

## Equity Research

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## Financials

### Flagstar Bancorp, Inc.

#### FBC Posts Emphatic 3Q15 Earnings Beat, But Lack of Mortgage Origination Catalyst Leaves Us on Sidelines

While Flagstar Bancorp (FBC) yesterday posted an impressive 3Q15 earnings beat and its shares reacted positively, we nevertheless struggle to see how such performance is sustainable and a corresponding increase in valuation is achievable short of a meaningful improvement in the purchase mortgage market. There is a limit to how much a company can cut in terms of noninterest expenses, and the amount of onerous legacy exposures that can be sold is also finite.

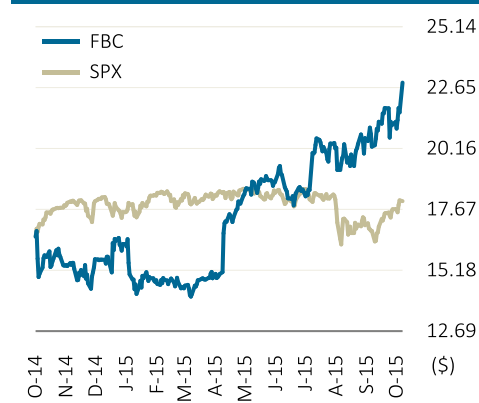
**FBC**

**\$22.85**

### NEUTRAL

52 week range                      \$14.10 - \$22.85  
Market Cap (m)                      \$1,285

#### Price Performance



Source: IDC

- ▶ FBC reported 3Q15 earnings per share of \$0.69, emphatically beating the consensus estimate (and our estimate) of \$0.36. The beat was impressive in that it was not driven by a single line item, but several, although the one area in which the company most exceeded expectations was noninterest expense. FBC management in prior quarters had focused on reducing noninterest expense to a level below \$140mm, and in 3Q15 the company got that line item to \$131mm, down from \$139mm in the prior quarter.
- ▶ FBC also sold \$214mm of interest-only loans during 3Q15 as the company continued its ongoing clean-up of its balance sheet, following up on its sale of \$386mm of such loans in 2Q15. Management said it has been reinvesting the proceeds of these sales into higher quality assets.
- ▶ Meanwhile, FBC's mortgage origination business – one of the company's three business segments, along with community banking and mortgage servicing, and the one that still represents the "swing factor" for the company and the stock – posted a gain on sale of \$68mm during 3Q15, down from \$83mm in 2Q15.
- ▶ **We are reiterating our Neutral rating on FBC.** While the company (continued on page 2)
- ▶ **Valuation:** Our valuation of FBC is within +/- 15% from current levels over the next 12 months. BTIG does not put price targets on Neutral-rated stocks.

## Estimates

	1Q14 A	2Q14 A	3Q14 A	4Q14 A	FY14 A	1Q15 A	2Q15 A	3Q15 A	4Q15 E	FY15 E	FY16 E
Diluted EPS (Adj.)	(1.51)	0.32	(0.61)	0.07	(1.72)	0.43	0.68	0.69	0.56	1.99	2.25
Tangible BVPS	19.29	19.90	19.28	19.64	19.64	20.43	20.98	21.91	22.17	22.17	24.74

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

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

*(continued from page 1)*

reported laudable 3Q15 results, with its stock trading at 1.04x its book value as of September 30, and in the absence of any visibility regarding a meaningful increase in its mortgage origination unit's production, we believe its shares are close to fairly valued. While we continue to believe FBC offers optionality to a wholesale rebound in the U.S. housing market, 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 at some point in the not-too-distant future.

