Company Name: Flagstar Bancorp Inc. (FBC)
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<<Unidentified Analyst>>

Okay. This afternoon we have Jim Ciroli from Flagstar Bank. Flagstar is a $17 billion, you want to call it S&L mortgage related institution, headquartered in Troy, Michigan providing services in 99 branches in the state. But it's also a national originator of mortgage – fifth largest in the country and so has correspondence and bankers in all 50 states, 90 to 100 retail centers.

<<James K. Ciroli, Executive Vice President, Chief Financial Officer>>

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<<Unidentified Analyst>>

95. And it's a top 20 mortgage servicer. Jim joined the bank about three – little over three years ago and came there from prior to stops at First Niagara and Huntington. He has the CPA and he is putting at good use of Flagstar. So with that, Jim.

<<James K. Ciroli, Executive Vice President, Chief Financial Officer>>

Thank you. I don't know, I'm really putting the CPA, that sort of use of Flagstar it does come in play. I appreciate you joining us today. I want to thank – thank you for inviting Flagstar, we're at $17 billion a lot smaller than the other people you've seen today and you'll see tomorrow. And so I'm privileged to appreciate the opportunity come here and tell you more about Flagstar, because I really do think that a, it requires a little bit more work, but it use a unique opportunities and I think do that additional work you'll find a nice little growing investment opportunity.

So the cautionary statements I trust you'll read on your own. Largely this is who we are. And so I wanted to just show you the map, and I want you to take away really two things about the map. One is we're – I guess we are savings and loan, I think that distinction becoming less and less important over time. Most importantly, we're a bank, we're based in Michigan. We're based in the part of Michigan. But people live the upper part of the little mitten bunch of animals and wolves and bears, et cetera.

We're very much Detroit focused, Detroit based and across that the red dots that you see there is where the majority of people live in Michigan. But also we combine that nice commercial bank with a national mortgage presence. So 45 offices in 27 different states across the country and we originate in every single state, license to originate in every single state by virtue of our Federal Savings Bank charter. And I do so through a network of over 1,700 third-party originators.

What this represents though? What we do that different and unique from the other people you've seen today? As we really take the essential aspects of the mortgage business, the origination side where we'll originate about $35 billion loans in 2017 and that was down year from 2016. So we'll originate that much in loans and those loans then turn into servicing opportunities. The servicing opportunities turn into nice escrow deposits, which helps fund our banking business. Among the people we fund from a banking perspective are warehouse customers, homebuilder customers, which helps speed the mortgage origination business and the fly we keep spinning.

But while some other people do certain aspects of the business model, the core of what we are at Flagstar is really doing all of those with scale. As I said the mortgage origination platform is going to originate about $35 billion this year. We service over $400,000 mortgage loans for others. And we've got a pretty decent sized loan generation capability, which we'll go into in a few slides.

So I just want to essentially get into the promise of today is on the theme of my presentation today. I think if you do your work, Flagstar represents a very attractive near-term opportunity for you. So even though we've been up about 40% on a year-to-date basis, we still trail other banking peers in terms of valuation. Our price to book is roughly the same relative valuation to other regional banks as it was right before the Trump election. So I think it still represents a significant upside as we continue to migrate from our mortgage routes to where our commercial bank is headed to in the future.

And I think also the price to book ratio gives our investors a significant downside protection as well at 1.5 times clock. Our analysts some of whom are here today and I appreciate them continuing to follow the story and continuing to do work on us. Our average price targets roughly $40 per share and while many of our investors have reaped a lot of that. There is still a nice upside to the story. And I continue to tell our self-side guys as low as or buy side people that I think they're underestimating what we can really do.

So let's talk about what we really can do. So the key to value creation at Flagstar is going to be growing the balance sheet. And we often talk about this, if we can grow the balance sheet another $5 billion and this is something that's well within our graph. We believe that we can add $1 to EPS. And the $1 to EPS at today's valuations should be worth another $13 in value to our stock, which is currently at $37, so $37, $13 that get you to $50. If somewhere in that migration people decide to value the earnings that one or two more turns, we could be – and I'm going to suggest that's over the course of the next two years trading in the $50 to $60 range just from that growth.

