NMI Holdings, Inc.
Third Quarter 2013 Earnings Conference Call
November 20, 2013

Operator: Good day, ladies and gentlemen, and thank you for standing by and welcome to the NMI Holdings, Inc.'s Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question and answer session and instructions will be given at that time.

If anyone should require assistance during today's program, you may press star then zero on your touchtone telephone for a live operator. As a reminder, today's conference may be recorded.

It's now my pleasure to turn the call over to Chief Financial Officer, Jay Sherwood. Sir, the floor is yours.

Jay: Thank you, Hewey(?). Good afternoon, and thank you for joining us today and for your interest in NMI Holdings. This is Jay Sherwood, the Chief Financial Officer of NMI. Joining me on the call today to discuss the results for the third quarter of 2013 is Brad Shuster, the company's Chairman and CEO.

I want to remind all participants that our earnings release of this afternoon, which may be accessed on NMI's website located at www.nationalmi.com under the Investor's tab, includes additional information about the company's quarterly results, which we will refer to during the call.

During the course of this call, we may make comments about our expectations for the future. Actual results could differ materially from those contained in these forward-looking statements. Additional information about those factors that could cause actual results or trends to differ materially from those discussed on the call can be found in our latest registration statement on Form S-1A, which was filed on Tuesday, November 19th.

If the company makes any forward-looking statements, we're not undertaking any obligation to update those statements in the future in light of subsequent developments. Further, no interested party should rely on the fact that the guidance of forward-looking statements are current at any time other than the time of this call.

I'll make some brief comments on our recent initial public offering, cover some financial highlights, the Fannie Mae pool transaction, and then turn the call over to Brad.

During the fourth quarter on November 14th, we announced the completion of our initial public offering of 2,415,000 shares at $13 per share before underwriting discounts. Gross proceeds to the company were $31.4 million and the net proceeds after underwriting discounts and other offering expenses and reimbursements were approximately $29 million.

As discussed in the registration statement related to our IPO, the primary purpose of the initial public offering was to meet certain NASDAQ listing requirements in order to list the company's shares on a national exchange in accordance with our registration rights agreement with stockholders, who participated in the $550 million private placement of our common stock completed in April, 2012. In addition, we are working to have a resale registration statement declared effective by the SEC in December, which is also part of the obligation we have to certain of our stockholders who purchased shares in the April, 2012 private placement. Stockholders who are party to this registration rights agreement are subject to a 30-day lockup period, which expires after December 7, 2013.

Our latest amendment to our shelf registration statement contains our third quarter financial results. We expect to file our Form 10Q related to Q3 in 2013 in mid-December.

For the third quarter of 2013 the company had total revenues of $2.2 million, which is primarily comprised of investment income of $1.5 million and premiums earned of $0.5 million. The majority of premiums earned relates to the Fannie Mae pool transaction, which became effective on September 1, 2013.

Total expenses for the quarter were $16 million, with approximately 44 percent of that related to payroll and related expenses. We had 125 employees at the end of the quarter.

Net loss for the quarter was $13.9 million or $0.25 per share. For the nine months ended September 30, 2013, the net loss was $42.1 million or $0.76 per share. Revenues and expenses over the same time period were $3.4 million and $45.5 million respectively.

Turning to the balance sheet, we ended the quarter with approximately $446 million cash and investments and $447 million in book equity, which amounts to $8.03 in book value per share as of the end of the third quarter. This does not take into account our initial public offering, which closed during the fourth quarter, nor a deferred tax asset of approximately $27 million, which is fully offset by a valuation allowance.

During the quarter, the vast majority of our new insurance written was related to the Fannie Mae pool transaction. This transaction covered approximately 22,000 loans with an aggregate unpaid principal balance of approximately $5.2 billion and a ten-year life.

Risk in force after taking into account the stop loss and deductible was approximately $93 million at the end of the third quarter. In bidding and pricing the transaction, we targeted a double digit return on capital based on the amount of economic capital required to support this transaction. Enough economic capital is the difference between premiums earned over the life of the transaction less claims paid under a stress loss scenario.

