

## Equity Research

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## Financials

### Assured Guaranty Ltd.

#### AGO a “Melting Ice Cube?” More Like “Sustainable Buyback Machine” and “Inexpensive Value Creator”

We anticipate that shares of Assured Guaranty (AGO) will be weaker this morning after a hedge fund manager laid out a bearish thesis on the stock at an investment conference yesterday after the market close. If such turns out to be the case, we believe this would represent an attractive opportunity to buy AGO shares at an even more attractive price when none of the notions underlying the argument in favor of the shorting the stock are new, and most are easily refuted through a quick review of the facts on the ground.

### AGO

**\$35.93**

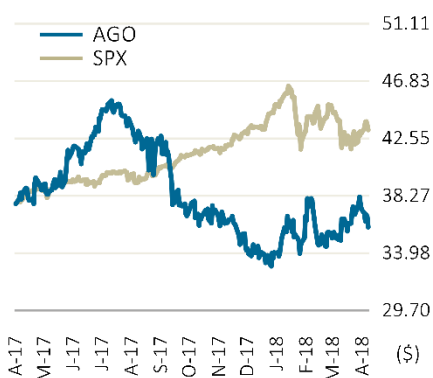
12 month target \$51.00

### BUY

52 week range \$33.01 - \$45.38

Market Cap (m) \$4,272

#### Price Performance



Source: IDC

- ▶ AGO during the manager’s presentation was labeled “a melting ice cube” that was “paying out the drops while it still can.” We believe this assessment is simply misguided. While it is true that AGO insured portfolio is running off more quickly than the company can replenish it with new insurance written, it is also true that it has an \$11.5bn investment portfolio that generated \$418mm in investment income in FY17.
- ▶ That’s hardly a description of a “melting ice cube,” especially insofar as that investment income is equal to the annual debt service on all of AGO’s insured exposure to Puerto Rico’s debt over the next decade.
- ▶ Moreover, the \$500mm+ in share buybacks that AGO is positioned to execute for years to come are hardly “drops,” and inasmuch as the company had \$2.8bn in excess capital above Standard & Poor’s “AAA” standard as of YE16 – a figure that we believe is well over \$3bn at this point given the capital released via portfolio run-off – it is well positioned to sustain that level of repurchases for years to come.
- ▶ Indeed, AGO’s ability to repurchase its shares at a steep discount to its adjusted book value (ABV) is a significant source of value creation. If there is anything “melting” in the case of AGO it is the company’s share count, which has shrunk by 43% since 2013.
- ▶ **Valuation:** Our \$51 price target is based on 0.65x our YE18E adjusted book value (ABV) per share of \$83.01, minus \$4.40 per share representing the estimated impact of potential losses related to AGO’s insured exposure to Puerto Rico’s debt.

## Estimates

	1Q17 A	2Q17 A	3Q17 A	4Q17 A	FY17 A	1Q18 E	2Q18 E	3Q18 E	4Q18 E	FY18 E	FY19 E
Operating Income	273	141	156	91	661	82	80	80	78	320	261
Oper. Inc. Per Share	2.15	1.15	1.29	0.77	5.40	0.71	0.71	0.72	0.72	2.86	2.60

