

# **Equity Research**

March 1, 2019

#### **Mark Palmer**

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ANADO

AMBC	\$19.77
12 month target	\$26.00
BUY	
52 week range	\$14.14 - \$22.22
Market Cap (m)	\$898
Price Performance	
— AMBC — SPX	24.44
- Mu	22.01
May and	19.57
N man	17.14
Show	14.70
	12.27

F-18 M-18 M-18 J-18 J-18 J-18 J-18 N-18 N-18 N-18 N-18 N-19 F-19

¢40 77

# **Financials**

# Ambac Financial Group, Inc.

# Takeaways from 4Q18 Call: Puerto Rico's Debt Restructuring in Aftermath of COFINA Deal in Focus

After Ambac Financial Group (AMBC) yesterday after the market close released a 4Q18 report highlighted by an adjusted earnings beat and significant progress in de-risking the company's insured portfolio, the company this morning hosted a conference call.

- AMBC, which had 78% of AMBC's total insured exposure to Puerto Rico's debt resolved when the plan of adjustment for the COFINA sales tax bonds was confirmed on February 12, noted that 80% of its remaining exposure to the island's debt was to the bonds of the Puerto Rico Infrastructure Financing Authority (PRIFA) and Puerto Rico Highway and Transportation Authority (PRHTA). The company realized \$120mm in benefits in losses and loss expenses related to the COFINA deal during the past two quarters.
- ▶ Management said AMBC was coordinating with fellow municipal bond insurers Assured Guaranty (AGO, Buy, \$52 PT) and MBIA (MBI, Buy, \$14 PT) to maximize recoveries on its PRHTA exposure while it was doing the same with FGIC (Private) on its PRIFA exposure. They noted that the company owns 25% and 37%, respectively, of the PRHTA and PRIFA bonds it insured and that it would opportunistically sell some of those bonds going forward.
- ► We are reiterating our Buy recommendation on AMBC and price target of \$26 based on a sum-of-the-parts analysis (see page 3) in which we assessed the value of the firm's operating subsidiary, its holding company, and its adjusted operating earnings through FY20E.
- Management said they were making progress on identifying acquisition targets that would enable AMBC to utilize the \$1.4bn of net operating losses (NOLs) at its holding company.
- ▶ Valuation: Our \$26 price target for AMBC is based on a sum-of-theparts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY20E.

#### **Estimates**

Source: IDC

	1Q18 A	2Q18 A	3Q18 A	4Q18 A	FY18 A	1Q19 E	2Q19 E	3Q19 E	4Q19 E	FY19 E	FY20 E
Net Income (Adj.)	330	37	(76)	11	301	(5)	(3)	(2)	0	(9)	137
Diluted EPS (Adj.)	7.22	0.79	(1.66)	0.24	6.47	(0.10)	(0.06)	(0.03)	0.00	(0.20)	2.82
Adj. BVPS	31.47	30.86	28.52	27.61	27.61	27.15	26.97	26.81	26.66	26.66	28.85



- ► Management added that their focus was on acquisitions within the insurance, credit and asset management spaces.
- ► Management noted that Puerto Rico Governor Ricardo Rossello in the aftermath of the First Circuit Court of Appeals' ruling last month that the appointment of the island's financial oversight board had been unconstitutional had authorized budget reapportionment without the approval of the board as required by the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA).
- Management said this action had increased the urgency around President Trump and the U.S. Senate acting to appoint and confirm a new oversight board for the island, a move that they believe would be favorable for AMBC and Puerto Rico's creditors.
- ▶ Management added that they supported the recommendation of Puerto Rico Resident Commissioner Jenniffer Gonzalez that the White House appoint a financial recover czar made last month. The proposal called for a federal official to coordinate the reconstruction needed on the island following the 2017 hurricanes given delays in disbursement of federal funds.
- ▶ AMBC scored a victory in early January in its representation and warranty (R&W) litigation against Bank of America (BAC, Not Rated) when New York State Supreme Court Justice Eileen Bransten issued her decisions on six motions that had been filed by BAC, with the judge finding in AMBC's favor on each one. However, BAC appealed those decisions and Judge William Sherwood, who replaced Judge Bransten following her retirement in January, said he would not schedule a trial date until after those appeals had been decided.
- As such, management said the earliest that they believed a trial date would be scheduled would be late in 2019. They added that they had been encouraged by the tone of Judge Sherwood during scheduling hearings on the AMBC-BAC case as he had noted the delaying tactics employed by the bank during the eight and a half years during which it has dragged on and said he expected it to move more quickly going forward.



