

Equity Research

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Financials

Flagstar Bancorp, Inc.

FBC's Clean-Up Continues as Sale of \$386mm of Interest-Only Loans Drives 2Q15 Earnings Beat

In the face of a challenging housing market backdrop that has served as a headwind to its core mortgage origination business, Flagstar Bancorp (FBC) has focused its efforts on de-risking its balance sheet and reducing the costs and risks associated with non-performing loans. The results of those efforts were on full display in 2Q15 as FBC sold \$386mm in interest-only loans as well as \$70mm of lower performing loans, helping to drive a \$10mm after-tax net allowance release and a solid earnings performance.

- ▶ FBC this morning reported 2Q15 earnings per share of \$0.68. Adjusting for the impact of the \$10.3mm allowance release, the company would have reported 2Q15 EPS of \$0.50, still well above the consensus estimate of \$0.37 and our estimate of \$0.29.
- ▶ While FBC is making strides in growing its mortgage servicing and Michigan-focused community banking units, we continue to view mortgage origination as the primary driver of the stock. That unit, which enjoyed a significant uptick in 1Q15, retreated a bit in 2Q15 as gain on loan sales declined sequentially to \$82.2mm from \$91.3mm and gain on sales margin ticked down by 6bps to 1.21%.
- ▶ **We are reiterating our Neutral recommendation on FBC.** While we have been impressed with management's self-help initiatives which have helped to decrease the stock's downside while laying the foundation for future earnings growth, we view the shares as close to fairly valued at about 0.95x book value as of June 30. While we believe FBC offers optionality to a rebound in housing, we would need to see real evidence of sustainable demand for residential mortgages before we would view the company's mortgage origination unit as in the early stages of a full-fledged resurgence, especially given the prospect of Federal Reserve interest rate increases later this year.
- ▶ **Valuation:** Our book value per share valuation for Flagstar Bancorp is within +/- 15% from current levels over the next 12 months. BTIG does not assign price targets to Neutral-rated stocks.

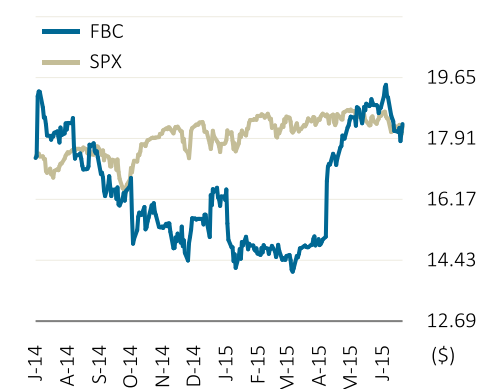
FBC

\$18.46

NEUTRAL

52 week range \$14.10 - \$19.44
Market Cap (m) \$1,038

Price Performance



Source: IDC

Estimates

| | 1Q14 A | 2Q14 A | 3Q14 A | 4Q14 A | FY14 A | 1Q15 A | 2Q15 A | 3Q15 E | 4Q15 E | FY15 E | FY16 E |
|--------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Diluted EPS (Adj.) | (1.51) | 0.32 | (0.61) | 0.07 | (1.72) | 0.43 | 0.68 | 0.36 | 0.37 | 1.46 | 1.38 |
| Tangible BVPS | 19.29 | 19.90 | 19.28 | 19.64 | 19.64 | 20.43 | 20.98 | 21.30 | 21.63 | 21.63 | 23.34 |

