

Equity Research

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MTG

12 month target

\$7.79

\$12.00

BUY

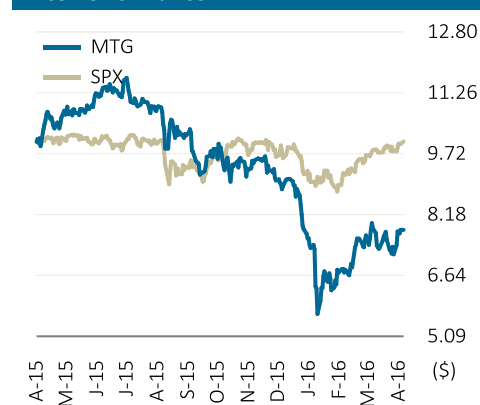
52 week range

\$5.66 - \$11.64

Market Cap (m)

\$3,421

Price Performance



Source: IDC

Financials

MGIC Investment Corporation

While Higher Losses Drive 1Q16 Earnings Miss, Credit Remains Benign and MTG Shares Remain Inexpensive

An ironic aspect of the MGIC Investment Group (MTG, Buy, \$12 PT) story is that unlike its private mortgage insurance (PMI) peers with no legacy exposures from 2005-2008, the company's profitability is not only a function of the amount of new insurance written (NIW) it can generate. The company is positioned to report improved operating results as its legacy portfolio runs off and new business written post-2008 under more stringent underwriting standards becomes a larger portion of its total insured exposures.

- ▶ MTG management during the company's 1Q16 conference call explained that given its decision to revise its rate structure and thereby cede some lower FICO business to the FHA, the company would write a "modestly" lower volume of business during 2016 versus the prior year while still growing its in-force portfolio in the single digits. As such, the boost to profitability associated with the run-off of MTG's older books became that much more important.
- ▶ So when MTG this morning reported \$8.3bn in NIW in 1Q16, down from \$9bn in the prior year period, the decline was somewhat larger-than-expected but not entirely unanticipated. However, the \$85mm in losses the company reported during the quarter was up from \$81.8mm in 1Q15. The consequence was that MTG posted 1Q16 earnings per share of \$0.17, trailing the consensus estimate of \$0.22 and our estimate of \$0.23.
- ▶ **We are reiterating our Buy recommendation on MTG and price target of \$12** based on 11x our 2018E earnings per share of \$1.11. Despite the modest 1Q16 setback, we believe the stock is inexpensive at 1.08x book value and that an improving portfolio mix should continue to drive higher profitability going forward.
- ▶ **Valuation:** Our price target of \$12 for MTG is based on 11X our 2018E EPS of \$1.11.

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Net Income (Adj.)	69	83	87	89	328	96	98	103	105	403	464
Diluted EPS (Adj.)	0.32	0.28	0.29	0.24	1.13	0.17	0.20	0.21	0.22	0.80	0.97
BVPS (Ex-AOCI)	5.43	5.62	5.83	6.03	6.03	6.25	6.47	6.70	6.94	6.94	7.93

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

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

- ▶ We note that MTG during 1Q15 had benefitted from a \$22mm reduction in losses due to positive development on its primary loss reserves, while its equivalent reduction during 1Q16 was just \$5mm. Hence, we do not see an evolving credit problem at the company: losses net of reserve changes declined due to fewer new delinquency notices. We think we and the Street simply got a bit ahead of our skis with regard to the pace of MTG's loss reduction.
- ▶ While MTG's NIW declined year-over-year, its insurance in force increased by 5.4% versus the prior year period to \$175bn. That result was in line with management's projection during the 4Q15 call when they announced a new rate card with a higher average premium rate aimed at generating after-tax returns in the mid-teens.
- ▶ MTG announced that it had received approval from its Wisconsin regulator, the OCI, to pay a special quarterly dividend of \$16mm during 1Q16. Management said that while such dividends remain characterized as "special," they expect similarly sized quarterly dividends going forward.
- ▶ Management said about 3,000 of the loans it insures would be subject to the FHFA's new principal reduction modification program, but they declined to estimate the potential impact of the program on its reserves.
- ▶ MTG said its market share at the end of 1Q16 was in the 19-20% range.
- ▶ MTG's book value per share increased by \$0.30 during 1Q16 to \$6.88.

