

Equity Research

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Financials

MBIA, Inc.

Perspective on GO-COFINA Settlement Framework Among Takeaways from Meeting with Management

The significance of the comprehensive settlement framework offered last week by certain of Puerto Rico's bondholders, the timing around the potential resolution of the Commonwealth's debt restructuring, and the extent to which its regulator is attuned to the municipal bond insurers' situation were among the topics discussed when we met with MBIA (MBI, Buy, \$14 PT) management last week at the company's headquarters in Purchase, NY.

Among those in attendance for MBI were CEO Bill Fallon, CFO Anthony McKiernan, National Public Finance Guarantee Corp. Chief Risk Officer Adam Bergonzi and Managing Director of Investor Relations Greg Diamond. Among our takeaways from the meeting were the following:

- ▶ The comprehensive settlement framework announced last Monday by the Ad Hoc Group of Puerto Rico general obligation (GO) bondholders, together with a group of COFINA sales tax bond holders and municipal bond insurers MBI, Assured Guaranty (AGO, Buy, \$51 PT) and Ambac Financial Group (AMBC, Buy, \$26 PT) was almost immediately rejected by both the Puerto Rico government and the island's financial oversight board. With that said, MBI management said they believed the framework still represented a step forward.
- ▶ "In the long run it sets up an expectation for how the COFINA seniors should be treated; it reflects an appropriate recovery for the COFINA senior bonds," Bergonzi said. "It showed that different creditors representing about half of Puerto Rico's \$72bn in debt, with conflicting interests, could come to an agreement."
- ▶ Management disagreed with suggestions that COFINA junior bondholders had been poorly represented in the framework agreement. "The COFINA group agreeing to the settlement framework has deal was done with substantial [COFINA] junior participation," Bergonzi said.
- ▶ **Valuation:** Our \$14 price target for MBI is based on 0.60x on our estimate of the company's pro forma ABV of \$28.60 adjusted for estimated losses of \$5.37 per share related to the company's insured exposure to Puerto Rico's debt.

MBI

\$8.62

12 month target

\$14.00

BUY

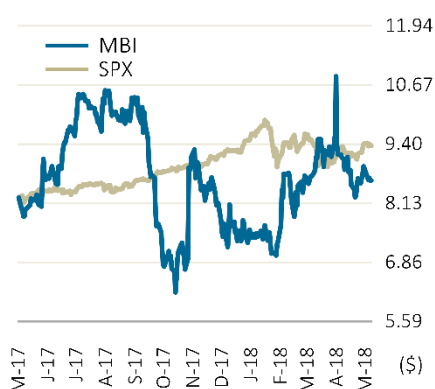
52 week range

\$6.22 - \$10.85

Market Cap (m)

\$760

Price Performance



Source: IDC

Estimates

	1Q17 A	2Q17 A	3Q17 A	4Q17 A	FY17 A	1Q18 A	2Q18 E	3Q18 E	4Q18 E	FY18 E	FY19 E
Diluted EPS (Adj.)	0.07	(1.10)	(0.91)	(1.74)	(4.27)	(0.69)	(0.05)	(0.02)	0.01	(0.82)	0.02
Operating Income	9	(139)	(113)	(167)	(410)	(61)	(4)	(2)	1	(66)	1

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

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

- ▶ Inasmuch as some investors have pointed to a lack of clarity around the timing of the resolution of Puerto Rico's debt restructuring, management reflected on prior municipal debt restructurings in which MBI has been involved such as Detroit.
- ▶ "You can go long periods of time when it appears the parties are far apart and then something happens and there's a big jump," Fallon said. "We haven't seen that catalyst yet. It could be something that happens in the court system, something that happens in DC ... based on our experience we believe it is unlikely we'll go all the way through the legal process to a plan of adjustment being applied by the court."
- ▶ "We don't expect to see a plan of adjustment from the court in the near term," Fallon added. "The plan of adjustment means more to us than the fiscal plan. If more time gets us to a more reasonable outcome then we can afford to be patient."
- ▶ Management said they strongly disagreed with criticism raised about the extent to which the New York State Department of Financial Services (NYSDFS) has been closely scrutinizing the municipal bond insurers. They noted that the regulator on a regular basis conducts a thorough review of more than 200 credits within National's insured portfolio at a forensic level and that it is frequently in contact with CFO McKiernan and National CRO Bergonzi about the situation in Puerto Rico.
- ▶ "I don't think the regulator is asleep with regard to any of this," Fallon said. "There are often disconnects between bond prices and how these situations are ultimately resolved, especially at pre-settlement stages. The regulator understands our loss reserving process, which incorporates our perspectives on claims to be paid the difference between the daily spot price [of Puerto Rico-issued bonds] and our opportunities for long-term recoveries."
- ▶ Management addressed some of the confusion among some investors about an 8-K that MBI filed on May 7 in which it noted that the company had moved to preserve its net operating losses (NOLs) by adopting an amendment to its by-laws prohibiting a person from becoming a 5% shareholder under Section 382 of the IRS Code. Under the change, MBI's existing Section 382 shareholders as of May 2 would not be required to sell their shares but would be restricted from increasing their ownership by more than 1% over their percentage stock ownership as of May 2 or, if lower, its percentage ownership after that date.
- ▶ "Under the 382 construct, National is not an owner of MBIA shares," Diamond explained. "The shares National bought are treated as treasury shares. Owning 5% of the company's shares does not necessarily make someone a 5% owner under 382. Vanguard owns 8% of MBIA shares and it is not a 5% holder under 382, because of the structure of its funds, which doesn't have a single entity or party with 5% of the economic ownership of MBIA's shares."