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

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

Income Statement

| Flagstar Bancorp Inc Operating Model \$ millions | Dec-12 2011 | Dec-12 2012A | Mar-13 1Q13A | Jun-13 2Q13A | Sep-13 3Q13A | Dec-13 4Q13A | Dec-13 2013A | Mar-14 1Q14A | Jun-14 2Q14A | Sep-14 3Q14A | Dec-14 4Q14A | Dec-14 2014A | Mar-15 1Q15A | Jun-15 2Q15A | Sep-15 3Q15E | Dec-15 4Q15E | Dec-15 2015E | Dec-16 2016E |
|--|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total interest income | 465.4 | 481.0 | 95.0 | 85.1 | 78.8 | 71.8 | 330.7 | 66.4 | 71.9 | 75.1 | 72.2 | 283.4 | 79.3 | 89.0 | 89.9 | 90.8 | 302.8 | 316.5 |
| Total interest expense | 220.0 | 183.7 | 39.3 | 38.0 | 36.1 | 30.6 | 144.0 | 8.2 | 9.5 | 10.7 | 10.9 | 36.9 | 14.4 | 16.5 | 16.6 | 16.7 | 39.2 | 40.0 |
| Net interest income | 245.4 | 297.2 | 55.7 | 47.1 | 42.7 | 41.2 | 186.7 | 58.2 | 62.4 | 64.4 | 61.3 | 246.5 | 64.9 | 72.5 | 73.3 | 74.1 | 263.6 | 276.5 |
| Loan fees and charges | 77.8 | 142.9 | 33.4 | 29.9 | 20.9 | 19.3 | 103.5 | 12.3 | 25.3 | 18.7 | 16.8 | 73.0 | 17.0 | 18.5 | 18.6 | 18.7 | 72.8 | 75.7 |
| Deposit fees and charges | 29.6 | 20.4 | 5.1 | 5.2 | 5.4 | 5.2 | 20.9 | 4.8 | 5.3 | 5.6 | 6.0 | 21.6 | 6.1 | 6.2 | 6.2 | 6.3 | 24.8 | 25.4 |
| Loan administration | 94.6 | 100.0 | 20.4 | 36.2 | 30.4 | 28.9 | 115.9 | 19.6 | 13.9 | 5.6 | 5.5 | 44.6 | 4.3 | 6.8 | 6.8 | 6.9 | 24.8 | 27.8 |
| Gain (loss) on trading securities | 21.1 | (2.0) | 0.1 | 0.0 | 0.0 | (0.0) | 0.1 | - | - | - | - | - | - | - | - | - | - | - |
| Loss on transferors' interest | (5.7) | (2.6) | (0.2) | - | - | - | (0.2) | - | - | - | - | - | - | - | - | - | - | - |
| Net gain on loan sales | 300.8 | 990.9 | 137.5 | 144.8 | 75.1 | 44.8 | 402.2 | 45.3 | 54.8 | 52.2 | 53.5 | 205.8 | 91.3 | 82.2 | 74.0 | 74.7 | 322.2 | 333.7 |
| Net gain (loss) on sale of MSR | (7.9) | (12.3) | (4.2) | (4.3) | (1.8) | (9.0) | (19.2) | 3.6 | 3.5 | 1.3 | 1.6 | 10.1 | (2.4) | 9.3 | - | - | 6.9 | - |
| Net (loss) gain on securities available-for-sale | - | 2.6 | - | - | - | 1.0 | 1.0 | - | - | - | - | - | - | - | - | - | - | - |
| Net gain on sale of assets | 22.7 | 0.0 | 1.0 | 1.1 | - | - | 2.0 | 2.2 | (2.7) | 4.9 | 1.7 | 6.1 | (0.4) | (1.6) | - | - | (2.0) | - |
| Total other than temporary gain | 79.2 | 2.2 | - | (8.8) | - | - | (8.8) | - | - | - | - | - | - | - | - | - | - | - |
| Loss recognized in other comprehensive income before taxes | (103.2) | (4.4) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Net impairment losses recognized in earnings | (24.0) | (2.2) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Representation and warranty reserve - change in estimate | (150.1) | (256.3) | (17.4) | (28.9) | (5.2) | 15.4 | (36.1) | 1.7 | (5.2) | (12.5) | 6.1 | (10.0) | 1.5 | 5.9 | 5.9 | 6.0 | 19.3 | 24.1 |
| Other fees and charges | 26.6 | 39.8 | 9.3 | 44.8 | 9.5 | 7.4 | 71.0 | (14.5) | 7.6 | 9.5 | 7.3 | 9.9 | 0.9 | (0.3) | (0.3) | (0.3) | (0.0) | (4.3) |
| Total non-interest income | 361.5 | 1,019.1 | 184.9 | 220.0 | 134.3 | 113.1 | 652.3 | 75.0 | 102.5 | 85.2 | 98.4 | 361.1 | 118.3 | 127.0 | 111.3 | 112.2 | 468.8 | 482.5 |
| Compensation and benefits | 246.4 | 270.9 | 77.2 | 70.9 | 61.6 | 69.6 | 279.3 | 65.6 | 55.2 | 53.5 | 59.0 | 233.3 | 60.8 | 59.1 | 60.3 | 60.6 | 240.8 | 245.4 |