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	Dec-18
\$ Millions	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16A	2Q16E	3Q16E	4Q16E	2016E	2017E	2018E
Net premiums written	1,017.83	923.48	881.96	234.46	226.78	317.99	241.06	1,020.28	231.28	241.26	246.28	250.79	969.61	1,067.63	1,131.24
Increase in unearned premiums	15.34	19.57	(37.59)	(17.17)	(13.27)	(78.75)	(14.87)	(124.06)	(9.94)	(11.49)	(11.73)	(11.94)	(45.10)	(50.84)	(53.87)
Net premiums earned	1,033.17	943.05	844.37	217.29	213.51	239.23	226.19	896.22	221.34	229.77	234.55	238.85	924.51	1,016.79	1,077.37
Investment income	121.64	80.74	87.65	24.12	25.76	25.94	27.93	103.74	27.81	28.37	28.93	29.51	114.62	127.17	136.22
Realized investment gains	197.72	6.06	1.50	26.33	0.17	-	1.23	27.72	3.06	-	-	-	3.06	-	-
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	2.58	12.46	6.37	2.55	2.57	2.60	14.10	10.56	10.88
Total revenues	1,378.36	1,039.44	941.80	270.22	243.13	269.51	257.93	1,040.78	258.58	260.69	266.06	270.96	1,056.28	1,154.51	1,224.46
Losses incurred	2,067.25	838.73	496.08	81.79	90.24	76.46	95.07	343.55	85.01	83.96	83.44	84.97	337.39	340.44	335.41
Change in premium deficiency reserve	(61.04)	(25.32)	(24.71)	(6.42)	(17.33)	-	-	(23.75)	-	-	-	-	-	-	-
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	41.74	41.84	41.95	42.05	167.58	169.26	172.03
Loss on extinguishment of debt	-	-	-	-	-	-	-	-	13.44	-	-	-	13.44	-	-
Interest expense	99.34	79.66	69.65	17.36	17.37	17.36	16.84	68.93	14.70	11.00	11.00	11.00	47.70	44.00	44.00
Total losses and expenses	2,307.01	1,085.59	687.07	133.75	128.15	142.26	148.92	553.09	154.89	136.80	136.39	138.03	566.11	553.70	551.44
Income (loss) before income taxes	(928.64)	(46.15)	254.72	136.46	114.98	127.25	109.00	487.69	103.69	123.89	129.66	132.93	490.17	600.81	673.03
Provision for income taxes	(1.57)	3.70	2.77	3.39	1.32	(695.60)	6.58	(684.31)	34.50	40.88	42.79	43.87	162.04	198.27	208.64
Net income (loss)	(927.08)	(49.85)	251.95	133.08	113.65	822.85	102.42	1,172.00	69.19	83.01	86.87	89.06	328.14	402.54	464.39
Adjusted EPS	(\$4.59)	(\$0.16)	\$0.61	\$0.32	\$0.28	\$0.29	\$0.24	\$1.13	\$0.17	\$0.20	\$0.21	\$0.22	\$0.80	\$0.97	\$1.11
Diluted shares outstanding	201.89	311.75	413.55	468.14	439.15	468.15	467.95	460.85	431.37	431.37	431.37	431.37	431.37	432.44	435.81
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%	33.1%	33.0%	31.0%
Book Value per diluted share	0.97	2.20	2.36	2.53	2.82	4.59	4.78	4.78	5.43	5.62	5.83	6.03	6.03	6.94	7.93
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	174,750.0	176,749.0	180,421.6	183,728.0	178,912.1	191,846.7	203,277.3
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	8,300.0	8,850.0	9,300.0	8,330.0	34,780.0	36,519.0	37,979.8
Average premium rate	0.62%	0.59%	0.53%	0.53%	0.51%	0.56%	0.52%	0.53%	0.51%	0.52%	0.52%	0.52%	0.52%	0.53%	0.53%

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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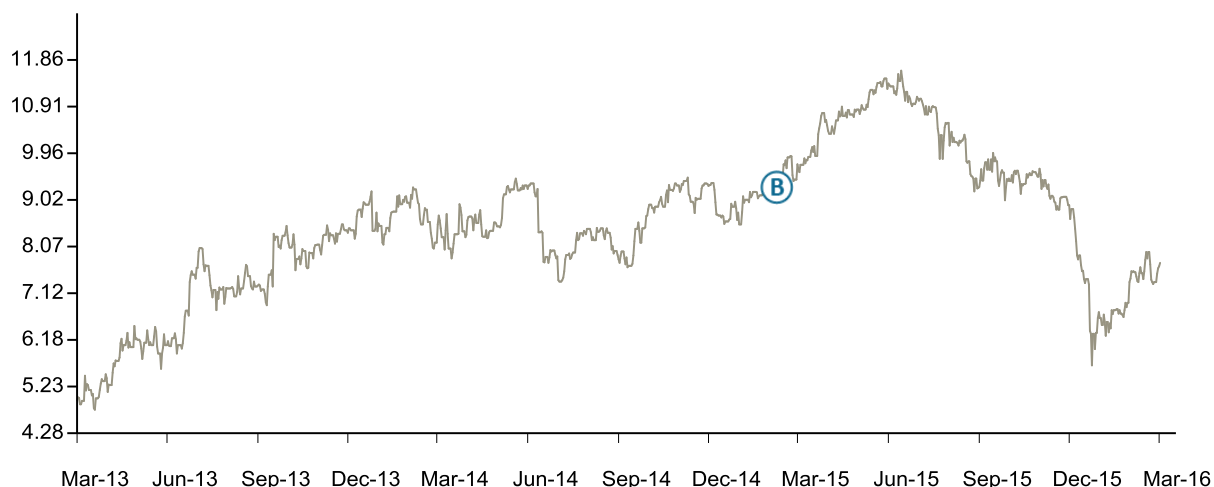
MGIC Investment Corporation (MTG, Buy)

Valuation: Our price target of \$12 for MTG is based on 11X our 2018E EPS of \$1.11.

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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