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

- ▶ As a result, AGO's ABV per share has increased from \$49.55 in 3Q13 to \$77.74 at YE17 – a trajectory that it is well positioned to sustain. AGO shares trade at just 0.46x the company's TBV as of YE17 such that those buybacks are highly accretive.
- ▶ AGO has other means of boosting its ABV, including the purchase of inactive bond insurers or the reinsurance of their portfolios. We believe this is likely to become apparent again when the company reports its 1Q18 results on May 3 as it should disclose the amount of accretion to ABV it will realize from the deal it announced in February to reinsure essentially all of the insured portfolio of Syncora Holdings (SYCRF, Not Rated).
- ▶ The manager stated that AGO had “fooled sleepy auditors and regulators,” a comment that we believe is unlikely to gain much sympathy for the shorts from PricewaterhouseCoopers or the New York State Department of Financial Services. We believe the auditors and regulators don't need to be overly alert to take note of AGO's \$11.8bn in claims paying resources as of YE17.
- ▶ Let's toss in the rating agencies for good measure: S&P in its recent annual review of the company stated that based on its capital position AGO could realize \$2.3bn in losses on its insured exposure to Puerto Rico's debt without any change in its financial adequacy or financial risk profile, which implies that there would be no change to its “AA” rating. We believe it is unlikely that the ultimate amount of losses that AGO will absorb on its \$4.966bn of net insured exposure to the Commonwealth's debt will come close to that figure.
- ▶ We believe the short thesis offered in the presentation boils down to a rehash of the threadbare arguments we have heard for years about how AGO's insured exposure to Puerto Rico would sink the company, combined with a bit of the kind of hyperbole about the impending doom facing the municipal bond market that sputtered out pitifully a few years ago. As such, we believe any downdraft in shares of AGO as a consequence of the presentation will be short-lived and that those who take advantage of it will be amply rewarded.

