

NMI Holdings, Inc.
Form 10-Q
April 28, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-36174
NMI Holdings, Inc.
(Exact name of registrant as specified in its charter)

DELAWARE 45-4914248
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2100 Powell Street, Emeryville, CA 94608
(Address of principal executive offices) (Zip Code)

(855) 530-6642
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Edgar Filing: NMI Holdings, Inc. - Form 10-Q

The number of shares of common stock, \$0.01 par value per share, of the registrant outstanding on April 26, 2016 was 59,080,468 shares.

TABLE OF CONTENTS

<u>Cautionary Note Regarding Forward Looking Statements</u>	<u>3</u>
<u>PART I</u>	<u>5</u>
Item 1. <u>Financial Statements</u>	<u>5</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>18</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>30</u>
Item 4. <u>Controls and Procedures</u>	<u>31</u>
<u>PART II</u>	<u>32</u>
Item 1. <u>Legal Proceedings</u>	<u>32</u>
Item 1A. <u>Risk Factors</u>	<u>32</u>
Item 6. <u>Exhibits</u>	<u>32</u>
<u>Signatures</u>	<u>33</u>
<u>Exhibit Index</u>	<u>i</u>

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act), and the U.S. Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward looking. These statements are often, but not always, made through the use of words or phrases such as "anticipate," "believe," "can," "could," "may," "predict," "potential," "should," "will," "estimate," "plan," "project," "continuing," "ongoing," "expect," "intend" or words of similar meaning and include, but are not limited to, statements regarding the outlook for our future business and financial performance. All forward looking statements are necessarily only estimates of future results, and actual results may differ materially from expectations. You are, therefore, cautioned not to place undue reliance on such statements which should be read in conjunction with the other cautionary statements that are included elsewhere in this report. Further, any forward looking statement speaks only as of the date on which it is made and we undertake no obligation to update or revise any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. We have based these forward looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy and financial needs. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward looking statements including, but not limited to:

- our limited operating history;
- our future profitability, liquidity and capital resources;
- developments in the world's financial and capital markets and our access to such markets, including reinsurance;
- retention of our existing certificates of authority in each state and the District of Columbia (D.C.) and our ability to remain a mortgage insurer in good standing in each state and D.C.;
- changes in the business practices of Fannie Mae and Freddie Mac (collectively, the GSEs), including implementation of the new Private Mortgage Insurer Eligibility Requirements (PMIERS) or decisions that have the impact of decreasing or discontinuing the use of mortgage insurance as credit enhancement;
- our ability to remain an eligible mortgage insurer under the PMIERS and other requirements imposed by the GSEs, which they may change at any time;
- actions of existing competitors, including governmental agencies like the Federal Housing Administration (FHA) and the Veterans Administration (VA), and potential market entry by new competitors or consolidation of existing competitors;
- adoption of new or changes to existing laws and regulations or their enforcement and implementation by regulators;
- changes to the GSEs' role in the secondary mortgage market or other changes that could affect the residential mortgage industry generally or mortgage insurance in particular;
- potential future lawsuits, investigations or inquiries or resolution of current inquiries;
- changes in general economic, market and political conditions and policies, interest rates, inflation and investment results or other conditions that affect the housing market or the markets for home mortgages or mortgage insurance;
- our ability to successfully execute and implement our capital plans, including our ability to enter into, and receive approval of, reinsurance arrangements on terms and conditions that are acceptable to us and to the GSEs;
- our ability to implement our business strategy, including our ability to write mortgage insurance on high quality low down payment residential mortgage loans, implement successfully and on a timely basis, complex infrastructure, systems, procedures, and internal controls to support our business and regulatory and reporting requirements of the insurance industry;
- our ability to attract and retain a diverse customer base, including the largest mortgage originators;
- failure of risk management or pricing or investment strategies;
- emergence of unexpected claim and coverage issues, including claims exceeding our reserves or amounts we had expected to experience;
-

our ability to utilize our net operating loss carryforwards, which could be limited or eliminated in various ways, including if we experience an ownership change as defined in Section 382 of the Internal Revenue Code;

3

failure to maintain, improve and continue to develop necessary information technology systems or the failure of technology providers to perform; and
ability to recruit, train and retain key personnel.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report on Form 10-Q, including the exhibits hereto. In addition, for additional discussion of those risks and uncertainties that have the potential to affect our business, financial condition, results of operations, cash flows or prospects in a material and adverse manner, you should review the Risk Factors in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2015 (2015 10-K), as subsequently updated in other reports we file from time to time with the U.S. Securities and Exchange Commission (SEC). Unless expressly indicated or the context requires otherwise, the terms "we," "our," "us" and "Company" in this document refer to NMI Holdings, Inc., a Delaware corporation, and its wholly owned subsidiaries on a consolidated basis.

