

Ambac Financial Group, Inc.

(AMBC, Buy, \$26.00 PT)

Ruling on Appeal of Pretrial Motions Removes Obstacle to Scheduling Trial in Largest Representation & Warranty Case

WHAT YOU SHOULD KNOW: Yesterday, the Supreme Court of the State of New York, Appellate Division, First Judicial Department (First Department) released a ruling related to Countrywide (CW) /Bank of America's (BAC, Not Rated) appeal of six pretrial motions in the Ambac Assurance Corporation et al. v. Countrywide Home Loans, Inc. case. The ruling preserves Ambac's breach of contract and fraudulent inducement claims against CW, eliminates a jury trial in favor of a bench trial for the BAC claims and severs the primary-liability claims against Countrywide from the contingent secondary-liability claims against BAC. The ruling did not limit Ambac's claims and removed the largest impediments to scheduling a trial, in our view.

- **Severed claims** – By severing the claims against Countrywide and Bank of America, Ambac will first go to trial with CW on the primary-liability claims: breach of contract and fraudulent inducement. Once decided, Ambac will then proceed to trial against BAC which primarily revolves around whether CW de facto merged with BAC or became its alter ego and is therefore jointly liable for judgements against CW. Previously, all these claims would have been addressed during the same trial.
- **July decision** – The First Department ruled that AMBC is not entitled to a jury trial on its secondary-liability claims against BAC. Importantly, a jury trial will remain for the primary-claims against CW. The jury trial is a source of leverage for AMBC in potential settlement negotiations, in our view.
- **Timing** – BAC has 30 days to request permission to appeal the First Department's rulings in this appeal. There is a status conference on the calendar in November for the primary case – we would expect AMBC to request scheduling a trial at that hearing and to gain additional insight into the eventual timing of trial.
- Overall, we view the ruling as a positive development for two reasons: The trial was put off pending the First Department's resolution of the appeals and Ambac's ability to proceed with both breach of contract and fraudulent inducement claims are preserved.
- **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.



September 18, 2019

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COMPANY DATA	
Closing Price:	\$19.99
Price Target:	\$26.00
Market Cap (\$M):	916.19
Shares Out (M):	45.8
Avg Daily Vol - 3 Months (M):	0.19
Dividend/Yield:	\$0.00/0.0%

REVISIONS		
	Previous	Current
Rating	Buy	Buy
Price Target	\$26.00	\$26.00
FY19E EPS	\$5.51	\$5.51
FY20E EPS	\$2.25	\$2.25
FY19E Rev. (M)	\$481.20	\$481.20

Diluted EPS (Adjusted)			
FY Dec	2018A	2019E	2020E
Q1	7.22	(0.20)	0.53
Q2	0.79	2.86	0.56
Q3	(1.66)	2.87	0.57
Q4	0.24	(0.02)	0.58
Calendar EPS	6.47	5.51	2.25
Calendar P/E	3.1x	3.6x	8.9x

REVENUE (\$M)			
FY Dec	2018A	2019E	2020E
Q1	174.06	100.37	79.63
Q2	150.64	81.68	79.69
Q3	134.02	219.20	79.25
Q4	51.95	79.95	78.83
FY	510.66	481.20	317.40

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

Investment Thesis

We believe AMBC shares are very inexpensive and are poised to appreciate with the realization of various catalysts including the achievement of a settlement of its representation and warranty (R&W) litigation against Bank of America/Countrywide, the emergence of clarity around its remaining insured exposures to Puerto Rico's debt, and the acquisition of a profitable company that will enable it to benefit from the \$1.3bn in NOLs at its holding company.

Upcoming Catalysts

- 3Q19 Earnings.
- Scheduling the trial in the Bank of America/Countrywide R&W case.

Base Case Assumptions

- AMBC realizes recoveries in R&W cases with Bank of America/Countrywide and NOMURA (NMR, Not Rated).

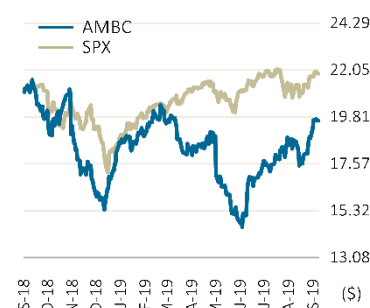
Upside Scenario

- Ambac successfully acquires a profitable company and can utilize a portion of the \$1.3B of NOLs at its holding company.
- Recoveries on R&W cases exceed our estimates.
- Losses on insured exposures to Puerto Rico and other credits are less than expected.

Downside Scenario

- Ambac is unable to enter into R&W settlements or the recoveries are less than expected.
- Additional losses on insured exposures to Puerto Rico and other credits.

Price Performance



Source: IDC

Company Description

Ambac Financial Group (NYSE: AMBC) is a municipal bond insurance company that provides guarantees that protect the holders of debt obligations against non-payment when due. AMBC's subsidiaries include Ambac Assurance Corporation (AAC) and Ambac UK. These businesses are in active run-off, which is being effectuated by transaction terminations, commutations, settlements and scheduled amortization of policy contracts.

