

Equity Research

July 19, 2016

Mark Palmer

(212) 588-6582

mpalmer@btig.com

Giuliano Bologna

gbologna@btig.com (212) 588-6583

Financials

MGIC Investment Corporation

Emphatic 2Q16 Earnings Beat Paced by Strong Premium Growth Highlights MTG's Discount Valuation

While a wholesale revival of MGIC Investment Corporation's (MTG) stock price is likely to require some follow-through from the U.S. government in its promises to cede a much more significant portion of the mortgage insurance space to private insurers, the much-stronger-than-expected 2Q16 results that the company reported this morning should serve as a reminder to investors of the company's potential, particularly in light of its discount valuation.

MTG

\$6.38

12 month target

\$12.00

BUY

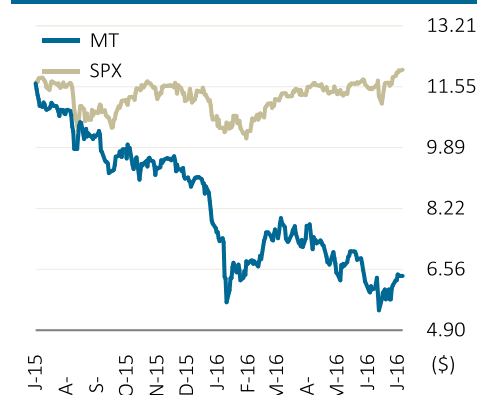
52 week range

\$5.44 - \$11.12

Market Cap (m)

\$2,802

Price Performance



Source: IDC

- ▶ MTG reported 2Q16 earnings per share of \$0.26, outpacing the consensus estimate (and our estimate) of \$0.20 and providing confirmation of media reports that emerged last week of particularly strong volumes in the private mortgage insurance (PMI) industry during the quarter.
- ▶ The earnings beat was facilitated by net written premiums of \$250.0mm versus our estimate of \$241.3mm and \$213.5mm in the prior-year period. Revenues of \$263.5mm exceeded the consensus estimate of \$254.6mm and our bullish estimate of \$260.1mm, as expectations had been lowered by MTG's 1Q16 earnings miss. Those tepid expectations for MTG's 2Q16 operating results were reflected in its valuation, as even with a 7.1% sequential increase in the company's book value per share to \$7.37 at June 30 the stock still trades at just 0.87x book.
- ▶ **We are reiterating our Buy recommendation on MTG and price target of \$12** based on 11x our 2018E earnings per share of \$1.11. While persistent buzz about a potential FHA mortgage insurance rate cut may serve as a near-term headwind to the stock, we believe MTG's 2Q16 performance demonstrated that it remains a solid franchise and that its stock represents an interesting source of optionality.
- ▶ **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 A	3Q16 E	4Q16 E	FY16 E	FY17 E
Net Income (Adj.)	69	109	92	94	365	98	102	107	111	418	482
Diluted EPS (Adj.)	0.32	0.28	0.29	0.24	1.13	0.17	0.26	0.22	0.22	0.87	0.98
BVPS (Ex-AOCI)	5.43	5.63	5.84	6.05	6.05	6.26	6.48	6.72	6.96	6.96	7.95

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

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

- ▶ Credit remained benign and remains a driver of increased profitability given the positive mix shift within MTG's insured portfolio. Losses incurred during 2Q16 were \$46.6mm, down from \$90.2mm in the prior year period, with that result aided by a \$55mm decline in losses stemming from positive development in primary loss reserves versus \$22mm in positive development in 2Q15. Delinquencies declined to 5.3% of loans in 2Q16 versus 6.3% at YE15 and 6.8% in the prior-year period.
- ▶ MTG confirmed that during 1Q16 it had paid a \$16mm dividend to its holding company from its insurance-writing subsidiary after receiving approval from its regulators. Combined with the \$16mm dividend for which the company received approval and paid in 1Q16, the confirmation bodes well for the continuation of steady dividends in future quarters.