PART I

Item 1. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

Condensed Consolidated Balance Sheets as of March 31, 2016 and December 31, 2015	<u>6</u>
Condensed Consolidated Statements of Operations and Comprehensive Loss for the three months ended March 31, 2016 and 2015	<u>7</u>
Condensed Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2016 and the year ended December 31, 2015	<u>8</u>
Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2016 and 2015	<u>9</u>
Notes to Condensed Consolidated Financial Statements	<u>10</u>

NMI HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 31, 2016	December 31, 2015
(In Thousands, except for share data)		
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost of \$551,780 and \$564,319 as of March 31, 2016 and December 31, 2015, respectively)	\$556,683	\$559,235
Cash and cash equivalents	73,302	57,317
Premiums receivable	6,578	5,143
Accrued investment income	3,144	2,873
Prepaid expenses	2,732	1,428
Deferred policy acquisition costs, net	20,948	17,530
Software and equipment, net	17,219	15,201
Intangible assets and goodwill	3,634	3,634
Other assets	74	90
Total assets	\$684,314	\$662,451
Liabilities		
Term loan	\$143,982	\$143,939
Unearned premiums	109,095	90,773
Accounts payable and accrued expenses	19,108	22,725
Reserve for insurance claims and claim expenses	1,137	679
Warrant liability, at fair value	797	1,467
Deferred tax	137	137
Total liabilities	274,256	259,720
Commitments and contingencies		
Shareholders' equity		
Common stock - class A shares, \$0.01 par value; 59,080,468 and 58,807,825 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively (250,000,000 shares authorized)	591	588
Additional paid-in capital	571,585	570,340
Accumulated other comprehensive loss, net of tax	2,512	(7,474)
Accumulated deficit	(164,630)	(160,723)
Total shareholders' equity	410,058	402,731
Total liabilities and shareholders' equity	\$684,314	\$662,451
See accompanying notes to consolidated financial statements.		

NMI HOLDINGS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
 (UNAUDITED)

	For the three months ended March 31,	
	2016	2015
	(In Thousands, except for share data)	
Revenues		
Net premiums written	\$38,129	\$ 12,921
Increase in unearned premiums	(18,322)	(5,985)
Net premiums earned	19,807	6,936
Net investment income	3,231	1,596
Net realized investment (losses) gains	(885)	613
Other revenues	32	—
Total revenues	22,185	9,145
Expenses		
Insurance claims and claims expenses	458	104
Underwriting and operating expenses	22,672	18,350
Total expenses	23,130	18,454
Other (expense) income		
Gain from change in fair value of warrant liability	670	1,248
Interest expense	(3,632)	—
Total other (expense) income	(2,962)	1,248
Loss before income taxes	(3,907)	(8,061)
Income tax benefit	—	(241)
Net loss	\$(3,907)	\$(7,820)
Net loss per share:		
Basic and diluted loss per share	\$(0.07)	\$(0.13)
Weighted average common shares outstanding	58,936,694	58,485,899
Net loss	\$(3,907)	\$(7,820)
Other comprehensive income, net of tax:		
Net unrealized gains in accumulated other comprehensive loss, net of tax expense of \$0 and \$1,431 for the quarters ended March 31, 2016 and March 31, 2015, respectively	9,101	2,672
Reclassification adjustment for losses (gains) included in net loss, net of tax expense of \$0 for the quarters ended March 31, 2016 and 2015	885	(613)
Other comprehensive income, net of tax	9,986	2,059
Comprehensive income (loss)	\$6,079	\$(5,761)
See accompanying notes to consolidated financial statements.		