- ▶ While MBI had \$236mm remaining under its share repurchase authorization as of May 3, management said they were not committed to any pace of buybacks going forward. “If we see that there is long-term value creation in doing it, then we’ll be buying back stock,” Fallon said. In spite of some investors’ musings that MBI could lend out its treasury shares to short sellers, Fallon said there was no reason he knew of why the company could not do so but added that “we have no intention for National to lend its shares of MBIA stock.”
- ▶ Management noted that National’s insured portfolio would continue to run off at a steady clip. “The insured portfolio was at \$66.5bn [in gross insured exposure] at the end of 1Q18 and with scheduled amortization, just over \$4bn more will run off before the end of the year,” Fallon said. “That means really low leverage in the portfolio, and that will be a big key on how much cash from National we can get to the holding company at some point.”
- ▶ Management said their focus continues to be on ensuring that MBI’s holding company has adequate liquidity. “The holding company’s current asset position gets us into 2022,” McKiernan said. “We reduced future interest expense and foreign exchange exposure when we repurchased the 2021 [Global Funding LLC medium-term notes] at a discount and would entertain other purchases of upcoming maturities.”

Income Statement

MBIA Operating Model (\$ Millions)	Dec-14 2014A	Dec-15 2015A	Dec-16 2016A	Mar-17 1Q17A	Jun-17 2Q17A	Sep-17 3Q17A	Dec-17 4Q17A	Dec-17 2017A	Mar-18 1Q18A	Jun-18 2Q18E	Sep-18 3Q18E	Dec-18 4Q18E	Dec-18 2018E	Dec-19 2019E
Total premiums earned	397.0	372.0	300.0	49.0	44.0	53.0	55.0	201.0	40.0	38.3	37.6	36.8	152.7	123.5
Net investment income	179.0	152.0	152.0	52.0	37.0	33.0	32.0	154.0	31.0	30.7	30.4	30.1	122.2	117.3
Fees and reimbursements	40.0	6.0	28.0	2.0	6.0	1.0	6.0	15.0	6.0	6.0	6.0	6.0	24.0	25.2
Realized gains (losses) and other settlements on insured derivatives	(444.0)	(28.0)	(40.0)	(31.0)	(3.0)	(7.0)	(10.0)	(51.0)	(19.0)	-	-	-	(19.0)	-
Unrealized losses on insured derivatives	903.0	157.0	21.0	(22.0)	6.0	6.0	10.0	-	14.0	-	-	-	14.0	-
Other than temporary impairments recognized in AOCI	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net change in fair value of insured derivatives	459.0	129.0	(19.0)	(53.0)	3.0	(1.0)	-	(51.0)	(5.0)	-	-	-	(5.0)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	78.0	63.0	84.0	17.0	(61.0)	(11.0)	31.0	(24.0)	(9.0)	-	-	-	(9.0)	-
Investment losses related to other-than-temporary impairments	(99.0)	(9.0)	(1.0)	-	(54.0)	(26.0)	(21.0)	(101.0)	-	-	-	-	-	-
Other-than-temporary impairments recognized in AOCI	84.0	(5.0)	(2.0)	(2.0)	43.0	(45.0)	(1.0)	(5.0)	(1.0)	-	-	-	(1.0)	-
Net investment losses related to other-than-temporary impairments	(15.0)	(14.0)	(3.0)	(2.0)	(11.0)	(71.0)	(22.0)	(106.0)	(1.0)	-	-	-	(1.0)	-
Other net realized gains (losses)	26.0	17.0	(279.0)	31.0	34.0	-	(5.0)	60.0	(1.0)	-	-	-	(1.0)	-
<i>Revenues of consolidated VIEs</i>														
Net investment income	50.0	86.0	31.0	6.0	6.0	8.0	7.0	27.0	8.0	-	-	-	8.0	-
Net gains (losses) on financial instruments at fair value and foreign exchange	50.0	42.0	-	(33.0)	14.0	21.0	128.0	130.0	4.0	-	-	-	4.0	-
