

## Equity Research

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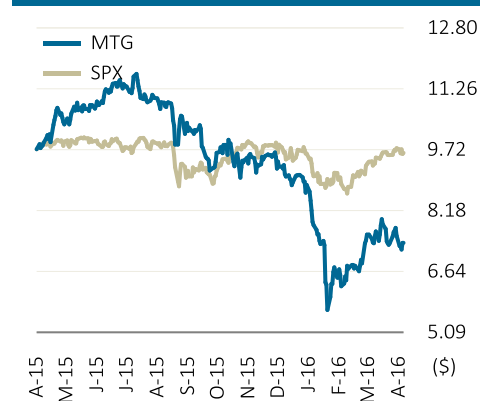
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**MTG** **\$7.36**  
12 month target \$12.00

### BUY

52 week range \$5.66 - \$11.64  
Market Cap (m) \$3,232

#### Price Performance



Source: IDC

## Financials

### MGIC Investment Corporation

#### MTG Seeks to Extend Shares' Recovery from January Swoon with 1Q16 Report, But Where Are Catalysts?

Shares in MGIC Investment Corporation (MTG, Buy, \$12 PT) had already been in free fall for several weeks amidst a broad market pullback when CEO Pat Sinks on January 21 told investors listening to the company's 4Q15 conference call that MTG likely would write less insurance in 2016 versus the prior year due to the new, flatter rate card it introduced in response to competitive pricing pressures and tighter capital rules. After the first three and a half weeks of the year, MTG shares had fallen by almost 35% and traded at just 0.86x the company's YE15 book value.

- ▶ Since then, MTG has bounced by 27% and the shares again trade north of book value. Such volatility is the backdrop as the company prepares to report its 1Q16 results. Much less volatile have been MTG's monthly operating statistics during the first three months of the year as insurance in force has grown between 5.4% and 5.6% each month – in line with what Sinks had projected during the 4Q15 call when he announced the new card with a higher average premium rate aimed at generating after-tax returns in the mid-teens.
- ▶ Moreover, MTG's delinquent inventory has continued to decline at a clip of greater than 20% year-over-year. While there has been much focus on the potential impact on new business volumes of the new rate card the company introduced in January in response to higher capital charges mandated by the GSEs and price competition, the run-off of its pre-2009 books of business and the resulting lower level of incurred losses remains a key driver of its profitability.
- ▶ Based on statistics from the Mortgage Bankers Association, mortgage activity played out through 1Q16 as Sinks in January had said he expected, with refinances lower versus the prior year and purchase transactions higher.
- ▶ **Valuation:** Our price target of \$12 for MTG is based on 11.5X our 2017E EPS of \$1.05.

## Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 E	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Net Income (Adj.)	95	105	96	99	396	109	119	110	113	451	481
Diluted EPS (Adj.)	0.32	0.28	0.29	0.24	1.13	0.23	0.25	0.23	0.23	0.94	1.05
BVPS (Ex-AOCI)	5.01	5.23	5.43	5.63	5.63	5.86	6.11	6.33	6.57	6.57	7.51

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

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

- ▶ That bodes well for U.S. private mortgage insurers (PMIs) such as MTG insofar as its market share for purchase loans is about four times higher than its share of refinances.
- ▶ We believe the impacts of the U.S. PMI “rate war” and the new capital charges on MTG’s new business prospects for 2016 are largely baked into its share price at this point, which then begs the question of what it would take for the stock to continue its recent momentum. While a meaningfully better-than-expected U.S. housing market or merger and acquisition activity that helped to ease the extent of price competition in the space could give MTG another leg up, we wouldn’t assign a high probability to either in the near term.
- ▶ We believe the most significant source of optionality for MTG and its peers right now is the potential for the Federal Housing Finance Agency (FHFA) and the GSEs to take action such that the U.S. government would share more risk with the PMIs going forward. While the FHFA continues to pay lip service to the idea of increased risk sharing, we have yet to see follow-through that would significantly increase the PMIs’ share of the U.S. mortgage insurance market.
- ▶ As such, any signal from the FHFA that the likelihood of meaningful risk-sharing action is increasing likely would refocus investors on the upside case for MTG. It was the enthusiasm engendered by that upside case that helped MTG shares to trade at about 1.7x book value last July.
- ▶ MTG is scheduled to report its 1Q16 results on Tuesday, April 19 before the market open with a conference call slated for 10am ET on that day. We estimate that MTG will report 1Q16 earnings per share of \$0.23 versus the consensus estimate of \$0.22.