# Ambac: Sum-of-the-Parts Analysis

Ambac Financial Group (AFG)	Gross Value	Value per Share
Holding Company Assets	\$455.0	\$9.25
Value of warrants if exercised	\$81.3	\$1.65
Total HoldCo Value	\$536.3	\$10.91
Ambac Assurance Corp. (AAC) Value	Gross Value	Value per Share
Investment Portfolio	\$3,647.3	\$74.16
Estimated Representation and Warraty Recoveries	\$2,470.7	\$50.24
Other subrogation	\$651.7	\$13.25
Estimated fraudulent inducement litigation recoveries	\$261.3	\$5.31
Total asset value	\$7,031.0	\$142.96
Claim liabilities	\$2,398.9	\$48.78
Total claim liabilities	\$2,398.9	\$48.78
Secured notes	\$1,941.00	\$39.47
Surplus notes	\$792.0	\$16.10
Junior surplus notes	\$488.0	\$9.92
Tier 2 note	\$259.0	\$5.27
Auction rate preferred shares (AMPS)	\$103.0	\$2.09
Total liabilities	\$5,981.9	\$121.63
AAC Value	\$1,049.1	\$21.33
Assumed multiple	0.65X	0.65X
AAC estimated value	\$681.9	\$13.87
Value of Operating Earnings	Gross Value	Value per Share
0.65X Adj. Operating Earnings (through FY20E)	\$47.0	\$0.96
Total value	\$1,265.2	\$25.73
FY20E Diluted shares		49.18

 $Source: \textit{BTIG Estimates and Company Documents.} \ \ \ \ \ \text{in millions except per share amounts}.$ 