| Commissions | 17.6 | 75.3 | 17.5 | 15.4 | 12.1 | 9.4 | 54.4 | 7.2 | 8.5 | 10.3 | 9.3 | 35.4 | 10.4 | 11.0 | 11.3 | 11.2 | 43.9 | 45.4 |
| Occupancy and equipment | 70.1 | 73.7 | 19.4 | 22.2 | 18.6 | 19.8 | 80.0 | 20.4 | 19.4 | 20.5 | 20.1 | 80.4 | 19.9 | 19.8 | 19.7 | 19.6 | 79.0 | 77.4 |
| Asset resolution | 128.3 | 91.3 | 16.4 | 15.9 | 16.3 | 3.4 | 52.0 | 11.5 | 17.9 | 13.7 | 13.4 | 56.5 | 7.8 | 4.7 | 4.7 | 4.7 | 22.0 | 19.2 |
| Federal insurance premiums | 41.6 | 49.3 | 11.2 | 7.8 | 7.9 | 7.9 | 34.9 | 5.0 | 6.8 | 5.6 | 5.3 | 22.7 | 5.5 | 6.3 | 6.3 | 6.4 | 24.5 | 25.8 |
| Other taxes | 2.8 | 4.2 | 0.9 | - | - | - | 0.9 | - | - | - | - | - | - | - | - | - | - | - |
| Warrant (income) expense | (6.9) | 8.9 | (3.5) | - | - | - | (3.5) | - | - | - | - | - | - | - | - | - | - | - |
| Loss on extinguishment of debt | - | 15.2 | - | - | - | 177.6 | 177.6 | - | - | - | - | - | - | - | - | - | - | - |
| Loan processing expense | - | 29.3 | 17.1 | 15.4 | 10.9 | 8.8 | 52.2 | 7.7 | 8.2 | 10.5 | 10.6 | 37.0 | 11.7 | 14.3 | 14.4 | 14.4 | 54.8 | 58.5 |
| Legal and professional expense | - | 230.2 | 28.8 | 16.4 | 19.6 | 79.2 | 144.1 | 13.9 | (2.1) | 15.0 | 10.8 | 37.7 | 9.0 | 7.8 | - | - | 16.8 | - |
| General and administrative | 134.7 | 141.3 | 11.5 | 10.4 | 11.5 | 12.9 | 46.3 | 7.9 | 7.4 | 50.3 | 10.8 | 76.3 | 11.9 | 15.9 | 16.4 | 16.5 | 60.6 | 66.7 |
| Total non-interest expense | 634.7 | 989.7 | 196.6 | 174.4 | 158.4 | 388.7 | 918.1 | 139.3 | 121.4 | 179.4 | 139.3 | 579.2 | 137.0 | 138.9 | 133.1 | 133.4 | 542.4 | 538.4 |
| Pre-provision income | (27.8) | 326.6 | 44.0 | 92.7 | 18.5 | (234.3) | (79.1) | (6.1) | 43.6 | (29.8) | 20.5 | 28.3 | 46.2 | 60.6 | 51.5 | 52.9 | 189.9 | 220.6 |
| Provision for loan losses | 176.9 | 276.0 | 20.4 | 31.6 | 4.1 | 14.1 | 70.1 | 112.3 | 6.2 | 8.1 | 5.0 | 131.6 | (3.5) | (13.3) | 8.8 | 8.8 | 0.8 | 36.2 |
| Pre-tax income | (204.8) | 50.5 | 23.6 | 61.1 | 14.5 | (248.5) | (149.3) | (118.4) | 37.4 | (37.9) | 15.5 | (103.2) | 49.7 | 73.9 | 42.7 | 44.1 | 189.1 | 184.4 |
| Taxes | 1.1 | (15.6) | - | (6.1) | 0.2 | (410.4) | (416.3) | (40.0) | 11.9 | (10.3) | 4.4 | (34.0) | 18.2 | 27.5 | 14.5 | 15.0 | 75.2 | 72.3 |
| Preferred stock dividend/accretion | 17.2 | 5.7 | 1.4 | 1.4 | 1.4 | 1.4 | 5.8 | 0.5 | - | - | - | 0.5 | - | - | - | - | - | - |
| Deferred cumulative dividends | - | 13.7 | 3.5 | 3.6 | 3.6 | 3.6 | 14.3 | 5.7 | 6.8 | 6.9 | 7.1 | 26.5 | 7.3 | 7.6 | 7.8 | 7.9 | 30.6 | 32.8 |
| Stock based awards | - | 4.8 | - | 0.4 | 0.4 | - | 0.8 | - | 0.6 | - | 0.5 | 1.1 | - | - | - | - | - | - |
| Net income | (223.0) | 46.9 | 18.6 | 61.8 | 8.8 | 156.8 | 246.1 | (84.6) | 18.1 | (34.6) | 11.1 | (97.3) | 24.2 | 38.8 | 20.4 | 21.1 | 83.3 | 79.3 |
| Diluted EPS | (4.02) | 0.84 | 0.33 | 1.10 | 0.16 | 2.77 | 4.34 | (1.51) | 0.32 | (0.61) | 0.07 | (1.72) | 0.43 | 0.68 | 0.36 | 0.37 | 1.46 | 1.38 |
| Diluted shares outstanding | 55.5 | 55.8 | 56.4 | 56.4 | 56.5 | 56.7 | 56.7 | 56.2 | 56.8 | 56.2 | 56.8 | 56.5 | 56.8 | 57.2 | 57.3 | 57.4 | 57.1 | 57.6 |
| Tangible Book Value Per Share | 14.80 | 16.12 | 16.46 | 17.66 | 17.79 | 20.66 | 20.66 | 19.29 | 19.90 | 19.28 | 19.64 | 19.64 | 20.43 | 20.98 | 21.30 | 21.63 | 21.63 | 23.34 |