We view the ruling on the appeals as a positive development insofar as it is the reason why the court pushed off scheduling a trial in the case. With that obstacle out of the way, we expect the court will schedule a trial. Procedurally, if BAC decides to request permission to appeal the First Department in the next 30 days and is granted the request, that could be a source of additional delays in the case. Although the odds of further appeals and delays continue to fall, in our view.

We continue to believe a settlement is the most likely outcome. With the resolution of remaining questions related to the case resolved, all parties have a better sense of their respective odds at trial which should encourage negotiations and narrow the gap between the amount AMBC would be willing to accept and the amount BAC would be willing to pay.

SOTP Valuation Analysis

Ambac Financial Group (AFG)	Gross Value	Value per Share
Holding Company Assets	\$469.0	\$9.40
Value of warrants if exercised	\$81.3	\$1.63
Total HoldCo Value	\$550.3	\$11.03
Ambac Assurance Corp. (AAC) Value	Gross Value	Value per Share
Investment Portfolio	\$3,584.6	\$71.82
Estimated Representation and Warranty Recoveries	\$2,263.2	\$45.34
Other subrogation	\$653.5	\$13.09
Other litigation recoveries	\$190.0	\$3.81
Total asset value	\$6,691.4	\$134.06
Claim liabilities	\$1,957.8	\$39.22
Total claim liabilities	\$1,957.8	\$39.22
Secured notes	\$1,918.0	\$38.43
Surplus notes	\$812.0	\$16.27
Junior surplus notes	\$498.0	\$9.98
Tier 2 note	\$270.0	\$5.41
Ambac UK Debt	\$12.0	\$0.24
Auction rate preferred shares (AMPS)	\$138.0	\$2.76
Total liabilities	\$5,605.8	\$112.31
AAC Value	\$1,085.6	\$21.75
Assumed multiple	0.65X	0.65X
AAC estimated value	\$705.6	\$14.14
Value of Operating Earnings	Gross Value	Value per Share
0.65X Adj. Operating Earnings (through FY20E)	\$55.8	\$1.12
Total value	\$1,311.7	\$26.28
FY20E Diluted shares		49.91