## Income Statement

Flagstar Bancorp Inc Operating Model	Dec-12	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Dec-16
\$ millions	2011	2012A	2013A	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15A	3Q15A	4Q15E	2015E	2016E
<b>Total interest income</b>	<b>465.4</b>	<b>481.0</b>	<b>330.7</b>	<b>66.4</b>	<b>71.9</b>	<b>75.1</b>	<b>72.2</b>	<b>283.4</b>	<b>79.3</b>	<b>89.0</b>	<b>91.0</b>	<b>91.9</b>	<b>302.8</b>	<b>316.5</b>
<b>Total interest expense</b>	<b>220.0</b>	<b>183.7</b>	<b>144.0</b>	<b>8.2</b>	<b>9.5</b>	<b>10.7</b>	<b>10.9</b>	<b>36.9</b>	<b>14.4</b>	<b>16.5</b>	<b>18.0</b>	<b>18.1</b>	<b>39.2</b>	<b>40.0</b>
<b>Net interest income</b>	<b>245.4</b>	<b>297.2</b>	<b>186.7</b>	<b>58.2</b>	<b>62.4</b>	<b>64.4</b>	<b>61.3</b>	<b>246.5</b>	<b>64.9</b>	<b>72.5</b>	<b>73.0</b>	<b>73.8</b>	<b>263.6</b>	<b>276.5</b>
Loan fees and charges	77.8	142.9	103.5	12.3	25.3	18.7	16.8	73.0	17.0	18.5	17.0	17.1	69.6	69.2
Deposit fees and charges	29.6	20.4	20.9	4.8	5.3	5.6	6.0	21.6	6.1	6.2	7.0	7.0	26.3	28.5
Loan administration	94.6	100.0	115.9	19.6	13.9	5.6	5.5	44.6	4.3	6.8	8.0	8.0	27.1	32.6
Gain (loss) on trading securities	21.1	(2.0)	0.1	-	-	-	-	-	-	-	-	-	-	-
Loss on transferors' interest	(5.7)	(2.6)	(0.2)	-	-	-	-	-	-	-	-	-	-	-
<b>Net gain on loan sales</b>	<b>300.8</b>	<b>990.9</b>	<b>402.2</b>	<b>45.3</b>	<b>54.8</b>	<b>52.2</b>	<b>53.5</b>	<b>205.8</b>	<b>91.3</b>	<b>82.2</b>	<b>68.0</b>	<b>68.7</b>	<b>310.2</b>	<b>223.1</b>
Net gain (loss) on sale of MSR	(7.9)	(12.3)	(19.2)	3.6	3.5	1.3	1.6	10.1	(2.4)	9.3	12.0	-	18.9	-
Net (loss) gain on securities available-for-sale	-	2.6	1.0	-	-	-	-	-	-	-	-	-	-	-
Net gain on sale of assets	22.7	0.0	2.0	2.2	(2.7)	4.9	1.7	6.1	(0.4)	(1.6)	1.0	-	(1.0)	-
Total other than temporary gain	79.2	2.2	(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)	(36.1)	1.7	(5.2)	(12.5)	6.1	(10.0)	1.5	5.9	6.0	6.0	19.4	24.4
Other fees and charges	26.6	39.8	71.0	(14.5)	7.6	9.5	7.3	9.9	0.9	(0.3)	9.0	9.0	18.6	127.2
<b>Total non-interest income</b>	<b>361.5</b>	<b>1,019.1</b>	<b>652.3</b>	<b>75.0</b>	<b>102.5</b>	<b>85.2</b>	<b>98.4</b>	<b>361.1</b>	<b>118.3</b>	<b>127.0</b>	<b>128.0</b>	<b>115.9</b>	<b>489.2</b>	<b>504.9</b>
Compensation and benefits	246.4	270.9	279.3	65.6	55.2	53.5	59.0	233.3	60.8	59.1	58.0	59.2	237.1	239.6
Commissions	17.6	75.3	54.4	7.2	8.5	10.3	9.3	35.4	10.4	11.0	10.0	9.9	41.3	40.1
Occupancy and equipment	70.1	73.7	80.0	20.4	19.4	20.5	20.1	80.4	19.9	19.8	20.0	19.9	79.6	78.6
Asset resolution	128.3	91.3	52.0	11.5	17.9	13.7	13.4	56.5	7.8	4.7	-	-	12.5	-
Federal insurance premiums	41.6	49.3	34.9	5.0	6.8	5.6	5.3	22.7	5.5	6.3	6.0	6.0	23.8	24.4
Other taxes	2.8	4.2	0.9	-	-	-	-	-	-	-	-	-	-	-
Warrant (income) expense	(6.9)	8.9	(3.5)	-	-	-	-	-	-	-	-	-	-	-
Loss on extinguishment of debt	-	15.2	177.6	-	-	-	-	-	-	-	-	-	-	-
Loan processing expense	-	29.3	52.2	7.7	8.2	10.5	10.6	37.0	11.7	14.3	14.0	14.1	54.1	57.0
Legal and professional expense	-	230.2	144.1	13.9	(2.1)	15.0	10.8	37.7	9.0	7.8	10.0	-	26.8	-
General and administrative	134.7	141.3	46.3	7.9	7.4	50.3	10.8	76.3	11.9	15.9	13.0	13.1	53.9	52.9
<b>Total non-interest expense</b>	<b>634.7</b>	<b>989.7</b>	<b>918.1</b>	<b>139.3</b>	<b>121.4</b>	<b>179.4</b>	<b>139.3</b>	<b>579.2</b>	<b>137.0</b>	<b>138.9</b>	<b>131.0</b>	<b>122.1</b>	<b>529.0</b>	<b>492.6</b>
<b>Pre-provision income</b>	<b>(27.8)</b>	<b>326.6</b>	<b>(79.1)</b>	<b>(6.1)</b>	<b>43.6</b>	<b>(29.8)</b>	<b>20.5</b>	<b>28.3</b>	<b>46.2</b>	<b>60.6</b>	<b>70.0</b>	<b>67.6</b>	<b>223.7</b>	<b>288.8</b>
Provision for loan losses	176.9	276.0	70.1	112.3	6.2	8.1	5.0	131.6	(3.5)	(13.3)	(1.0)	7.1	(10.7)	28.6
<b>Pre-tax income</b>	<b>(204.8)</b>	<b>50.5</b>	<b>(149.3)</b>	<b>(118.4)</b>	<b>37.4</b>	<b>(37.9)</b>	<b>15.5</b>	<b>(103.2)</b>	<b>49.7</b>	<b>73.9</b>	<b>71.0</b>	<b>60.5</b>	<b>234.4</b>	<b>260.3</b>
Taxes	1.1	(15.6)	(416.3)	(40.0)	11.9	(10.3)	4.4	(34.0)	18.2	27.5	24.0	20.6	90.3	97.7
Preferred stock dividend/accretion	17.2	5.7	5.8	0.5	-	-	-	0.5	-	-	-	-	-	-
Deferred cumulative dividends	-	13.7	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	0.8	-	0.6	-	0.5	1.1	-	-	-	-	-	-
<b>Net income</b>	<b>(223.0)</b>	<b>46.9</b>	<b>246.1</b>	<b>(84.6)</b>	<b>18.1</b>	<b>(34.6)</b>	<b>11.1</b>	<b>(97.3)</b>	<b>24.2</b>	<b>38.8</b>	<b>39.2</b>	<b>32.0</b>	<b>113.6</b>	<b>129.8</b>
<b>Diluted EPS</b>	<b>(4.02)</b>	<b>0.84</b>	<b>4.34</b>	<b>(1.51)</b>	<b>0.32</b>	<b>(0.61)</b>	<b>0.07</b>	<b>(1.72)</b>	<b>0.43</b>	<b>0.68</b>	<b>0.69</b>	<b>0.56</b>	<b>1.99</b>	<b>2.25</b>
Diluted shares outstanding	55.5	55.8	56.7	56.2	56.8	56.2	56.8	56.5	56.8	57.2	57.2	57.3	57.1	57.6
<b>Tangible Book Value Per Share</b>	<b>14.80</b>	<b>16.12</b>	<b>20.66</b>	<b>19.29</b>	<b>19.90</b>	<b>19.28</b>	<b>19.64</b>	<b>19.64</b>	<b>20.43</b>	<b>20.98</b>	<b>21.91</b>	<b>22.17</b>	<b>22.17</b>	<b>24.74</b>