Income Statement

MGIC - Operating Model	Dec-12	Dec-13	Dec-14	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Dec-18
\$ Millions	2012A	2013A	2014A	2015A	1Q16A	2Q16A	3Q16E	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E	2018E
Net premiums written	1,017.83	923.48	881.96	1,020.28	231.28	250.02	247.29	251.88	980.47	259.28	266.41	273.97	280.28	1,079.93	1,185.58
Increase in unearned premiums	15.34	19.57	(37.59)	(124.06)	(9.94)	(18.56)	(11.78)	(11.99)	(52.27)	(12.35)	(12.69)	(13.05)	(13.35)	(51.43)	(56.46)
Net premiums earned	1,033.17	943.05	844.37	896.22	221.34	231.46	235.51	239.89	928.20	246.93	253.72	260.92	266.93	1,028.50	1,129.12
Investment income	121.64	80.74	87.65	103.74	27.81	27.25	27.79	28.35	111.20	29.20	30.08	30.98	31.91	122.16	130.85
Realized investment gains	197.72	6.06	1.50	27.72	3.06	0.84	-	-	3.89	-	-	-	-	-	-
Total other than temporary losses	(2.31)	(0.33)	(0.14)	0.64	-	-	-	-	-	-	-	-	-	-	-
Prostion of losses recognized in other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net impairment losses recognized in earnings	(2.31)	(0.33)	(0.14)	0.64	-	-	-	-	-	-	-	-	-	-	-
Other revenue	28.15	9.91	8.42	12.46	6.37	3.99	4.03	4.07	18.48	4.07	4.12	4.16	4.20	16.54	17.04
Total revenues	1,378.36	1,039.44	941.80	1,040.78	258.58	263.53	267.34	272.31	1,061.76	280.20	287.91	296.06	303.03	1,167.20	1,277.02
Losses incurred	2,067.25	838.73	496.08	343.55	85.01	46.59	80.75	82.25	294.60	83.86	86.17	86.15	88.14	344.32	378.02
Change in premium deficiency reserve	(61.04)	(25.32)	(24.71)	(23.75)	-	-	-	-	-	-	-	-	-	-	-
Amortization of deferred policy acquisition costs	7.45	10.64	7.62	-	-	-	-	-	-	-	-	-	-	-	-
Underwriting and operating expenses	194.00	181.88	138.44	164.37	41.74	37.59	37.69	37.78	154.80	37.88	37.97	38.07	38.16	152.07	154.56
Loss on extinguishment of debt	-	-	-	-	13.44	1.87	-	-	15.31	-	-	-	-	-	-
Interest expense	99.34	79.66	69.65	68.93	14.70	12.24	11.61	11.61	50.17	11.61	11.61	11.61	11.61	46.46	46.46
Total losses and expenses	2,307.01	1,085.59	687.07	553.09	154.89	98.30	130.05	131.64	514.88	133.35	135.75	135.83	137.91	542.85	579.04
Income (loss) before income taxes	(928.64)	(46.15)	254.72	487.69	103.69	165.24	137.29	140.67	546.89	146.85	152.16	160.22	165.12	624.35	697.98
Provision for income taxes	(1.57)	3.70	2.77	(684.31)	34.50	56.02	45.31	46.42	182.24	48.46	50.21	52.87	54.49	206.04	216.37
Net income (loss)	(927.08)	(49.85)	251.95	1,172.00	69.19	109.22	91.98	94.25	364.64	98.39	101.95	107.35	110.63	418.32	481.60
Adjusted EPS	(\$4.59)	(\$0.16)	\$0.61	\$1.13	\$0.17	\$0.26	\$0.22	\$0.22	\$0.87	\$0.23	\$0.24	\$0.25	\$0.26	\$0.98	\$1.11
Diluted shares outstanding	201.89	311.75	413.55	460.85	431.37	446.14	446.14	446.14	442.45	446.59	447.03	447.48	447.93	447.26	450.73
Tax rate	0.2%	-8.0%	1.1%	-140.3%	33.3%	33.9%	33.0%	33.0%	33.3%	33.0%	33.0%	33.0%	33.0%	33.0%	31.0%
Book Value per diluted share	0.97	2.20	2.36	4.78	5.43	5.63	5.84	6.05	6.05	6.26	6.48	6.72	6.96	6.96	7.95
Average primary IIF	166,537.5	159,425.0	160,350.0	169,300.0	174,750.0	176,250.0	179,437.5	182,771.4	178,302.2	186,361.5	191,487.0	196,923.5	201,455.8	194,057.0	213,041.8
Total primary NIW	24,100.0	29,800.0	33,400.0	43,000.0	8,300.0	12,600.0	9,300.0	8,330.0	38,530.0	9,130.0	10,710.0	9,997.5	9,163.0	39,000.5	40,170.5
Average premium rate	0.62%	0.59%	0.53%	0.53%	0.51%	0.53%	0.53%	0.53%	0.52%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%

Source: BTIG Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

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.