In order to be eligible to participate in the transaction, Fannie Mae required bidders to have a risk to capital ratio no greater than 18:1 on its current risk in force, taking into account the adequacy of reserves for delinquent loans and have an additional amount of capital equal to the risk in force associated with the pool transaction. Out of the seven approved mortgage insurance companies, we believe this perhaps left two other mortgage insurance companies qualified to bid on the transaction in addition to National MI.

Under our expected persistency and loss scenario, we expect to earn $20 million in premiums and incur low losses over the life of this transaction. The expected loss scenario is based on the fact that the loans were originated in the second half of 2012. They're all 30-year fixed rate mortgages with a weighted average LTV of 77 percent and an average FICO score above 760. The $20 million in premiums we expect to collect is significantly front-end loaded as the premium is based on the unpaid principal balance which will decline over time. The same is true of the risk in force and capital required to support the transaction.

With that, I'll turn it over to Brad.

Brad: Thank you, Jay. I will cover several topics, including the expected release of new capital standards by the GSEs and their regulators, the FHFA, state licensing, lending integration and our differentiated product offering.

The GSEs and the FHFA have been working for quite some time on developing new capital standards for the mortgage insurance industry. It is our understanding that the GSEs plan to issue those new capital standards prior to yearend. While state insurance regulators are discussing the development of new capital standards for the industry, we believe the capital standards imposed by the GSEs and the FHFA will be extremely important since the GSEs are the counterparties to the majority of the mortgage insurance being written today.

While we do not know for certain, we expect the new capital standards to take into account the risk associated with the policies being written, allowing more leverage on less risky products. However, we believe there will likely be an overall cap on a company's risk to capital ratio, regardless of the mix of business of something lower than the current 25:1 maximum. We expect there will be a transition period primarily for the benefit of legacy companies allowing legacy mortgage insurance companies some period of time to become compliant with the new capital standards.

We are looking forward to the release announcement and enforcement of the new capital standards. We believe it is logical to think that the new capital standards will lead to better pricing discipline in the industry. As we have seen recently, in an industry where large national account lenders prefer that all mortgage insurance companies price in close proximity to one another, there is little advantage gained by one participant lowering prices as that is quickly matched by the rest of the industry.

On state licensing, as previously disclosed, we are currently licensed in 49 out of the 51 jurisdictions. The two remaining jurisdictions are Florida and Wyoming. In October, we participated in a hearing with the Office of Insurance Regulation in Florida to discuss the status of our application and address their remaining concerns. We believe the hearing went well and we addressed all their remaining issues to their satisfaction. Although there can be no guarantees, we are hopeful that we will be granted a license in Florida in the near future.

In Wyoming, we have a hearing scheduled in December where we hope to address Wyoming's concern regarding its seasoning requirement. Over 40 other states have a seasoning requirement similar to Wyoming, all of whom, with the exception of Florida, have waived it for National MI.

On lender integration, as previously disclosed we continue to make very good progress with the number of our national accounts. Integrating with the largest lenders, largest national accounts is the key to opening up the field in our regional accounts. We have a fully staffed national accounts sales team, which has been working with our 36 national accounts for over a year. Integrating with large national accounts takes time, especially as they face the implementation of Dodd-Frank and CFPB regulations. Fortunately, those regulations must be completed by lenders in early 2014. We have also hired a number of field account managers to address the regional accounts and we plan on hiring additional account managers as more large national accounts are fully integrated in the early part of next year.

During the fourth quarter, we received a number of loans from a top five national account and importantly these loans came through the delegated channel. With the exception of National MI, loans that come through the delegated channel are not underwritten by the mortgage insurance industry. Today, 60 to 70 percent of loans with mortgage insurance come through the delegated channel. We believe we are operating a differentiated product because of the better terms of coverage we can offer our customers, specifically because we underwrite all of the loans that have our mortgage insurance attached. This includes all loans that come through both the delegated channel and the non-delegated channel.