Source: BTIG Research 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.

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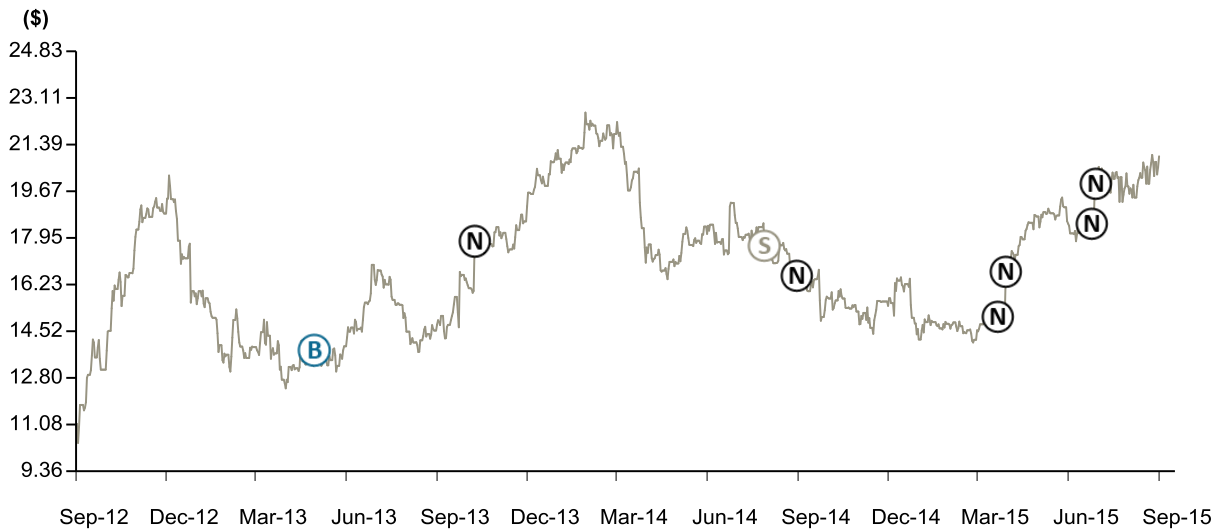
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#### Flagstar Bancorp, Inc. (FBC, NEUTRAL)

**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
28-Jul-15	19.95		Mark Palmer	NEUTRAL
20-Oct-15	20.97		Mark Palmer	NEUTRAL

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