Regulatory Disclosures

Analyst Stock Ratings Definitions

BTIG LLC's ("BTIG") ratings, effective May 10, 2010, are defined as follows:

BUY – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

NOT RATED – A stock that is not rated but that is covered by BTIG.

Distribution of Ratings and Investment Banking Clients

BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. **Stocks under coverage as of the end of the most recent calendar quarter (June 30, 2016): 185**

Distribution of BTIG's Research Recommendations (as of June 30, 2016):

BUY: 61.6%; NEUTRAL: 35.7%; SELL: 2.7%

Distribution of BTIG's Investment Banking Services (as of June 30, 2016):

BUY: 84.6%; NEUTRAL: 15.4%; SELL: 0%

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

Company Valuation and Risk Disclosures

MGIC Investment Corporation (MTG, Buy, \$12 PT)

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

Other Disclosures

Additional Information Available Upon Request

General Disclosures

Research reports produced by BTIG LLC ("BTIG") are published for and intended to be distributed solely to BTIG institutional and corporate clients. Recipients of BTIG reports will not be considered clients of BTIG solely because they may have received such BTIG report.

The equity research analyst(s) responsible for the preparation of this report receives compensation based upon a variety of factors, including the quality and accuracy of research, internal/client feedback, and overall Firm revenues.

BTIG reports are based on public information and BTIG considers the same to be reliable, comprehensive information, but makes no representation or warranty that the reports are accurate or complete. BTIG opinions and information provided in this report are as of the date of the report and may change without notice.

This research report is not an offer to buy or sell or solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. This research report was not drafted specifically for any particular individual or entity and is not a personal recommendation to participate in any particular trading strategy or transaction. Any recipient of this research report should obtain independent advice specific to their personal circumstances before undertaking any investment activity and must make their own independent evaluation of any securities or financial instruments.

Facts, views or opinions presented in this report have not been reviewed by, and may not reflect information known to, employees or other professionals in the "BTIG Group" (BTIG Group includes, but is not limited to, BTIG and its parents, subsidiaries and/or affiliates). BTIG Group employees, including Sales Representatives and Traders, may provide oral or written commentary or advice that may be inconsistent with the opinions and/or

views expressed in this research report. BTIG Group employees and/or its affiliates not involved in the preparation of this research report may have investments in securities or derivatives of securities of companies mentioned in this report that are inconsistent with the views discussed in this report.

Investors in securities products bear certain risks in conjunction with those investments. The value of, and income from, any investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors within or beyond the companies control. Recipient of the research reports should be aware that investments in equity securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in equity securities should be undertaken only upon consideration of issues relating to the recipient's overall investment portfolio and objectives (such as diversification by asset class, industry or company) as well as time horizon and liquidity needs. Further, past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. There may be time limitations on the exercise of options or other rights in any securities transactions.

Investing in foreign markets and securities, including ADRs, is subject to additional risks such as currency fluctuation, limited information, political instability, economic risk, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. Non-U.S. reporting issuers of foreign securities, however, may not make regular or complete public disclosure relating to their financial condition or the securities that they issue.

The trademarks and service marks contained herein are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability of any damages of any kind relating to such data. The report or any portion hereof may not be reprinted, sold or redistributed without the written consent of BTIG. This report is intended only for use by the recipient. The recipient acknowledges that all research and analysis in this report are the property of BTIG and agrees to limit the use of all publications received from BTIG within his, or her or its, own company or organization. No rights are given for passing on, transmitting, re transmitting or reselling the information provided.

Jurisdiction and Dissemination

BTIG is a U.S. broker-dealer and member of FINRA and SIPC.

BTIG Australia Limited ACN 128 554 601, member of ASIC and ASX; BTIG Hong Kong Limited, an Exchange Participant of SEHK and licensed and regulated by the SFC; BTIG Ltd, member of the LSE, authorized and regulated by the FSA; and BTIG Singapore Pte Ltd, registered and licensed with MAS; are all separate but affiliated entities of BTIG. Unless governing law permits otherwise, you must contact a BTIG entity in your home jurisdiction for further information, or if you want to use our services in effecting a transaction.

Issues and approved for distribution in the UK and EEA by BTIG Ltd. to eligible counterparties and professional clients only. Issued and distributed in Australia to "wholesale clients" only by BTIG Australia Limited. In Singapore and Hong Kong, further information may be obtained from BTIG Singapore Pte Ltd and BTIG Hong Kong Limited, respectively.