## Income Statement

Assured Guaranty Ltd Earnings Model	Dec-14	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Dec-19
\$ millions	2014A	2015A	1Q16A	2Q16A	3Q16A	4Q16A	2016A	1Q17A	2Q17A	3Q17A	4Q17A	2017A	1Q18E	2Q18E	3Q18E	4Q18E	2018E	2019E
Present value of new business production (PVP)	168.0	179.0	38.0	41.0	50.0	85.0	214.0	99.0	70.0	39.0	77.0	285.0	86.9	91.2	95.8	100.5	374.4	468.0
Net earned premiums (NEP)	570.0	766.0	183.0	214.0	231.0	236.0	864.0	164.0	162.0	186.0	178.0	690.0	124.2	121.8	121.8	119.4	487.2	375.0
Net realized investment gains (losses)	(60.0)	(26.0)	(13.0)	10.0	(2.0)	(24.0)	(29.0)	32.0	15.0	7.0	(14.0)	40.0	-	-	-	-	0.0	0.0
Realized gains and settlements on credit derivatives	23.0	(18.0)	8.0	24.0	15.0	(18.0)	29.0	15.0	-	(1.0)	(29.0)	(15.0)	-	-	-	-	0.0	0.0
Incurred losses on credit derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-credit impairment FV gains (losses) on credit derivatives	800.0	746.0	(68.0)	39.0	6.0	92.0	69.0	39.0	(11.0)	59.0	34.0	121.0	-	-	-	-	0.0	0.0
Net change in FV of credit derivatives	23.0	(18.0)	8.0	24.0	15.0	(18.0)	29.0	15.0	5.0	(1.0)	(29.0)	(15.0)	-	-	-	-	0.0	0.0
Fair value gain (loss) on committed capital securities	(11.0)	27.0	(16.0)	(11.0)	(23.0)	50.0	-	(2.0)	2.0	(4.0)	2.0	(2.0)	-	-	-	-	0.0	0.0
Financial guaranty variable interest entity (VIE) revenue	255.0	38.0	18.0	4.0	(11.0)	27.0	38.0	10.0	12.0	3.0	5.0	30.0	-	-	-	-	0.0	0.0
Other income	14.0	251.0	34.0	18.0	256.0	(10.0)	298.0	147.0	22.0	274.0	9.0	452.0	-	-	-	-	0.0	0.0
Net investment income	403.0	423.0	99.0	98.0	94.0	117.0	408.0	122.0	101.0	99.0	96.0	418.0	96.5	97.0	97.4	97.9	388.8	382.0
<b>Total revenue</b>	<b>1,994.0</b>	<b>2,207.0</b>	<b>245.0</b>	<b>396.0</b>	<b>566.0</b>	<b>470.0</b>	<b>1,608.0</b>	<b>527.0</b>	<b>308.0</b>	<b>623.0</b>	<b>281.0</b>	<b>1,613.0</b>	<b>220.7</b>	<b>218.8</b>	<b>219.2</b>	<b>217.3</b>	<b>876.0</b>	<b>757.0</b>
Loss and loss adjustment expenses	126.0	424.0	90.0	102.0	(9.0)	112.0	295.0	59.0	72.0	223.0	34.0	388.0	34.1	34.1	34.0	34.1	136.3	82.5
Deferred acquisition costs	25.0	20.0	4.0	5.0	4.0	5.0	18.0	4.0	4.0	5.0	6.0	19.0	4.0	4.0	4.0	4.0	16.0	16.0
FSAH acquisition-related expenses	-	-	-	-	-	-	-	-	-	-	-	0.0	-	-	-	-	-	0.0
Interest expense	92.0	101.0	26.0	25.0	26.0	25.0	102.0	24.0	25.0	24.0	24.0	97.0	24.0	24.0	24.0	24.0	96.0	96.0
Financial guaranty VIE expense	-	-	-	-	-	-	-	-	-	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0
Operating expenses	220.0	231.0	60.0	63.0	65.0	57.0	245.0	68.0	57.0	58.0	61.0	244.0	61.3	61.6	61.9	62.2	247.1	252.0
<b>Total expenses</b>	<b>463.0</b>	<b>776.0</b>	<b>180.0</b>	<b>195.0</b>	<b>86.0</b>	<b>199.0</b>	<b>660.0</b>	<b>155.0</b>	<b>158.0</b>	<b>310.0</b>	<b>125.0</b>	<b>748.0</b>	<b>123.4</b>	<b>123.7</b>	<b>124.0</b>	<b>124.3</b>	<b>495.4</b>	<b>446.5</b>
Income before income taxes	1,531.0	1,431.0	65.0	201.0	480.0	271.0	948.0	372.0	150.0	313.0	156.0	865.0	97.3	95.1	95.3	93.0	380.6	310.5
Provision for income taxes	443.0	375.0	6.0	55.0	1.0	74.0	136.0	55.0	(3.0)	105.0	104.0	261.0	15.6	15.2	15.2	14.9	60.9	49.7
Tax rate	28.9%	26.2%	9.2%	27.4%	0.2%	27.3%	14.3%	14.8%	-2.0%	33.5%	66.7%	30.2%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%
