

Equity Research

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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 FY 20E.
- ▶ 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-the-parts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY20E.

AMBC **\$19.77**

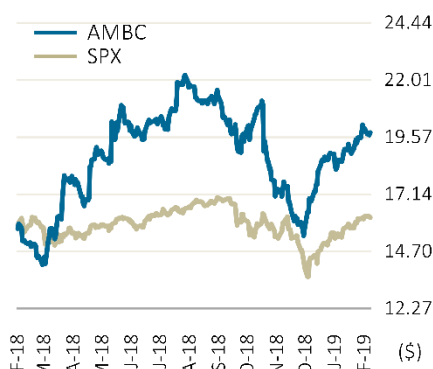
12 month target \$26.00

BUY

52 week range \$14.14 - \$22.22

Market Cap (m) \$898

Price Performance



Source: IDC

Estimates

| | 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 |

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

- ▶ 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 Warranty 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: BTIG Estimates and Company Documents. \$ in millions except per share amounts.

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

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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

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

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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.

Ambac Financial Group, Inc. (AMBC)

(\$)



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.

Assured Guaranty Ltd. (AGO)



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.

MBIA, Inc. (MBI)

(\$)



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 |

Company-Specific Regulatory Disclosures

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