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

- ▶ Sinks during the 4Q15 call said MTG had been having ongoing talks with its Wisconsin regulator, the OCI, to pay quarterly dividends, adding that he hoped to gain approval for special dividends in the very near term. What is the status of MTG’s efforts to receive permission to initiate dividends? How should investors think about the potential size of these dividends?
- ▶ While announcing MTG’s new rate card, Sinks said the company expected less business among borrowers with lower FICO scores due to its higher prices such that they could purchase mortgage insurance less expensively through the FHA. He suggested that MTG’s customer service and the ability of borrowers to cancel coverage bought from the company – an option not available through the FHA – could help it to retain some of that lower-FICO business despite the price differential. Has the shift of some lower-FICO borrowers to the FHA occurred since the introduction of the new rate card to the extent that Sinks had projected?

- ▶ The 2016 FHFA Scorecard required the agency to analyze and assess front-end risk sharing. MTG management during the 4Q15 call indicated that it had been engaged in discussions with the FHFA and GSEs about deeper coverage mortgage insurance both as a company and through the PMIs' trade association. Has the FHFA given management any indication it is willing to take action toward such an end, if only in the form of a pilot program?
- ▶ Management noted that about 6% of MTG's portfolio risk is focused on Texas, with about 2% focused on Houston, adding that they had seen no signs of credit deterioration in these markets due to the impact of lower energy prices through the third week in January. Has management seen any deterioration in its insured exposures to those markets since the company's 4Q15 report?