NMI HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

	Common Stock - Class A Shares (In Thousands)	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balances, January 1, 2015	58,429	\$ 584	\$562,911	\$ (3,607)	\$(132,930)	\$426,958
Common stock: class A shares issued under stock plans, net of shares withheld for employee taxes	379	4	(694)	—	—	(690)
Share-based compensation expense	—	—	8,123	—	—	8,123
Change in unrealized investment gains/losses, net of tax of \$0	—	—	—	(3,867)	—	(3,867)
Net loss	—	—	—	—	(27,793)	(27,793)
Balances, December 31, 2015	58,808	\$ 588	\$570,340	\$ (7,474)	\$(160,723)	\$402,731
Common stock: class A shares issued under stock plans, net of shares withheld for employee taxes	272	3	(162)	—	—	(159)
Share-based compensation expense	—	—	1,407	—	—	1,407
Change in unrealized investment gains/losses, net of tax of \$0	—	—	—	9,986	—	9,986
Net loss	—	—	—	—	(3,907)	(3,907)
Balances, March 31, 2016	59,080	\$ 591	\$571,585	\$ 2,512	\$(164,630)	\$410,058

See accompanying notes to consolidated financial statements.

NMI HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the three months ended March 31,	
	2016	2015
	(In Thousands)	
Cash flows from operating activities		
Net loss	\$(3,907)	\$(7,820)
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized investment losses (gains)	885	(613)
Gain from change in fair value of warrant liability	(670)	(1,248)
Depreciation and other amortization	1,316	1,099
Amortization of debt discount and debt issuance costs	418	—
Share-based compensation expense	1,410	2,005
Noncash intraperiod tax allocation	—	(241)
Changes in operating assets and liabilities:		
Accrued investment income	(271)	(25)
Premiums receivable	(1,435)	(615)
Prepaid expenses	(1,304)	(37)
Deferred policy acquisition costs, net	(3,418)	(2,298)
Other assets	16	453
Unearned premiums	18,322	5,985
Reserve for insurance claims and claims expenses	458	104
Accounts payable and accrued expenses	(11,085)	(4,291)
Net cash provided by (used in) operating activities	735	(7,542)
Cash flows from investing activities		
Purchase of fixed-maturity investments, available-for-sale	(71,319)	(61,676)
Proceeds from redemptions, maturities and sale of fixed-maturity investments, available-for-sale	89,422	33,935
Purchase of software and equipment	(2,319)	(1,317)
Net cash provided by (used in) investing activities	15,784	(29,058)
Cash flows from financing activities		
Issuance of common stock	449	333
Taxes paid related to net share settlement of equity awards	(608)	(334)
Repayments of term loan	(375)	—
Net cash used in financing activities	(534)	(1)
Net increase (decrease) in cash and cash equivalents	15,985	(36,601)
Cash and cash equivalents, beginning of period	57,317	103,021
Cash and cash equivalents, end of period	\$73,302	\$66,420
Supplemental disclosures of cash flow information		
Noncash financing activities		
Interest paid	\$3,255	\$—
See accompanying notes to consolidated financial statements.		

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and Basis of Presentation

NMI Holdings, Inc. (NMIH) is a Delaware corporation, incorporated in May 2011, to provide private mortgage guaranty insurance (which we refer to as mortgage insurance or MI) through its wholly owned insurance subsidiaries, National Mortgage Insurance Corporation (NMIC) and National Mortgage Reinsurance Inc One (Re One). In April 2012, we completed a private placement of our securities, through which we offered and sold an aggregate of 55,000,000 of our Class A common shares resulting in net proceeds of approximately \$510 million (the Private Placement), and we completed the acquisition of our insurance subsidiaries for \$8.5 million in cash, common stock and warrants, plus the assumption of \$1.3 million in liabilities. In November 2013, we completed an initial public offering of 2.4 million shares of our common stock, and our common stock began trading on the NASDAQ exchange on November 8, 2013, under the symbol "NMIH."

In April 2013, NMIC, our primary insurance subsidiary, issued its first mortgage insurance policy. NMIC is licensed to write mortgage insurance in all 50 states and D.C. In August 2015, NMIH capitalized with \$0.5 million a wholly owned subsidiary, NMI Services, Inc. (NMIS), through which we began to offer outsourced loan review services to mortgage loan originators in the fourth quarter of 2015.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, which include the results of NMIH and its wholly owned subsidiaries, have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC for interim reporting and include other information and disclosures required by accounting principles generally accepted in the U.S. (GAAP). Our accounts are maintained in U.S. dollars. These statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2015 included in our Annual Report on Form 10-K. All intercompany transactions have been eliminated. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as of the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The results of operations for the interim period may not be indicative of the results that may be expected for the full year ending December 31, 2016.