#### **Income Statement**

Ambac Financial Group Inc. Operating Model	Dec-14	Dec-15	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Dec-20
(\$ millions)	2014A	2015A	2016A	1Q17A	2Q17A	3Q17A	4Q17A	2017A	1Q18A	2Q18A	3Q18A	4Q18A	2018A	1Q19E	2Q19E	3Q19E	4Q19E	2019E	2020E
Net premiums earned	246.36	312.60	197.29	47.61	43.15	52.99	31.52	175.28	30.88	25.84	25.64	28.73	111.09	23.43	22.69	21.97	21.27	89.35	82.92
Net investment income	300.95	266.29	313.37	81.56	85.16	87.18	107.06	360.95	110.24	66.66	58.33	37.48	272.72	57.48	57.24	56.79	56.37	227.89	248.42
Total about the standard form	(25.52)	(55.50)	(00.70)	(24.45)	(4.76)	(25.66)	(5.04)	(5.4.63)	(0.24)	(4.04)	(0.27)	(4.54)	(2.25)						
Total other than temporary impairment losses  Portion of loss recognized in other comprehensive income	(26.63) 0.84	(66.69) 41.03	(89.70) 67.88	(21.15) 17.21	(1.76)	(25.66) 12.15	(6.04) 5.09	(54.63) 34.45	(0.34) 0.04	(1.01)	(0.27)	(1.64) (0.02)	(3.26)			-	-	-	
Net other than temporary impairment losses recognized in earnings	(25.79)	(25.66)	(21.82)	(3.94)	(1.76)	(13.51)	(0.96)	(20.17)	(0.30)	(1.01)	(0.27)	(1.66)	(3.24)				-	-	-
Net realized investment gains	58.78	53.48	39.28	(4.90)	4.18	6.15	(0.07)	5.37	4.86	47.15	30.20	29.41	111.62	-	-	-	-	-	-
Change in fair value of credit derivatives:	204	2.79	0.04	0.20	4.43	0.42	0.42	4.50	0.44	0.00	0.40		0.20						
Realized gains and other settlements Unrealized gains (losses)	3.04 20.86	38.92	0.91 19.19	0.20 0.85	1.13 5.49	0.13 0.05	0.12 8.40	1.59 14.78	0.11 (0.45)	0.09 (0.31)	0.10 0.15	(44.72)	0.30 (45.33)			-	-	-	-
Net change in fair value of credit derivatives	23.91	41.70	20.11	1.05	6.62	0.18	8.52	16.37	(0.35)	(0.22)	0.25	(44.72)	(45.03)		-	-	-	-	-
Derivative products	(181.09)	(42.54)	(50.27)	(1.51)	34.07	3.98	23.03	59.57	25.54	9.15	17.33	-	52.02	-	-	-	-	-	-
Net unrealized gains (losses) on extinguishment of debt	(74.72)	0.08	4.85	2.74	2.18	-	(4.42)	4.92	3.12	0.01	-	-	3.12	-	-	-	-	-	-
Other income Income (loss) on variable interest entities	12.50 (32.21)	7.15 31.57	17.45 (14.09)	(0.09) 3.70	0.47 (1.22)	0.05 (4.05)	(1.13) 21.24	(0.71) 19.67	(0.51) 0.57	2.49 0.58	0.69 1.83	2.25 0.45	4.92 3.44			-		-	
income (1033) on variable interest endles	(32.21)	31.57	(14.03)	3.70	(1.22)	(4.03)	21.24	15.07	0.57	0.50	1.03	0.43	3.44						
Total revenues before expenses and reorganization items	328.67	644.66	506.15	126.23	172.85	132.97	189.20	621.25	174.06	150.64	134.02	51.95	510.66	80.91	79.93	78.76	77.64	317.24	331.34
Losses and loss expense	(545.57)	(768.71)	(11.49)	135.01	66.10	209.81	102.27	513.19	(247.40)	32.58	33.50	(42.30)	(223.61)	-	-		-	_	
Underwriting and operating expenses	101.47	102.70	113.66	27.98	31.05	33.79	28.69	121.52	36.43	26.06	28.37	21.34	112.20	20.81	19.77	18.78	17.84	77.19	65.97
Insurance intangible amortization	151.83	169.56	174.61	37.53	33.47	45.69	34.17	150.85	28.64	23.24	26.42	28.98	107.28	26.08	24.52	23.05	21.66	95.32	74.42
Interest expense	127.48	116.53	124.34	31.57	28.23	29.15	30.99	119.94	48.07	62.45	65.67	66.06	242.26	64.74	63.12	61.55	60.01	249.42	128.12
Goodwill impairment	(164.79)	514.51 134.59	401.12	232.09	158.86	318.43	196.12	905.50	(134.25)	144.33	153.96	74.09	238.13	111.63	107.41	103.37	99.51	421.92	268.51
Total expenses before reorganization items	(164./9)	134.59	401.12	232.09	158.86	318.43	196.12	905.50	(134.25)	144.33	153.96	74.09	238.13	111.63	107.41	103.37	99.51	421.92	268.51
Pretax loss from continuing operations before reorganization items	493.46	510.07	105.03	(105.86)	13.99	(185.47)	(6.92)	(284.25)	308.31	6.31	(19.95)	(22.14)	272.53	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Reorganization items	0.21	-	-	-	-	-	-	-	-	-	-	-	L - I	-	-	-	-	-	