And how we're going to do it? I think there are three key pillars to that value creation. One is, you got to have well diversified proven asset generation capabilities. We're going to show you what we've done over the past three years, show you how we've done it, most importantly because how we do it is not well understood. You need to have outside capital generation between the returns we're generating and the capital we can unlock within our balance sheet, I'll walk you through how that happens. I'll walk you through how – through that earnings growth over the next two years.

We can support our level of growth without adding to – just organically. We're going to generate the capital we need to support that kind of earnings growth. And then finally, we need to fund that. We currently have about $1.7 billion of runway from the funding perspective but we can continue to grow. But admittedly, I'd say the execution risk lies in that last element of the three pillars. I'm going to walk you through just exactly what the abundant opportunities for us to tap into that additional funding need are.

So moving ahead, here's what we've done over the last three years. And what we've done is pretty good. So I came to Flagstar about three years ago. And when I came there we're $10 billion institution and we're now at $17 billion institution. What we've done through our asset generation capabilities, adding to those asset generation capabilities over the course of time has been to generate a CAGR for earning assets and importantly net interest income of 21% over that period of time.

So the extra $5 billion that we are talking about represents relative growth rate from this point on forward of about 15%, so below that already proven trajectory. And I want to say two things more about that trajectory. One is, we've achieved that asset growth despite selling $2.3 billion of additional loans. Three years ago, we had a portfolio of $1 billion in size interest only loans and TDRs from our mortgage business. We had to sell that get that off the balance sheet to replace those assets we immediately funded that with some of our mortgage loan production, which is truly in our business on our balance sheet – on Flagstar's balance sheet suboptimal.

So as we have grown the commercial bank, we've also accelerated the rotation of that quick add that we did in early 2015 and sold another $1.3 billion in early 2016. Finally, a big event for Flagstar and not to dwell too much on in the history, repaid our TARP in the third quarter of 2016. And so we've achieved the net interest income CAGR despite having a higher level of expensive funding to repay that TARP prefer, which wasn't in the net interest income at the beginning of that period. And the funding to redeem that TARP is in – actually a detriment to the net interest income we see there at the end.

So I think, we've got a proven asset generation capability. As I mentioned before, how we do it is important. So the course of what we do at Flagstar is recruit seasoned bankers from our larger banks competitors. I don't want to say, who they are. But I think you can guess, is who they are. What we've given you here is, just how we do it. So we've recruiting seasoned bankers with a good reputation in the markets that we serve. We bring them over to Flagstar. They come because of various reasons including, they see the opportunities being greater at Flagstar. Or they're in the Detroit market and they don't want to move to name your out of town location. Or another institutions move them out of town, and they want to move back to the place where they grew up.

So all those lead to the way we acquire loans. So our acquisition models really about finding the good bankers, recruiting them into Flagstar. And then how they're move their seasoned loan portfolios, kind of and as it is where it is, from some other banks balance sheet to our banks balance sheet. And why that's important is, we're not trying to cut our covenants – we're trying – not trying to go covenant light to move credits over. We're up trying to cut price and move credits over.

We're doing the movements on the basis of the relationship with that person has with their clients, with their customers. And we’re able to do that successfully. And we've got in the past two years, a total of 44 new RMs coming over, which is really essential to the growth we’re showing.

We also have, in addition to the 44, which was as of September 30, I’m aware of four others coming just in Q4 alone, there are on this list. We continue to execute in that business model well. The other part of asset generation is doing as well diversified way. We've seeing so many people kind of flame out by doing one thing, doing it well, but fully exploiting the markets and going over their skews a little bit in the market. What I want you to focus on is not any one of these individual pies, but the well diversification of all the pies.

The one to the left is our warehouse loan portfolio, which breaks it down between who sells and who doesn't sell the Flagstar. But if you look at our CRE portfolio, it's well diversified. And you look at our C&I portfolio, the big red chunk of the pie has to do with some of the mortgage aspects. The MSR financing, the servicing advance financing, what we do as part of our mortgage business. But other than that the pie is just a well diversified pie and amazingly considering that we're effectively at Detroit based or Michigan based banks, very low level of direct auto exposure. Of course, being in Michigan, we're always indirectly exposed to banking.

