

>: The Right Time to Buy Countrywide Financial Corp. (CFC)

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Countrywide Financial CORP. (NYSE: CFC) is offering investors the opportunity to buy a quality Fortune 500 company cheap, *very*cheap.

Buying low and selling high is a strategy most covet, but never truly understand how to accomplish. When the market creates buying opportunities, most investors shy away, scared off by the prospect of continued loss in the investment. The art of buying low and selling high is finding a quality company that has been beaten down by the market, but is ripe for a comeback.

Countrywide is presenting investors this opportunity. I know your first reaction is "yeah right, there is no way I am going to put my money into this mortgage meltdown." As a Wall Street broker, I *often*heard that same response when I presented an opportunity like this one to my clients.

It's a valid feeling. The problem is, feelings and emotions should have zero to do with investing. Investing is about buying quality companies cheap (unless you're a day trader, but we are talking about investing). Warren Buffett has created an empire on this very principle.

There are three factors driving this particular stock down:

1. Their exposure to the sub-prime mess;
2. Third quarter losses the company reported;
3. An overall panic in the housing market.

The question is: Do these factors support this low valuation?

Right now CFC is trading at \$13.60 per share after a down trend that began in May at \$41.00. At today's price, the valuation is less than a third of the 52-week high of \$45.26 which was set in January.

The current valuation is not validated when looking at Countrywide's overall position in the housing market. We're talking about the largest mortgage lender in the country, originating \$3 trillion in mortgage loans since 1969. This quarter, their mortgage loan portfolio continued to grow, reaching \$1.47 trillion in October, an increase of \$202 billion, or 16%, from October 2006.

Only 1% of all loans originated in Countrywide's history have completed foreclosure. Of their sub-prime loans, the driving force behind the housing "crisis", less than 4% are currently in default. This percentage truly puts Countrywide's exposure into perspective.

Really beating down Countrywide's stock was their reported net loss of \$1.2 billion in the 3rd quarter of 2007. This was their first quarterly loss in 25 years ... safe to say an anomaly supplied by sub-prime woes. *The troubles affecting Countrywide are industry broad*, not a specific operating mistake of Countrywide itself, and seem to be part of a correction in the overall housing market.

Looking forward, losses accrued in the 3rd quarter are not re-accruing, as the company projects a profit in the fourth quarter of 2007 and throughout 2008. Countrywide is trading at a trailing P/E ration of 3.81, while Bank of America (BAC) is trading at a P/E of 10.46 and Fannie Mae (FNM) at 13.26.

Obviously, Countrywide is trading at



right the ship. In order to deal with the sub-prime issues, Countrywide has embarked on several ventures to help home borrowers maintain their payments and avoid default. They currently have \$33.6 billion of "highly reliable liquidity" to help deal with housing defaults, and assigned 2,700 staff members to mitigate default losses.

Countrywide expects to cut foreclosures by 35% in 2007 from 2006. The company has shown consistent quality growth over the years, and I don't believe that the management completely lost their ability to manage based on one quarter. 25 years without even one quarter of reported losses is pretty amazing, and a signal that the company will rebound.

Federal inquiries into Countrywide's lending practices do not appear validated. The company has been lending since 1969, and embarked on a "we house America program" to fund \$1 trillion in home loans to help lower income and minority individuals buy homes and acquire mortgages. In this program, Countrywide loaned \$789 billion as of August 2007. They are the leading lender in home mortgages to all minorities, including African Americans, Asians, and Hispanics.

The company once championed for their efforts is now being demonized for their lending practices. In order to protect themselves going forward, Countrywide will "tighten underwriting guidelines and enhance controls," requiring higher FICA scores from prospective borrowers. Tightened restrictions are a bad sign for lower income and minority homebuyers. Nevertheless, a stricter mortgage criterion is a positive sign for investors, as Countrywide will have substantially fewer sub-prime mortgages to worry about going forward.

Aside from their mortgage business, Countrywide has large revenue streams from other services and subsidiaries. For example, Countrywide is the third largest Federal Reserve Bank in the nation. Banking Operations' assets were \$106 billion in October 2007, compared to \$83 billion in October 2006.

Countrywide's mortgage refinance division is sure to see an increase in business as the Fed continues to lower interest rates. Panic in the housing market -- which helped pummel Countrywide's stock -- may also be a catalyst for lower interest rates, and in turn lay the groundwork for Countrywide's comeback.

Of course, in the short term, Countrywide's stock could remain volatile. I am not saying this is the lowest point to come, but the stock is cheap for a company of this quality. Countrywide may trade to \$10, or even \$9 in the short term. But from a technical standpoint, the stock does appear to have bottomed out.

Recall other leaders of their industries that nobody wanted:

Merrill Lynch(Symbol: MER), a Wall Street leader that dropped from around \$55.00 to \$15.00 in another financial "crisis" -- October 1998.

- Up 200% within 6 months. Today it's at \$57.00.

Yahoo Inc.(Symbol: YHOO), king of the web, from as high as \$125.00, then dropped to \$4.00 when the dot-com bubble burst -- October 2002.

- Up 1000% in 4 years. Today it's at \$26.10.

EMC Corp.(Symbol: EMC), leader of data storage that traded from around \$104 to \$4.00 -- October 2002.

- Up over 400% in recent weeks near \$25.00. Today it trades at \$19.72.

The list goes on, but my point is that *nobody* wanted to go near these industry leaders, which is *why* they were so cheap. The common denominator was that in each case investors were saying that "this is different."

In 1 to 2 years, Countrywide's stock could trade up to \$26 easily, which would still be \$20 off the 52-week high.

It takes a lot of guts to buy a stock getting hammered in a bear industry. The market presents opportunities, leaving it up to the sharp investor to have the guts to take advantage.

-- John Micheline

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