Pre-tax loss from continuing operations	493.25	510.07	105.03	(105.86)	13.99	(185.47)	(6.92)	(284.25)	308.31	6.31	(19.95)	(22.14)	272.53	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Provition for income taxes	9.56	17.36	30.71	19.58	6.88	5.44	12.56	44.46	2.61	1.95	2.21	(1.68)	5.09	-	-	-	-	-	-
Net income (loss)	483.70	492.70	74.32	(125.44)	7.11	(190.91)	(19.48)	(328.72)	305.70	4.36	(22.16)	(20.46)	267.44	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Noncontrolling interests & other	(0.38)	(0.71)	(0.53)	-	-	-	-	- 1	-	-	81.69	-	81.69	-	-	-	- 1	- 1	-
Net income (loss) attributable to shareholders	484.07	493.41	74.84	(125.44)	7.11	(190.91)	(19.48)	(328.72)	305.70	4.36	(103.85)	(20.46)	185.76	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Net loss	483.70	492.70	74.32	(125.44)	7.11	(190.91)	(19.48)	(328.72)	305.70	4.36	(22.16)	(20.46)	267.44	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Unrealized gains on securities	252.60	(159.73)	67.90	51.34	12.65	(0.43)	(125.00)	(61.45)	-	-	60.81	-	60.81	-	-	-	-	-	-
Loss: reclasification adjustment for net gain	-	-	-	-	-	-	-	- 1	-	-	-	-	-	-	-	-	-	-	-
Gain (loss) on foreign currency translation	(43.60)	(45.03)	(122.13)	12.59	29.29	24.62	-	66.51	-	-	(8.87)	-	(8.87)	-	-	-	-	-	-
Amortization of postretirement benefit	(0.82)	(0.69)	0.02	2.29	(0.34)	(0.34)	(425.00)	1.61	-	-	0.04	-	0.04	-	-	-	-	-	-
Total other comprehensive income net of tax	208.19	(205.44)	(54.21)	66.22	41.60	23.85	(125.00)	6.67	-	-	51.97	-	51.97	-	-	-	•	-	-
Total comprehensive income (loss)	691.88	287.26	20.11	(59.23)	48.71	(167.05)	(144.48)	(322.05)	305.70	4.36	29.81	(20.46)	319.42	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Less: comprehensive income (loss) attributable to the noncontrolling interest																			
Net income (loss)	(0.38)	(0.71)	(0.53)	-	-	-	-	-	-	-	-	-		-	-	-	-	-	-
Other Total comprehensive income (loss) attributable to Ambac financial group	(0.43) <b>692.69</b>	(0.37) 288.34	20.64	(59.23)	48.71	(167.05)	(144.48)	(322.05)	305.70	4.36	81.69 (51.87)	(20.46)	81.69 <b>237.73</b>	(30.72)	(27.48)	(24.61)	(21.87)	(104.68)	62.83
Total Comprehensive income (loss) attributable to Ambat iniancial group	052.05	200.34	20.04	(55.25)	40.71	(107.03)	(144.40)	(322.03)	303.70	4.30	(51.67)	(20.40)	257.75	(30.72)	(27.46)	(24.01)	(21.07)	(104.00)	02.03
Diluted EPS	\$10.31	\$10.72	\$1.64	(\$2.77)	\$0.16	(\$4.20)	(\$0.43)	(\$7.23)	\$6.70	\$0.09	(\$2.27)	(\$0.45)	\$3.99	(\$0.66)	(\$0.59)	(\$0.52)	(\$0.46)	(\$2.23)	\$1.29
Operating EPS	\$13.58	\$25.13	\$6.86	(\$2.02)	\$1.54	(\$3.30)	\$0.12	(\$3.63)	\$7.22	\$0.79	(\$1.66)	\$0.24	\$6.47	(\$0.10)	(\$0.06)	(\$0.03)	(\$0.00)	(\$0.20)	\$2.82
operating at a	713.30	723.13	70.00	(72.02)	71.54	(75.50)	70.12	(23.03)	77.22	Ş0.73	(71.00)	70.24	Ç0.47	(70.10)	(50.00)	(20.03)	(50.00)	(50.20)	72.02
Common shares outstanding	45.09	45.17	45.21	45.29	45.37	45.40	45.40	45.37	45.47	45.68	45.75	45.76	45.67	46.21	46.68	47.14	47.61	46.91	48.63
Diluted shares outstanding	46.93	46.01	45.72	45.29	45.77	45.40	45.40	45.47	45.65	46.47	45.70	45.76	46.56	46.21	46.68	47.14	47.61	46.91	48.63
CARROLL VII Ch Cl Cl Cl	620.0:	627.26	627.65	625.0-	626.5-	622.24	620.42	420	ć.o	440.50	620.23	627.70	627.75	627.45	626.51	626.05	625.56	635.56	436.0
GAAP Book Value per Share - Diluted Adjusted Book Value per Share - Diluted	\$29.81 \$7.47	\$37.28 \$24.70	\$37.89 \$29.44	\$35.87 \$27.05	\$36.57 \$28.27	\$33.21 \$24.56	\$30.42 \$24.25	\$30.42 \$24.25	\$40.41 \$31.47	\$40.51 \$30.86	\$38.24 \$28.52	\$37.79 \$27.61	\$37.79 \$27.61	\$37.13 \$27.15	\$36.54 \$26.97	\$36.02 \$26.81	\$35.56 \$26.66	\$35.56 \$26.66	\$36.84 \$28.85
Aujusteu book value per share - Diruteu	21.41	.7∠4./U	325.44	Ş∠1.U3	240.41	J24.JU	324.2J	<i>⊋</i> ∠4.23	<i>γ</i> ο1.4/	33U.00	3L0.JZ	<b>3∠1.01</b>	321.UI	221.13	<i>ا</i> 2.025	32U.01	320.00	\$20.00	220.03