## 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	4Q15A	2015A	1Q16E	2Q16E	3Q16E	4Q16E	2016E	2017E
<b>Net premiums written</b>	<b>1,017.83</b>	<b>923.48</b>	<b>881.96</b>	<b>234.46</b>	<b>226.78</b>	<b>317.99</b>	<b>241.06</b>	<b>1,020.28</b>	<b>248.70</b>	<b>253.97</b>	<b>259.88</b>	<b>265.17</b>	<b>1,027.71</b>	<b>1,116.77</b>
Increase in unearned premiums	15.34	19.57	(37.59)	(17.17)	(13.27)	(78.75)	(14.87)	(124.06)	(15.18)	(15.50)	(15.86)	(16.18)	(62.72)	(63.21)
<b>Net premiums earned</b>	<b>1,033.17</b>	<b>943.05</b>	<b>844.37</b>	<b>217.29</b>	<b>213.51</b>	<b>239.23</b>	<b>226.19</b>	<b>896.22</b>	<b>233.52</b>	<b>238.47</b>	<b>244.01</b>	<b>248.98</b>	<b>964.99</b>	<b>1,053.56</b>
Investment income	121.64	80.74	87.65	24.12	25.76	25.94	27.93	103.74	28.48	29.05	29.64	30.23	117.40	127.08
Realized investment gains	197.72	6.06	1.50	26.33	0.17	-	1.23	27.72	-	-	-	-	-	-
Total other than temporary losses	(2.31)	(0.33)	(0.14)	-	-	0.64	-	0.64	-	-	-	-	-	-
Proston of losses recognized in other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Net impairment losses recognized in earnings</b>	<b>(2.31)</b>	<b>(0.33)</b>	<b>(0.14)</b>	<b>-</b>	<b>-</b>	<b>0.64</b>	<b>-</b>	<b>0.64</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Other revenue	28.15	9.91	8.42	2.48	3.70	3.70	2.58	12.46	2.63	2.66	2.68	2.71	10.69	11.01
<b>Total revenues</b>	<b>1,378.36</b>	<b>1,039.44</b>	<b>941.80</b>	<b>270.22</b>	<b>243.13</b>	<b>269.51</b>	<b>257.93</b>	<b>1,040.78</b>	<b>264.63</b>	<b>270.19</b>	<b>276.33</b>	<b>281.92</b>	<b>1,093.08</b>	<b>1,191.65</b>
Losses incurred	2,067.25	838.73	496.08	81.79	90.24	76.46	95.07	343.55	74.90	76.49	78.27	79.86	309.52	324.93
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	-	-	-	-	-	-	-	-	-	-	-
Underwriting and operating expenses	194.00	181.88	138.44	41.03	37.88	48.44	37.02	164.37	37.12	37.21	37.30	37.39	149.02	150.52
Interest expense	99.34	79.66	69.65	17.36	17.37	17.36	16.84	68.93	16.84	16.84	16.84	16.84	67.34	67.34
<b>Total losses and expenses</b>	<b>2,307.01</b>	<b>1,085.59</b>	<b>687.07</b>	<b>133.75</b>	<b>128.15</b>	<b>142.26</b>	<b>148.92</b>	<b>553.09</b>	<b>122.37</b>	<b>113.03</b>	<b>132.41</b>	<b>134.09</b>	<b>501.90</b>	<b>518.56</b>
<b>Income (loss) before income taxes</b>	<b>(928.64)</b>	<b>(46.15)</b>	<b>254.72</b>	<b>136.46</b>	<b>114.98</b>	<b>127.25</b>	<b>109.00</b>	<b>487.69</b>	<b>142.26</b>	<b>157.16</b>	<b>143.93</b>	<b>147.83</b>	<b>591.18</b>	<b>673.09</b>
Provision for income taxes	(1.57)	3.70	2.77	3.39	1.32	(695.60)	6.58	(684.31)	46.95	51.86	47.50	48.78	195.09	222.12
<b>Net income (loss)</b>	<b>(927.08)</b>	<b>(49.85)</b>	<b>251.95</b>	<b>133.08</b>	<b>113.65</b>	<b>822.85</b>	<b>102.42</b>	<b>1,172.00</b>	<b>95.32</b>	<b>105.30</b>	<b>96.43</b>	<b>99.05</b>	<b>396.09</b>	<b>450.97</b>
<b>Adjusted EPS</b>	<b>(\$4.59)</b>	<b>(\$0.16)</b>	<b>\$0.61</b>	<b>\$0.32</b>	<b>\$0.28</b>	<b>\$0.29</b>	<b>\$0.24</b>	<b>\$1.13</b>	<b>\$0.23</b>	<b>\$0.25</b>	<b>\$0.23</b>	<b>\$0.23</b>	<b>\$0.94</b>	<b>\$1.05</b>
Diluted shares outstanding	201.89	311.75	413.55	468.14	439.15	468.15	467.95	460.85	468.42	468.89	469.35	469.82	469.12	471.00
Tax rate	0.2%	-8.0%	1.1%	2.5%	1.1%	-546.7%	5.0%	-140.3%	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	4.81	4.81	5.01	5.23	5.43	5.63	5.63	6.57
Average primary IIF	166,537.5	159,425.0	160,350.0	165,500.0	167,450.0	170,700.0	173,550.0	169,300.0	176,240.0	179,979.9	184,161.7	187,912.0	182,073.4	196,926.8
Total primary NIW	24,100.0	29,800.0	33,400.0	9,000.0	11,800.0	12,400.0	9,800.0	43,000.0	8,820.0	9,440.0	9,920.0	8,820.0	37,000.0	38,480.0
Average premium rate	0.62%	0.59%	0.53%	0.53%	0.51%	0.56%	0.52%	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, 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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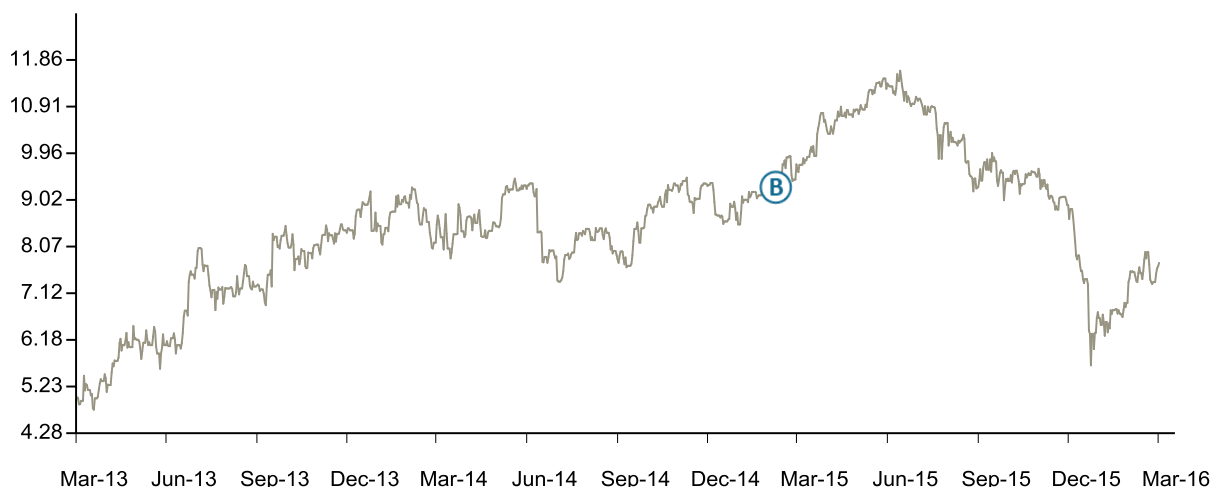
#### MGIC Investment Corporation (MTG, Buy)

**Valuation:** Our price target of \$12 for MTG is based on 11.5X our 2017E EPS of \$1.05

**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

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