And then finally, looking at the center top pie, that's our whole loan portfolio, and what you see there is – there's probably an over dominance. Then where will be in the future on residential mortgage loans. And that may be counterintuitive to many of you, because Flagstar is such a presence in the mortgage space. The big slice of pie of course, is loans held for sale and will continue to have that – has be part of our earning asset mix, have that be part of our balance sheet, always. And we can attenuate that up and down depending on what our capital needs and desires are. But the kind of the mustard shave there if you will, is our first mortgages that we put in the portfolio and over time, I would tell you – I see that coming down and down and down.

And that the commercial aspects continuing to rise and be a – come a bigger piece of that pie. But what's important about the mortgage and what I want you to take away from this, is that we can always fill whatever our capital investment needs are, by diverting our mortgage loan production to the balance sheet and the word diverting the pieces of that mortgage production stream that we like. So if we like a particular geography or particular products type, we can always load that up to the balance sheet. And so it’s incredible asset generation engine.

I will spend a lot of time with this slide. It's just as – its three proof points on the flywheel that we walkthrough earlier as how we – wherever you can enter on the flywheel, we can turn that into a holistic relationship with the client. But I want to move next to capital. Because the other thing that people don't appreciate is our incredible capital generation engine we have. So as I mentioned, we've grown from $10 billion to $17 billion over the course of three years, and we've done that without having go-to-market to raise equity. So we effectively increase the size of our balance sheet 70% and done that organic with organic capital generation.

Now admittedly, it's just creating up trap capital, what we've been doing is really a combination of three things. One is having really strong return on equity, that will certainly help in generating capital. Two, we had net operating losses that we're earning our way out off. So we're not only just growing capital by our ROE, but we're really growing at a pretax ROE level. And then the third source of the trap capital is the MSR assets that we had in the balance sheet.

Over three years ago, we had 56% of our Tier 1 capital in MSR asset. More recently, that's down to the mid-teens and with the NPRs, the capital regulation changes that are proposed, this quarter we lead that climb a little bit. The MSR asset for us is an attractive asset, we hedge it from a interest rate risk, convexity risk, forward volatility risk standpoint and are able to generate a pretty good return on the asset without taking the inordinate levels of risk that you might see in – especially the non-banks' balance sheet, who don't have the ability to hedge it.

But what I want you to know is two things. One is the 70 basis points – 70 to 80 basis points, I'd say of trap capital in our NOLs that we should release over the next 12 months. And there's a similar amount of capital that's traps that gets released as soon as the capital rules go into effect, I'm expecting in the first quarter of 2018.

And so with that robust capitals, we're able to take where we are today, which the Tier 1 leverage ratio. Tier 1 leverage is our constraining capital ratio. And through earnings and I've used first call consensus earnings over the next nine quarters, Q4 in the next two years. So consensus earnings with the trap capital that's in our NOLs, the trap capital that's in our MSRs which could freed up with the new capacity regulations that we go from 8.8% Tier 1 leverage capital to 9.5% Tier 1 leverage capital, despite growing the balance sheet another $5 billion.

So we expect to – in that 9.5% really just represents the 8.8%, we currently report plus the benefit of the change in the capital regulations. So effectively, self-funding all the capital we need for that balance sheet growth. Then again, the balance sheet growth should at meaningfully to our stock price.

And then finally, let's talk a little bit about liquidity and funding. So as we look at our balance sheet, it's a bank – it's a different balance sheet what you're used too. We have a significant amount of warehouse loans and those are loans that turnover every two to three weeks. That's a pretty – it's a highly liquid asset class and it's an asset class that has very little risk content, but pays us a really nice spread.

When you impair that with our loans held for sale, the loans that we originate to sell that are just in the process of moving from our balance sheet to the balance sheet of Fannie, Freddie, Ginnie, or the jumbo loans are moving these days through our MBS securitization capability. So those are all loans in the process of leaving our balance sheet. They turn roughly every 60 days right now. But if we wanted to that could turn every 30 days. And we fund those two categories. The warehouse loans and the loans held for sale with our escrow deposits that we get from our mortgage business.