Source: BTIG Estimates and Company Documents



# **BTIG Covered Companies Mentioned in this Report**

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, \$26.00 PT; Current Price: \$19.77; Analyst: Mark.Palmer) ASSURED GUARANTY LTD. (AGO, Buy, \$52.00 PT; Current Price: \$41.76; Analyst: Mark.Palmer) MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$9.93; 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.

### **Regulatory Disclosures**

### **Ratings Definitions**

BTIG LLC's ("BTIG") ratings, effective June 12, 2017, are defined as follows:

**BUY** – A security which is expected to produce a positive total return of 15% or greater over the 12 months following the recommendation. The BUY rating may be maintained as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

**SELL** – A security which is expected to produce a negative total return of 15% or greater over the next 12 months following the recommendation. The SELL rating may be maintained as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

**NEUTRAL** – A security which is not expected to appreciate or depreciate meaningfully over the next 12 months. **NOT RATED** – A security which is not rated or covered by BTIG.

**UNDER REVIEW** – Effective immediately, coverage of the following securities is Under Review. Ratings, price targets, disclosures, and estimates for the companies listed below are suspended and should no longer be relied upon.

### Distribution of Ratings and Investment Banking Clients

BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. Stocks under coverage as of the end of the most recent calendar quarter (December 31, 2018): 331

Distribution of BTIG's Research Recommendations (as of December 31, 2018):

BUY: 59.8%; NEUTRAL: 38.1%; SELL: 2.1%

Distribution of BTIG's Investment Banking Services (as of December 31, 2018):

BUY: 27.3%; NEUTRAL: 11.1%; SELL: 0.0%

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

# Company Valuation and Risk Disclosures

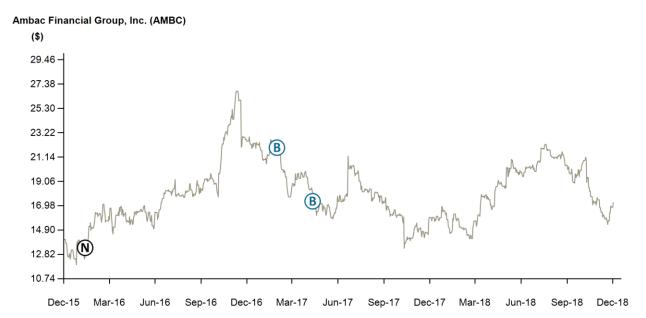
Ambac Financial Group, Inc. (AMBC, Buy, \$26.00 PT)

**Valuation:** Our \$26 price target for AMBC is based on a sum-of-the-parts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY20E.