Earnings per Share

Basic net loss per share is based on the weighted-average number of common shares outstanding, while diluted net loss per share is based on the weighted-average number of common shares outstanding and common stock equivalents that would be issuable upon the exercise of stock options, other share-based compensation arrangements, and the dilutive effect of outstanding warrants. As a result of our net losses for the three months ended March 31, 2016 and 2015, 7,351,338 and 7,137,901, respectively, of our common stock equivalents we issued under share-based compensation arrangements and warrants were not included in the calculation of diluted net loss per share as of such dates because they were anti-dilutive.

Deferred Policy Acquisition Costs

Costs directly associated with the successful acquisition of mortgage insurance policies, consisting of certain selling expenses and other policy issuance and underwriting expenses, are initially deferred and reported as deferred policy acquisition costs (DAC). For each book year of business, these costs are amortized to expense in proportion to estimated gross profits over the estimated life of the policies. Total amortization of DAC for the three months ended March 31, 2016 and 2015 were \$0.9 million and \$0.4 million, respectively.

Premium Deficiency Reserves

We consider whether a premium deficiency exists at each fiscal quarter using best estimate assumptions as of the testing date. Per Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 944, a premium deficiency reserve shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs and maintenance costs exceeds related unearned premiums and anticipated investment income. We have determined that no premium deficiency reserves were necessary for the three months ended March 31, 2016 or 2015.

Recent Accounting Pronouncements

In August 2014, the FASB issued an update that requires an entity's management to evaluate whether there is substantial doubt about that entity's ability to continue as a going concern and, if so, disclose that fact. An entity's management will also be required to evaluate and disclose whether its plans alleviate that doubt. The guidance is effective for annual periods ending after

10

NMI HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 15, 2016 and for interim and annual periods thereafter. We do not expect the adoption of this update to have a material effect on the presentation of our financial statements and notes therein.

In April 2015, the FASB issued Accounting Standard Update (ASU) 2015-03, Simplifying the Presentation of Debt Issuance Cost (Subtopic 835-30). This update is intended to simplify the presentation of debt issuance costs. In accordance with the new standard, debt issuance costs are presented as a direct deduction from long-term debt. The amended guidance is effective for fiscal years, and interim periods within those fiscal years, beginning December 15, 2015, with early adoption permitted. The Company has elected to early adopt ASU 2015-03 beginning with the year ended December 31, 2015. Application of this standard eliminated the presentation of a deferred cost (asset) and instead required debt issuance costs be presented as a direct deduction from total debt.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This update is intended to provide a consistent approach in recognizing revenue. In accordance with the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, ASU 2015-14 deferred the provisions of ASU 2014-09 to be effective for interim and annual periods beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718). This update is intended to provide improvements to employee share-based payment accounting. The areas for simplification in the update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted in any period. The Company is currently evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update requires that businesses recognize rights and obligations associated with certain leases as assets and liabilities on the balance sheet. The standard also requires additional disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases. For public business entities, this update is effective for annual periods beginning after December 15, 2018, and interim periods therein. Early adoption is permitted in any period. The Company is currently evaluating the impact the adoption of this ASU will have on the consolidated financial statements.

Reclassifications

Certain items in the financial statements as of March 31, 2016 and for the period ended March 31, 2015 have been reclassified to conform to the current period's presentation. There was no effect on net income or shareholders' equity previously reported.

2. Investments

We have designated our investment portfolio as available-for-sale and report it at fair value. The related unrealized gains and losses are, after considering the related tax expense or benefit, recognized as a component of accumulated other comprehensive loss in shareholders' equity. Net realized investment gains and losses are reported in income based upon specific identification of securities sold.

Fair Values and Gross Unrealized Gains and Losses on Investments

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
As of March 31, 2016	(In Thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	\$59,941	\$335	\$(30)	\$60,246
Municipal debt securities	23,478	468	(38)	23,908