As we compare that mortgage loans with mortgage deposit plus our loans – our borrowings we get from the Federal Home Loan Bank, which the mortgage loans largely sell fund. So if you look at that, and then you look at this from – what I call bank loan to deposit ratio to take our total loans plus the warehouse loans those are kind of volatile. And you take our total deposits plus the escrow deposits. You come to a bank, loan to deposit ratio of 78% which is where we get – there's another $1.7 billion of additional funding, before we had a loan to deposit ratio of 100%.

As I think about the liquidity risk that we're taking even on a 100% loan to deposit ratio and you look at the $1.1 billion that we have in warehouse loans that turned every 10 days to 15 days, the $4.5 billion of loans helper sales that we could liquidate within a month. And over $2 billion of government securities we have on the balance sheet, we have ample liquidity to be able to take that loan – bank loan to deposit ratio of 200%. But should we not have that how we're going to fund ourselves. We think there are abundant sources of additional liquidity. Admittedly in the value narrative, this is where we need to execute, so there are really four sources of additional deposits that we think our – at our disposal.

Let me start off with in the upper right quadrant with sub-servicing income. As we sub-service loans, we're competing against a lot of non-bank and those sub-service loans come with escrow deposits, the principal and interest, the taxes insurance you make monthly payment bond, we collect and then remit periodically. Through growing our sub-servicing income for the 400,000 customers that we serve today, up to 800 or 1 million customers that's where we think the business can and will scale within the next two years to three years. We will basically double the 1.5 billion, we currently hold on our balance sheet. MSRs additionally, with the new capital regulations we can hold more MSRs, that will allow us to hold more escrow deposits on our balance sheet.

Going down to the lower left quadrant. I mentioned before we have 99 branches in the state of Michigan, we also have 95 loan production offices. And oftentimes those of you who've gotten mortgage, have also probably received an offer from the mortgage company telling you, if you open up a checking account with us, we'll give you a small break on your mortgage. So we're looking at that as an opportunity to stand up a direct banking, online opening capability through our mortgage loan offices and we're not quite sure as to what the sizing of that deposit opportunities going to be.

I've seen some pretty incredible numbers at this point, but I don't necessarily believe them. It's my job to be skeptical. But it makes sense for us to continue to try to develop those 95 out of state mortgage loan production offices into branches that can effectively take deposits. And we will go the route of fully making them deposit – depository branches, because that would be a rather expensive proposition, but we believe that we can stand up a digital capability and bring more deposits in.

Then finally, I would tell you that if that doesn't work, we believe that there are acquisitions that are available in the marketplace that are less attractive to other financial institution that we can bring on deposits through non-organic mean in a positive way.

Then finally, we always come back to mortgage. And how do we think about mortgage. And shouldn't we talk a lot about banking, but let's talk about mortgage for a second. So lot of people who look at the mortgage market in a passing way, I think of the mortgage market is volatile. Yes, I can tell you it certainly can be volatile. What we've done along the bottom of the slide as we've gone back and look at the past 25 years. And if you look at the past 25 years, its more volatile and I'm showing you there, because anyone looks at that again in the passing kind of way often does it in nominal dollars. You need to convert that to real dollars. And you need also factor in the fact that U.S. population has grown 30% that time period.

So we normalized those two factors. What we find is that looking at the pure historical nominal dollars tells a more volatile story and what really exists. What really exists I would suggests in that blue band, that middle stuff, the go-go years of – 10 years to 15 years ago that's never going to happen again. But that blue band is where we should be operating. 2016 we're operating near the top of that blue band. In 2017 and 2018, it's much more muted. We're operating in the middle to the lower half of that band. What’s important is that you have the scale, so that when the markets good, you can rise with that tied or when the markets bad, you can take advantage of that scale, to still be profitable and to consolidate share.

How we consolidated share in 2017, through two acquisitions. So the first part, we're expecting the market to be down approximately 20% this year. So that's replacing roughly $7 billion in volume. So in February, we've got the delegated correspondent business of Stearns Lending, that was roughly a $7 billion of your volume business. So yes, if replacing the volume was our to-do list, check, we've done in February. But they came on a lower margin. So we had to replace not just the volume, but the revenue. And in May, we made another acquisition this time of a retail mortgage lender in San Francisco Bay Area called Opes Advisors. And so with the combination of those two, Opes was doing about $3 billion a year, but it was retail.