<b>Net income</b>	<b>1,088.0</b>	<b>1,056.0</b>	<b>59.0</b>	<b>146.0</b>	<b>479.0</b>	<b>197.0</b>	<b>881.0</b>	<b>317.0</b>	<b>153.0</b>	<b>208.0</b>	<b>52.0</b>	<b>730.0</b>	<b>81.7</b>	<b>79.9</b>	<b>80.0</b>	<b>78.1</b>	<b>319.7</b>	<b>260.8</b>
Realized losses on investments, after tax	(34.0)	(25.0)	(9.0)	9.0	(1.2)	(17.0)	(18.2)	21.66	10.00	4.8	(26.0)	10.5	-	-	-	-	-	-
Unrealized (losses) gains on credit derivatives, after tax	500.0	358.0	(43.0)	32.0	(2.4)	48.1	34.7	16.92	(13.33)	37.6	(31.6)	9.6	-	-	-	-	-	-
Unrealized gains (losses) on capital securities, after tax	(7.0)	17.0	(10.0)	(11.0)	(13.9)	35.4	0.5	(1.35)	1.33	(2.7)	3.7	1.0	-	-	-	-	-	-
Foreign exchange gains (losses) on revaluation of premiums receivable	(15.0)	(10.0)	(2.0)	(17.0)	(1.2)	(8.5)	(28.7)	6.77	14.00	12.3	14.9	47.9	-	-	-	-	-	-
Non-economic fair value adjustment and net interest margin of VIEs	153.0	17.0	10.0	(6.0)	(10.3)	16.0	9.7	5.0	-	-	-	5.0	-	-	-	-	-	-
<b>Operating income</b>	<b>491.0</b>	<b>699.0</b>	<b>113.0</b>	<b>139.0</b>	<b>508.0</b>	<b>139.0</b>	<b>899.0</b>	<b>273.0</b>	<b>141.0</b>	<b>156.0</b>	<b>91.0</b>	<b>661.0</b>	<b>81.7</b>	<b>79.9</b>	<b>80.0</b>	<b>78.1</b>	<b>319.7</b>	<b>260.8</b>
Net income/share	6.48	7.15	0.43	1.08	3.61	1.50	6.62	2.49	1.25	1.72	0.44	5.90	0.71	0.71	0.72	0.72	2.86	2.59
After-tax realized losses on investments	(0.2)	(0.17)	(0.07)	0.07	(0.01)	(0.13)	(0.14)	0.17	0.08	0.04	(0.22)	0.07	-	-	-	-	-	-
After-tax unrealized (losses) gains on credit derivatives	3.1	2.49	(0.32)	0.24	(0.02)	0.37	0.27	0.13	(0.11)	0.31	(0.27)	0.07	-	-	-	-	-	-
Unrealized gains (losses) on committed capital securities	(0.0)	0.11	(0.07)	(0.08)	(0.10)	0.27	0.01	(0.01)	0.01	(0.02)	0.03	0.01	-	-	-	-	-	-
Forex gains (losses) on revaluation of premiums receivable	(0.1)	(0.07)	(0.01)	(0.13)	(0.01)	(0.06)	(0.21)	0.05	0.11	0.10	0.12	0.39	-	-	-	-	-	-
Effect of consolidating VIE	0.9	0.12	0.07	(0.04)	(0.08)	0.12	0.07	0.04	0.00	0.00	0.00	0.04	-	-	-	-	-	-
<b>Operating income/share</b>	<b>\$2.83</b>	<b>\$4.69</b>	<b>\$0.83</b>	<b>\$1.03</b>	<b>\$3.83</b>	<b>\$1.06</b>	<b>\$6.72</b>	<b>\$2.15</b>	<b>\$1.15</b>	<b>\$1.29</b>	<b>\$0.77</b>	<b>\$5.40</b>	<b>\$0.71</b>	<b>\$0.71</b>	<b>\$0.72</b>	<b>\$0.72</b>	<b>\$2.86</b>	<b>\$2.60</b>
Book value per share	\$35.70	\$43.15	\$44.88	\$46.64	\$50.34	\$50.81	\$50.81	\$53.96	\$56.39	\$58.34	\$58.96	\$58.96	\$60.10	\$61.12	\$62.13	\$63.16	\$63.16	\$67.66
Operating book value per share	\$36.78	\$42.32	\$43.72	\$44.86	\$48.95	\$49.89	\$49.89	\$52.52	\$54.32	\$55.89	\$56.22	\$56.22	\$57.70	\$59.07	\$60.40	\$61.75	\$61.75	\$67.46
Unearned premium reserve less DAC, after tax	\$16.17	\$17.96	\$17.58	\$16.57	\$16.57	\$16.33	\$16.33	\$18.63	\$18.79	\$18.59	\$21.16	\$21.16	\$21.23	\$21.18	\$21.11	\$21.04	\$21.04	\$21.74
Present value of future installment premiums	\$0.68	\$0.83	\$0.67	\$0.69	\$1.18	\$1.06	\$1.06	\$1.24	\$1.24	\$1.22	\$1.26	\$1.26	\$1.23	\$1.20	\$1.16	\$1.13	\$1.13	\$1.04
<b>Adjusted book value per share</b>	<b>\$52.67</b>	<b>\$60.06</b>	<b>\$60.90</b>	<b>\$61.31</b>	<b>\$65.88</b>	<b>\$66.45</b>	<b>\$66.45</b>	<b>\$71.53</b>	<b>\$73.46</b>	<b>\$74.81</b>	<b>\$77.76</b>	<b>\$77.76</b>	<b>\$79.27</b>	<b>\$80.55</b>	<b>\$81.76</b>	<b>\$83.01</b>	<b>\$83.01</b>	<b>\$89.25</b>
Diluted shares outstanding	173.7	149.1	135.7	134.8	132.8	131.7	133.8	127.1	122.7	120.7	118.9	122.4	115.6	112.9	110.4	107.9	111.7	100.4