The GSEs are in the process of wrapping up a year-long project to more closely align the provisions of each of the approved mortgage insurers' master insurance policy. The GSEs have done this through the development of common principles that spell out standards that each approved mortgage insurer's master policy must meet. Once the project is completed, which we currently expect to happen prior to yearend, all mortgage insurers must begin filing and using their master policy that conforms to these common principles.

One of these principles addresses rescission relief and requires approved mortgage insurers' master policies to offer rescission relief to lenders after 36 months provided the borrower has had no more than two late payments. The GSEs' principles also permit an insurer to offer rescission relief in less than 36 months provided the insurer underwrites the loan. Because our business plan already calls for us to underwrite each loan whether it comes to us through the delegated or non-delegated channel, we will be able to offer rescission relief in less than 36 months on all of our policies. The fact that we can offer rescission relief in less than 36 months on all of our policies and not just those loans that come through the non-delegated channel has resonated well with the large national accounts that bore the brunt of the mortgage insurance industry's rescission practices that continue today.

As Jay mentioned, we spent approximately $45 million through September 30, 2013. That, combined with the time and money we've spent since our formation in 2012, has been put to work hiring a highly experienced management team and sales force, building the necessary information technology and operational infrastructure, obtaining regulatory approvals and integrating with our customers. While this building phase was not as exciting as generating revenue from issuing new mortgage insurance policies, it has been a necessary part of our development and we believe we are now ready to face off with the market.

With that, I will open it up to your questions.

Operator: Thank you, sir. Ladies and gentlemen on the phone lines, to queue up for a phone question you may press star then one on your touchtone phone. If your question has been answered or wish to remove yourself from the phone queue, you may press the pound key. Again, ladies and gentlemen, if you would like to ask a question at this time, you may press star then one on your touchtone phone. One moment for questioners to queue.

And it looks like our first question in the phone queue will come from the line of Jeffrey Dunn with Allen and Partners(?). Please go ahead. Your line is open.

Q: Thanks. Good afternoon. Could you provide an update on your technology system and some of the issues you mentioned in your prior S-1s, particularly if there's been any impairment you've taken and what actions or incremental investments you've made since then?

Brad: Hi, Jeff. This is Brad. I'll start and then I'll turn it over to Jay to comment on the accounting. But we've made very good progress on the technology front. Our frontend system is functioning well. We're launching our new billing and policy servicing just in a few days here, as well as a new default and claims management module. We're very happy with the overall progress.

We have made a decision to build a new frontend module, which should come online sometime next year. That will offer us greater flexibility in terms of what we're able to do from a systems standpoint on the frontend. And that does have some accounting ramifications associated with it. For that, I'll turn it over to Jay.

Jay: Hi, Jeff. This has all been disclosed in our latest SEC filings, too, Jeff, but let me cover it for you. We invested in that system on the software side approximately $9 million. About $5 million of that was part of the purchase price and another $4 million was invested over time as we developed it.

We accelerated the amortization related to the billing and servicing and the claims and delinquency module to about a seven month period starting in the middle of this year and that amounted to about $4 million in accelerated amortization of that system. And then over an 18 month period, again starting at the middle of this year, we'll accelerate the remaining portion of that amortization.

Q: Great. And then, Jay, can you -- in terms of thinking about how the premiums on the Fannie policy comes through, is there a bips(?) on IEF(?) that we should be looking at or is there an amortization schedule that you can share? Or give us some way to try to triangulate how those premiums are going to be reflected in your financials.

Jay: Sure, Jeff. The premiums earned and premiums written will be the same. Those will be exactly the same numbers. We're assuming 80 percent persistency. That's where some judgment is involved. You'll have to sort of make your own assumptions in terms of how the insurance in force runs off on that policy but we assume 80 percent persistency. It tends to start out a little higher than that and then the persistency goes down over time in years two and three.

The premium on that, that's been disclosed by Fannie Mae on their website and they disclose that as a monthly premium. You can get that there. But as we said, it's about $20 million over the ten year life, heavily frontend loaded.