So the margins were roughly 3%. Our margins in the past have averaged about 90 basis points. So between the combination of the Stearns delegated correspondent business that yield somewhere between 20 basis and 30 basis points margin. And the $3 billion of Opes volume will be brought on to yield somewhere around 300 basis points of volume. In the down year of the 2017 represents for the mortgage market and Flagstar has a 2% national share. We've effectively replace the volume and the profitability and the revenues. So while the mortgage market will be volatile, I would suggest to you players like Flagstar have the ability to weather out and take advantage of that volatility.

And finally the last thing I'll leave you with. Again I think Flagstar represents tremendous upside. I want to point out a couple of things in that. Low credit risk, low market risk, low liquidity risk, plenty of capital, and I think that's a combination for success. From a credit risk perspective, no commercial billing from since over 30 days, very, very low NPL levels and a loan loss coverage ratio of 2%, 2% of our loans are in the allowance of loan loss, which is roughly 50% stronger than the next strongest mid-size bank.

From a market risk position, we try to manage the bank is neutral as possible. We're not going to sit here and tell you, we want to be asset sensitive, we're not going to try to be liability sensitive. We're going to really try to keep ball right the middle of the fair way. There is enough things that can go wrong. From a rate risk perspective that we don't want to try to guess what might happen in the future. Our crystal ball just isn't that good. Then also from a mortgage risk perspective, price risk perspective if you will, we hedge the MSR both in terms of interest rate risk, but also convexity and for volatility. And if you look at other people who either hedge the MSR, but do so an inadequate way or tell you that the MSR is a natural hedge against the originations business or vice versa.

I would run the other direction. We walk though the bundle of liquidity and at the bottom of the chart, it shows you our CET1 ratio, which is in the middle of the pack today, but with the capital regulations that are coming out we expect in the first quarter of 2018, that should be marked improvement in our capital ratio. So low credit risk, low market risk, low liquidity risk, plenty of capital.

So with that, I've got about 10 minutes to take any questions that you might have.

Q&A

<Q>: [Question Inaudible]

<A – James K. Ciroli>: So the question was, if the regulators take the hold limit up to 25%, what does that mean for Flagstar and what do we think the returns are on the asset? We guide to returns of 5% to7%. I think we can significantly up on that. We have so far this year. This past quarter we reported returns of 11%. What I would tell you is, we’re still kind of cautious as to where that market is. And we're going to hedge setting expectations too high. So that we don't over promise, but I think the returns of 5% to 7% were better are achievable. And I think that what we saw this past quarter have been 11% in the less return of the asset is something that we believe is doable. But maybe not doable every quarter and it was also be impacted by whatever sales we still have to affect. The 25% hold limit that was important, it’s a partial, but not – it’s a small start to leveling the playing field between the non-banks they can hold an unlimited amount of their capital, 200% or 300% if they want in the MSR assets, but banks can’t.

So it’s a start to trying to level the playing field of regulatory discrimination between the banks and the non-banks. But I think the implications on taking it from 10% to 25% for us is not only the return I articulated before, but also the fact that a 10% that doesn’t give you a lot of flexibility to kind of weather out the degrees that might exist within that MSR market. And as we’re producing roughly $35 billion of mortgages every year, that’s creating in mortgage assets of roughly $350 million and that’s about what our hold limit is, at the 25% level.

So we’re stuck with selling at the 25% we’re still going to be a regular periodic seller in the marketplace and it be able to go to the marketplace without the compulsion to sell significantly strengthened – strengthens our hand in that negotiation. So I think the execution that we’re able to achieve will be much better in that market. Kevin?

<Q>: [Question Inaudible]

<A – James K. Ciroli>: So the question was with the move to 25%, does that encouraged bigger banks to step in and create more competition for Flagstar. I don’t think it changes anything. I think the big banks already had excess capacity of book MSRs in their balance sheet, and we’re seeing a lot of that. You’re seeing some of the large regional banks step back into mortgage and become more competitive. But they’re doing so largely within their own branch network or

largely within their own footprint. So there are a few banks that are out there trying to execute in all the channels that we're executing in.