**Risks:** The primary risks to achieving our recommendation and price target include the possibility that reserves against losses associated with RMBS and other insured instruments may prove inadequate, that fiscal stress of



state and local governments could translate into increased losses, declines in value of investment portfolio could impede Ambac's ability to pay its liabilities and Ambac Assurance Corp. may be unable to exit rehabilitation.



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

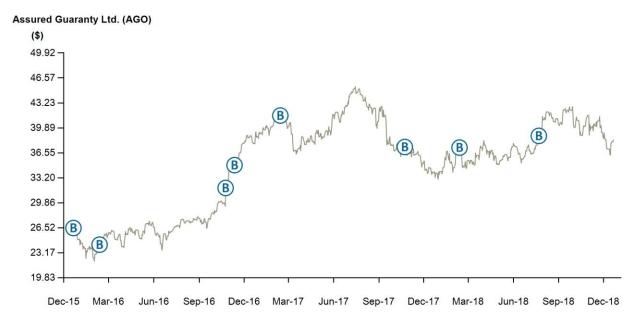
Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
16-May-13	23.67	31	Mark Palmer	Buy
04-Mar-14	34.49	NA	Mark Palmer	Neutral
01-Mar-17	21.90	28	Mark Palmer	Buy
11-May-17	17.34	26	Mark Palmer	Buy

#### Assured Guaranty Ltd. (AGO, Buy, \$52.00 PT)

**Valuation:** Our \$52 price target is based on 0.60x our YE19E adjusted book value (ABV) per share of \$92.39, minus \$5.23 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.





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

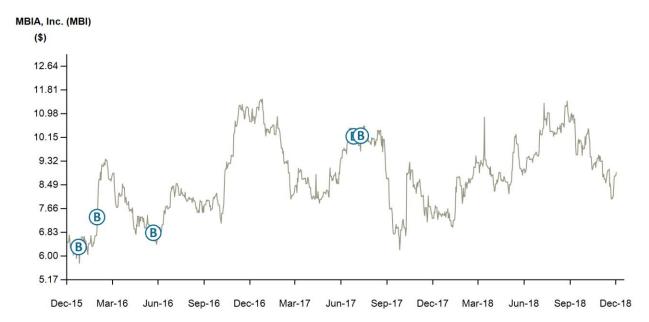
Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
08-Aug-13	21.91	37	Mark Palmer	Buy
07-Nov-14	24.53	39	Mark Palmer	Buy
25-Feb-15	26.37	40	Mark Palmer	Buy
07-May-15	26.11	41	Mark Palmer	Buy
29-Jun-15	23.76	NA	Mark Palmer	Neutral
08-Jul-15	24.49	34	Mark Palmer	Buy
05-Nov-15	28.49	35	Mark Palmer	Buy
04-Nov-16	31.80	37	Mark Palmer	Buy
22-Nov-16	34.84	41	Mark Palmer	Buy
23-Feb-17	41.48	49	Mark Palmer	Buy
03-Nov-17	37.29	50	Mark Palmer	Buy
22-Feb-18	37.19	51	Mark Palmer	Buy
02-Aug-18	38.77	52	Mark Palmer	Buy

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

**Valuation:** Our \$14 price target is based on 0.55x on our estimate of the company's ABV of \$27.38 adjusted for estimated losses of \$2.16 per share related to the company's insured exposure to Puerto Rico's debt. Our new 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.





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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
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	6.65	10	Mark Palmer	Buy
05-Nov-15	8.15	11	Mark Palmer	Buy
01-Mar-16	7.35	13	Mark Palmer	Buy
21-Jun-16	6.80	14	Mark Palmer	Buy
26-Jul-17	10.17	13	Mark Palmer	Buy
09-Aug-17	10.20	14	Mark Palmer	Buy

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BTIG LLC had an investment banking services client relationship during the past 12 months with: Ambac Financial Group, Inc. (AMBC), Assured Guaranty Ltd. (AGO), MBIA, Inc. (MBI)

#### Other Disclosures

Additional Information Available Upon Request

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