Q: Thank you.

Operator: Thank you, sir. And again, ladies and gentlemen, just as a reminder, to queue up for a phone question, you may press star then one on your touchtone phone. Again, star one to queue up for a question. One moment for additional questions to queue. And again, ladies and gentlemen, if you would like to ask a question, you may press star then one.

And it looks like we do have another question. It'll be a follow-up question from Jeffrey Dunn. Please go ahead, sir. Your line is now open.

Q: _____ line _____ to come back in. Can you both talk about -- obviously the conditions in the market have changed dramatically since you've raised money, recaps, IPOs, more people deciding they want to come to the business. How are you thinking about the buildup of market share? You've detailed what makes you unique. But obviously there's also headwinds out there. Is there any way you can talk about how you expect market share to develop over, say, a three to five year timeframe? What is realistic? Is there anything we can look to historically as a proxy for how you might develop? Is there anything you can share on that front to help us out on that?

Brad: Well, yeah, sure, Jeff. This is Brad. I'll start and then I'll turn it over to Jay. But in terms of how the market has changed, yeah there has been some capital raised by market participants, some of the legacy companies. But they're still relatively highly levered from a capital standpoint in relation to our unencumbered capital base. We think we have a significantly differentiated product offering through our approach to underwriting every loan and what the enables us to provide in terms of coverage in our master policy. And I've been meeting with a lot of customers in the last several weeks at the MBA meeting and elsewhere and explaining our value proposition to them and I can tell you I'm very encouraged by the kind of response we're getting.

We think the take up in the marketplace of our product is going to be very good. And some of the things you hear about people looking at the market and coming into it is just an indication of what we see as it's going to be a very vibrant and healthy underwriting environment for some time going forward and we think we're very well-positioned to participate in that market and do very well with our approach. Jay?

Jay: Jeff, this is Jay. I'll just add a few more comments. We certainly think about market share within the private mortgage insurance market but we're a bit more focused on the level of insurance in force we need to get to to break even. That's how we're thinking about it, because as you know, one's market share will be a function of a lot of factors: Total originations, the split between FHA and private mortgage insurance and then ultimately our share of the private MI market. And there's a lot of moving parts in there.

And so, to give you a sense for the level of insurance in force required to break even, we estimate it'll be between $12 and $14 million of insurance in force. As you know, there's a recent example out there of another mortgage insurance company that started a few years ahead of us and they required something similar in terms of insurance in force and I don't think there's a reason to believe we would be dramatically different than that. Now, again, as to how long it takes for us to get there, I think that would be a reasonable place to start in terms of that proxy as well. But it'll be a function of the overall size of the mortgage origination market, the private MI market, and, again, how the insured market is split between private MI and the FHA. As Brad mentioned, though, we do believe we have a differentiated product from the rest of the industry. And while we can't prove it in the numbers yet, we get great feedback from our large national accounts and we do think that will lead to outsized market share.

Q: And judging by -- you said you received a bundle(?) of loans from a top five account. Are the doors open at this point? Is the flow of business now starting -- going to start coming on? Is that how I should interpret that comment or is there still things there to do?

Brad: Jeff, this is Brad -- I think the first quarter of next year is a really important time for us when we complete full integration with a couple of the largest national accounts and that really kind of opens up the correspondent channels for those in our -- the smaller, sort of regional and other type of correspondent lenders that tend to sell up to those large aggregators. That's kind of a time in which we're thinking that we'll be able to address the majority of the market and that'll only build as we get further into 2014.

Q: Thank you.

Jay: Thanks.

Operator: Thank you, Mr. Dunn. And again, ladies and gentlemen, to ask a question you may press star then one on your touchtone phone. Presenters, I'm showing no additional phone questions in the queue. I'll turn the program back over to Mr. Shuster for any additional or closing remarks.

Brad: Well, thank you to everyone who's on the call. We appreciate your interest in the company. And thank you very much.

Operator: Thank you, gentlemen, and thank you, ladies and gentlemen. This does conclude today's call. You may now all disconnect.

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