So I think it does help them a bit. But I don't think it changes the landscape competitively from where we currently are to where we'll be in the future. Because they're at 10%, they're still able to compete effectively in that space and a 25%, it's like taking the water in the swimming pool from 10 feet deep to 25 feet deep still you can't touch standing up. So I don't think if we can change the competitive landscape too much. Scott, yes.

<Q>: [Question Inaudible]

<A – James K. Ciroli>: So the question is, if the mortgage deduction is limited, how will that impact like those business I guess. So honestly, we saw that on CNBC today and my first reaction was that the value of our MSR just went up. Because the prepayments are slow. But I think that when you look at some of the geographies where the average loan might be more about above $500,000 limit, like on the West Coast, like in the New England, New York area. I think, it could have a small dampening effect on home prices and home affordability. Especially, like in the Bay Area where you can get a shack – I'm sorry, I should say the San Francisco Bay Area, we can get a shack for close to $1 million it seems.

But I think the large part of the country and we do business in all 50 states, I think the large part of the country that type of limitation is going to be more shorter shrub. And the economic stimulus that we hopefully gain from the rest of tax reform package should create more jobs and create more economic activity that will offset any potential negative that we might see from at the upper end of the mortgage market having a deduction limitation, I think it's pretty novel as well start that limitation of $500,000, so even that I'm guessing it, how this is going to work, I haven't seen anything. But at a $1 million mortgage you would only have 50% of that interest be deductible and 50% be non-deductible. So that's a nice way to phase that in. So I don't think it's going to be too abrupt for any particular homeowners. Thanks for the question. Yes, Terry.

<Q>: [Question Inaudible]

<A – James K. Ciroli>: Happy too. So the question was MatlinPatterson, being a 62% shareholder of Flagstar, what's their timeline looks like, what are they, what's their current involvement with the company and what's the future. I'm not really able to speak for MatlinPatterson, they invested initially in 2009, it was in 2007 fund. So you can understand how these typically work, I've never seen the fund documents like I couldn't answer specific questions nor am I prepared too.

I also – circling back to, I said, I came to Flagstar three years ago, and three years ago MatlinPatterson was in our offices on a daily basis. And at that point their cost basis was $28 a share and stock is trading around $14. So I think it be hove them to be in there on a daily basis. But we really over – I see over the past, it's probably been two years at this point, since they've made any kind of regular trip either on a monthly basis.

And now they have two people on our board of directors out of nine total. And we see them a board meetings only. And they've been very hands off. I think they have a high degree of confidence. And I would tell you, they seem to – as board members they see what our strategic plans are. I think they have a lot of confidence that there's continued growth opportunities in the value they have here. So we're now at $37 a share pretty nicely above the $28 per share cost basis in their investment. You're greater partner, yeah.

<Q>: [Question Inaudible]

<A – James K. Ciroli>: I think it's very important. You see the demographics moving and the shift especially in the mortgage business we're talking about how do we serve the millennials, one to the millennial start buying homes. So I think Rocket mortgage, especially from Quicken, Quicken was big refi shop and they're looking at the same things that iSource looking at which is the markets pivoting more towards the purchase market and with they destroy their business model.

So I think Rocket was an essential aspect of how they're planning to navigate that pivot. It's home grown technology admittedly on their own. I think JPM and Wells Fargo also growing their own technology. But I would offer that, look, we have neither the crystal ball that you need to figure out, where technology is going to be two years from now.

So if we design something today, it's going to be two to three years before we can deploy it, what our strategy from a technology perspective has been, is will let other people develop similar computing technology, some of those people will develop things that work, some of them won't develop things that work. And when they deploy the technology that works will be a renter of their technology.

And I would offer there are solutions that are in the market today that compete rather effectively and some people might say even more effectively with Rocket. And some of the larger banks even our initial users of that that new technology. So that's how we've always approached technology and that's how we continue to approach technology.

<<Unidentified Analyst>>

All right, Jim. And thanks very much.

<<James K. Ciroli, Executive Vice President, Chief Financial Officer>>

Thank you.