	2.9	1.9	0.6	(3.4)	0.4	0.1	(5.5)	3.5	(1.4)	(5.5)	(1.7)	1.1	-	(6.0)	-	-	-	-	-	-
Other expense	-	-	(2.1)	(17.4)	(14.2)	(3.4)	(5.6)	(3.0)	(3.0)	(15.0)	(3.1)	(3.1)	(3.0)	(3.0)	(12.1)	(3.0)	(3.0)	(3.0)	(3.1)	(12.1)	(12.4)
Income (loss) before income taxes	(56.7)	(48.3)	(25.9)	11.5	52.8	26.5	32.3	31.8	45.2	136.0	39.0	51.0	63.9	64.9	218.8	66.3	68.1	72.1	78.5	285.1	331.5
Income tax expense (benefit)	-	(2.4)	-	(54.4)	30.7	4.2	7.1	7.0	9.7	28.0	6.1	11.9	14.2	14.9	47.0	13.3	15.7	16.6	18.1	63.6	73.9
Net income (loss)	(56.7)	(46.0)	(25.9)	65.8	22.0	22.4	25.2	24.8	35.5	108.0	32.9	39.1	49.8	50.0	171.7	53.1	52.5	55.5	60.4	221.5	257.6
Diluted EPS	(1.01)	(0.79)	(0.44)	0.19	0.60	0.34	0.40	0.46	0.46	1.67	0.56	0.59	0.71	0.71	2.54	0.75	0.74	0.78	0.85	3.13	3.60
Diluted shares outstanding	56.01	58.28	58.70	60.09	63.03	65.70	68.62	68.84	69.01	68.04	69.00	69.59	70.14	70.31	69.76	70.49	70.66	70.84	71.02	70.75	71.46
New insurance written	158	3,451	12,242	21,191	21,585	6,460	6,513	7,361	6,962	27,296	6,913	12,179	14,100	6,997	40,189	7,155	9,134	9,870	7,242	33,401	34,403
Insurance in force	162	3,370	14,595	32,168	48,465	53,434	58,089	66,501	71,452	71,452	76,072	84,466	92,381	95,221	95,221	97,615	101,868	106,645	108,554	108,554	120,344
Book value	463.2	427.0	402.7	477.3	509.1	601.9	629.6	660.5	701.5	701.5	751.9	812.4	873.5	923.5	923.5	976.5	1,029.0	1,084.5	1,145.0	1,145.0	1,402.6
Book value per share	8.27	7.33	6.84	7.80	8.00	9.16	9.18	9.59	10.16	10.16	10.90	11.67	12.45	13.13	13.13	13.85	14.56	15.31	16.12	16.12	19.55

Source: BTIG Estimates and Company Documents



BTIG Covered Companies Mentioned in this Report

NMI HOLDINGS, INC. (NMIH, Buy, \$36.00 PT; Current Price: \$29.12; 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.

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Company Valuation and Risk Disclosures

NMI Holdings, Inc. (NMIH, Buy, \$36.00 PT)

Valuation: Our \$36 price target for NMIH is based on 10x our FY21E adjusted EPS estimate of \$3.60. The multiple we employ is based on comparable company analysis.

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

NMI Holdings, Inc. (NMIH)



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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
07-Apr-15	7.48	10	Mark Palmer	Buy
01-Nov-16	7.65	11	Mark Palmer	Buy
05-Jan-17	10.55	13	Mark Palmer	Buy
02-Nov-17	16.50	17	Mark Palmer	Buy
20-Dec-17	17.75	21	Mark Palmer	Buy
27-Feb-18	19.95	26	Mark Palmer	Buy
12-Feb-19	22.60	28	Mark Palmer	Buy
01-May-19	27.84	33	Mark Palmer	Buy
31-Jul-19	24.88	36	Mark Palmer	Buy

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