Source: BTIG Research Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

el, 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.

el, 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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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.

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Distribution of BTIG's Research Recommendations (as of June 30, 2015):

BUY: 65%; NEUTRAL: 31%; SELL: 4%

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BUY: 83%; NEUTRAL: 17%; 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-Specific Regulatory Disclosures

Flagstar Bancorp, Inc. (FBC)

Valuation

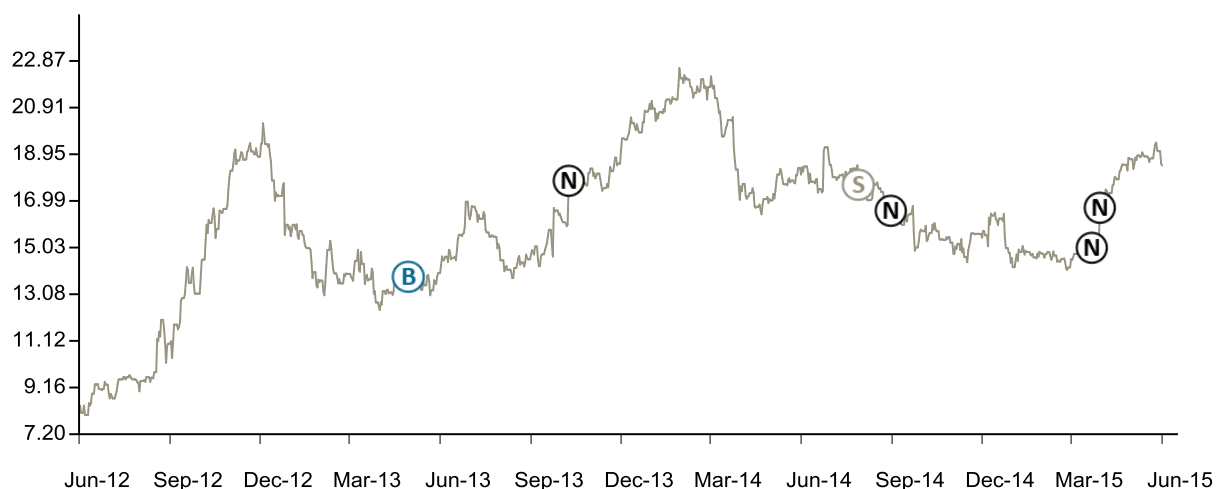
Our TBV per share valuation for Flagstar Bancorp is within +/- 15% from current levels over the next 12 months. BTIG does not put price targets on Neutral-rated stocks.

Risks

The primary risks to our recommendation include a significant increase in Flagstar Bancorp's mortgage origination gain-on-sale volumes, a significant increase in the company's servicing business, and a quick and unimpactful resolution to the allegations raised by the Consumer Financial Protection Bureau (CFPB).

Flagstar Bancorp, Inc. (FBC)

(\$)



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

| Date | Closing Price (\$) | Target Price (\$) | Analyst | Rating |
|-----------|--------------------|-------------------|-------------|---------|
| 29-May-13 | 13.81 | 18 | Mark Palmer | BUY |
| 07-Nov-13 | 17.82 | | Mark Palmer | NEUTRAL |
| 27-Aug-14 | 17.66 | 15 | Mark Palmer | SELL |
| 29-Sep-14 | 16.56 | | Mark Palmer | NEUTRAL |
| 20-Apr-15 | 15.03 | | Mark Palmer | NEUTRAL |
| 28-Apr-15 | 16.69 | | Mark Palmer | NEUTRAL |
| 24-Jul-15 | 18.46 | | Mark Palmer | NEUTRAL |

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