Source: BTIG Estimates and Company Documents

## BTIG Covered Companies Mentioned in this Report

ASSURED GUARANTY LTD. (AGO, Buy, \$51.00 PT; Current Price: \$35.93; Analyst: Mark.Palmer)

## 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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**Distribution of BTIG's Research Recommendations (as of March 31, 2018):**

**BUY: 59.6%; NEUTRAL: 36.5%; SELL: 3.9%**

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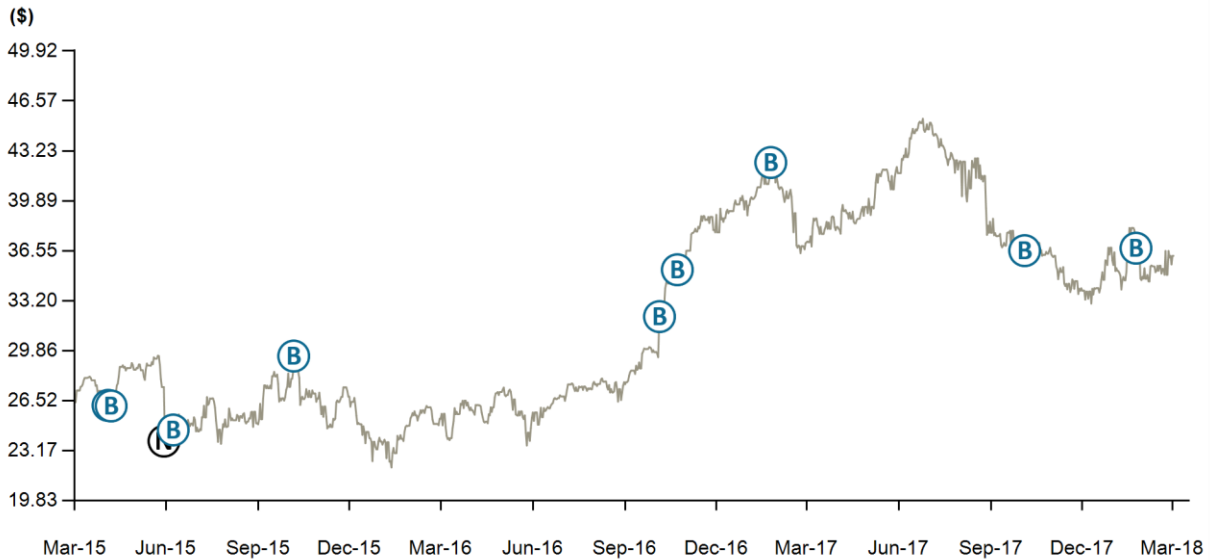
### Company Valuation and Risk Disclosures

#### Assured Guaranty Ltd. (AGO, Buy, \$51.00 PT)

**Valuation:** Our \$51 price target is based on 0.65x our YE18E adjusted book value (ABV) per share of \$83.01, minus \$4.40 per share representing the estimated impact of potential losses related to AGO's insured exposure to Puerto Rico's debt.

**Risks:** The primary risk to achieving our target price include ratings downgrade risks, credit risk related to municipal bond and structured product exposures, and exposures to troubled Puerto Rico credits.

**Assured Guaranty Ltd. (AGO)**



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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
05-Dec-11	12.23	35	Mark Palmer	Buy
29-Feb-12	16.80	37	Mark Palmer	Buy
07-Aug-12	11.72	35	Mark Palmer	Buy
08-Aug-13	21.91	37	Mark Palmer	Buy
07-Nov-14	24.53	39	Mark Palmer	Buy
25-Feb-15	26.37	40	Mark Palmer	Buy
07-May-15	26.11	41	Mark Palmer	Buy
29-Jun-15	23.76	NA	Mark Palmer	Neutral
08-Jul-15	24.49	34	Mark Palmer	Buy
05-Nov-15	29.47	35	Mark Palmer	Buy
04-Nov-16	32.10	37	Mark Palmer	Buy
22-Nov-16	35.24	41	Mark Palmer	Buy
23-Feb-17	42.38	49	Mark Palmer	Buy
03-Nov-17	36.51	50	Mark Palmer	Buy
22-Feb-18	36.67	51	Mark Palmer	Buy

## Company-Specific Regulatory Disclosures

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Additional Information Available Upon Request

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