Net gains (losses) on extinguishment of debt	6.0	(1.0)	-	8.0	-	-	19.0	27.0	-	-	-	-	-	-
Total revenues	1,270.0	852.0	294.0	77.0	72.0	33.0	251.0	433.0	73.0	75.0	73.9	72.9	294.8	266.1
Losses and loss adjustments	133.0	123.0	220.0	94.0	170.0	205.0	214.0	683.0	72.0	21.6	20.5	19.5	133.6	68.7
Amortization of deferred acquisition costs	44.0	50.0	40.0	7.0	8.0	8.0	-	23.0	4.0	3.8	3.6	3.4	14.8	11.5
Operating	195.0	140.0	137.0	29.0	32.0	21.0	24.0	106.0	20.0	19.0	18.1	17.1	74.2	66.9
Interest	210.0	199.0	197.0	48.0	50.0	50.0	49.0	197.0	51.0	49.7	48.5	47.3	196.5	177.6
Expenses of consolidated VIEs														
Operating	8.0	13.9	14.0	2.0	3.0	3.0	2.0	10.0	2.0	2.0	1.9	1.9	7.7	7.0
Interest	39.0	39.0	25.0	17.0	19.0	19.0	20.0	75.0	20.0	20.0	20.0	20.0	80.0	80.0
Total expenses	629.0	564.9	633.0	197.0	282.0	306.0	309.0	1,094.0	169.0	116.1	112.6	109.2	506.8	411.6
Pre-tax income (loss)	641.0	287.1	(339.0)	(120.0)	(210.0)	(273.0)	(58.0)	(661.0)	(96.0)	(41.1)	(38.6)	(36.3)	(212.0)	(145.5)
Provision (benefit) for income taxes	72.0	109.0	-	(48.0)	1,019.0	(6.0)	(21.0)	944.0	2.0	-	-	-	2.0	-
Net income (loss)	569.0	178.1	(339.0)	(72.0)	(1,229.0)	(267.0)	(37.0)	(1,605.0)	(98.0)	(41.1)	(38.6)	(36.3)	(214.0)	(145.5)
Diluted EPS	3.02	1.08	(2.55)	(0.55)	(9.71)	(2.17)	(0.39)	(16.71)	(1.11)	(0.48)	(0.46)	(0.45)	(2.65)	(2.06)
Operating EPS	0.98	0.51	0.23	0.07	(1.10)	(0.91)	(1.74)	(4.27)	(0.69)	(0.05)	(0.02)	0.01	(0.82)	0.02
Diluted shares outstanding	188.27	165.66	133.11	131.40	126.60	123.00	96.04	96.04	88.13	85.63	83.13	80.63	80.63	70.63

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$8.62; Analyst: Mark.Palmer)

ASSURED GUARANTY LTD. (AGO, Buy, \$51.00 PT; Current Price: \$35.64; Analyst: Mark.Palmer)

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, \$26.00 PT; Current Price: \$18.84; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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MBIA, Inc. (MBI, Buy, \$14.00 PT)

Valuation: Our \$14 price target is based on 0.60x on our estimate of the company's pro forma ABV of \$28.60 adjusted for estimated losses of \$5.37 per share related to the company's insured exposure to Puerto Rico's debt. Our valuation reflects our assumption that MBI will now realize no tax benefit on its Puerto Rico-related losses.

Risks: The primary risks to our valuation include greater than expected losses with respect to insured exposure to Puerto Rico's debt. Increased losses on the broader insured municipal portfolio. The potential negative impact of a credit rating downgrade on the company's ability to write new business and regulatory risks.

MBIA, Inc. (MBI)
(\\$)



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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
30-Nov-11	9.70	22.50	Mark Palmer	Buy
30-Jun-14	11.04	NA	Mark Palmer	Neutral
15-Aug-14	10.49	12	Mark Palmer	Buy
12-May-15	9.09	13	Mark Palmer	Buy
29-Jun-15	6.37	NA	Mark Palmer	Neutral
23-Jul-15	6.29	10	Mark Palmer	Buy
05-Nov-15	8.28	11	Mark Palmer	Buy
01-Mar-16	7.93	13	Mark Palmer	Buy
21-Jun-16	6.82	14	Mark Palmer	Buy
26-Jul-17	10.21	13	Mark Palmer	Buy
09-Aug-17	10.38	14	Mark Palmer	Buy

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