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

Income Statement

Ambac Financial Group Inc. Operating Model (\$ millions)	Dec-14 2014A	Dec-15 2015A	Dec-16 2016A	Dec-17 2017A	Mar-18 1Q18A	Jun-18 2Q18A	Sep-18 3Q18A	Dec-18 4Q18A	Dec-18 2018A	Mar-19 1Q19A	Jun-19 2Q19A	Sep-19 3Q19E	Dec-19 4Q19E	Dec-19 2019E	Dec-20 2020E
Net premiums earned	246.36	312.60	197.29	175.28	30.88	25.84	25.64	28.73	111.09	27.76	7.83	16.51	15.91	68.01	61.49
Net investment income	300.95	266.29	313.37	360.95	110.24	66.66	58.33	37.48	272.72	54.84	86.46	47.85	48.94	238.09	193.32
Total other than temporary impairment losses	(26.63)	(66.69)	(89.70)	(54.63)	(0.34)	(1.01)	(0.27)	(1.64)	(3.26)	(0.03)	-	-	-	(0.03)	-
Portion of loss recognized in other comprehensive income	0.84	41.03	67.88	34.45	0.04	(0.00)	-	(0.02)	0.02	-	-	-	-	-	-
Net other than temporary impairment losses recognized in earnings	(25.79)	(25.66)	(21.82)	(20.17)	(0.30)	(1.01)	(0.27)	(1.66)	(3.24)	(0.03)	-	-	-	(0.03)	-
Net realized investment gains	58.78	53.48	39.28	5.37	4.86	47.15	30.20	29.41	111.62	17.23	35.86	-	-	53.09	-
Change in fair value of credit derivatives:															
Realized gains and other settlements	3.04	2.79	0.91	1.59	0.11	0.09	0.10	-	0.30	-	-	-	-	-	-
Unrealized gains (losses)	20.86	38.92	19.19	14.78	(0.45)	(0.31)	0.15	(44.72)	(45.33)	(16.16)	(35.41)	-	-	(51.57)	-
Net change in fair value of credit derivatives	23.91	41.70	20.11	16.37	(0.35)	(0.22)	0.25	(44.72)	(45.03)	(16.16)	(35.41)	-	-	(51.57)	-
Derivative products	(181.09)	(42.54)	(50.27)	59.57	25.54	9.15	17.33	-	52.02	-	-	-	-	-	-
Net unrealized gains (losses) on extinguishment of debt	(74.72)	0.08	4.85	4.92	3.12	0.01	-	-	3.12	-	-	-	-	-	-
Other income	12.50	7.15	17.45	(0.71)	(0.51)	2.49	0.69	2.25	4.92	0.80	(8.91)	142.00	-	133.89	-
Income (loss) on variable interest entities	(32.21)	31.57	(14.09)	19.67	0.57	0.58	1.83	0.45	3.44	15.92	3.29	-	-	19.22	-
Total revenues before expenses and reorganization items	328.67	644.66	506.15	621.25	174.06	150.64	134.02	51.95	510.66	100.37	89.13	206.36	64.85	460.70	254.82
Losses and loss expense	(545.57)	(768.71)	(11.49)	513.19	(247.40)	32.58	33.50	(42.30)	(223.61)	12.41	(133.48)	-	-	(121.07)	-
Underwriting and operating expenses	101.47	102.70	113.66	121.52	36.43	26.06	28.37	21.34	112.20	24.92	29.09	21.09	20.04	95.13	76.71
Insurance intangible amortization	151.83	169.56	174.61	150.85	28.64	23.24	26.42	28.98	107.28	36.28	226.24	29.93	28.13	320.58	96.64
Interest expense	127.48	116.53	124.34	119.94	48.07	62.45	65.67	66.06	242.26	67.98	67.38	66.03	63.76	265.15	140.90
Goodwill impairment	-	514.51	-	-	-	-	-	-	-	-	-	-	-	-	-
Total expenses before reorganization items	(164.79)	134.59	401.12	905.50	(134.25)	144.33	153.96	74.09	238.13	141.58	189.23	117.05	111.93	559.79	314.25
Pretax loss from continuing operations before reorganization items	493.46	510.07	105.03	(284.25)	308.31	6.31	(19.95)	(22.14)	272.53	(41.21)	(100.11)	89.31	(47.08)	(99.09)	(59.43)
Reorganization items	0.21	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pre-tax loss from continuing operations	493.25	510.07	105.03	(284.25)	308.31	6.31	(19.95)	(22.14)	272.53	(41.21)	(100.11)	89.31	(47.08)	(99.09)	(59.43)
Provision for income taxes	9.56	17.36	30.71	44.46	2.61	1.95	2.21	(1.68)	5.09	1.99	28.32	-	-	30.31	-
Net income (loss)	483.70	492.70	74.32	(328.72)	305.70	4.36	(22.16)	(20.46)	267.44	(43.20)	(128.43)	89.31	(47.08)	(129.40)	(59.43)
Noncontrolling interests & other	(0.38)	(0.71)	(0.53)	-	-	-	81.69	-	81.69	-	-	-	-	-	-
Net income (loss) attributable to shareholders	484.07	493.41	74.84	(328.72)	305.70	4.36	(103.85)	(20.46)	185.76	(43.20)	(128.43)	89.31	(47.08)	(129.40)	(59.43)
Net loss	483.70	492.70	74.32	(328.72)	305.70	4.36	(22.16)	(20.46)	267.44	(43.20)	(128.43)	89.31	(47.08)	(129.40)	(59.43)
Unrealized gains on securities	252.60	(159.73)	67.90	(61.45)	-	-	60.81	-	60.81	-	-	-	-	-	-
Loss: reclassification adjustment for net gain	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gain (loss) on foreign currency translation	(43.60)	(45.03)	(122.13)	66.51	-	-	(8.87)	-	(8.87)	-	-	-	-	-	-
Amortization of postretirement benefit	(0.82)	(0.69)	0.02	1.61	-	-	0.04	-	0.04	-	-	-	-	-	-
Total other comprehensive income net of tax	208.19	(205.44)	(54.21)	6.67	-	-	51.97	-	51.97	-	-	-	-	-	-
Total comprehensive income (loss)	691.88	287.26	20.11	(322.05)	305.70	4.36	29.81	(20.46)	319.42	(43.20)	(128.43)	89.31	(47.08)	(129.40)	(59.43)
Less: comprehensive income (loss) attributable to the noncontrolling interest															
Net income (loss)	(0.38)	(0.71)	(0.53)	-	-	-	-	-	-	-	-	-	-	-	-
Other	(0.43)	(0.37)	-	-	-	-	81.69	-	81.69	-	-	-	-	-	-
Total comprehensive income (loss) attributable to Ambac financial group	692.69	288.34	20.64	(322.05)	305.70	4.36	(51.87)	(20.46)	237.73	(43.20)	(128.43)	89.31	(47.08)	(129.40)	(59.43)
Diluted EPS	\$10.31	\$10.72	\$1.64	(\$7.23)	\$6.70	\$0.09	(\$2.27)	(\$0.45)	\$3.99	(\$0.94)	(\$2.79)	\$1.91	(\$0.99)	(\$2.78)	(\$1.21)
Operating EPS	\$13.58	\$25.13	\$6.86	(\$3.63)	\$7.22	\$0.79	(\$1.66)	\$0.24	\$6.47	(\$0.20)	\$1.88	\$2.55	(\$0.40)	\$3.81	\$0.76
Common shares outstanding	45.09	45.17	45.21	45.37	45.47	45.68	45.75	45.76	45.67	45.83	45.99	46.79	47.49	46.53	49.00
Diluted shares outstanding	46.93	46.01	45.72	45.47	45.65	46.47	45.70	45.76	46.56	45.83	45.99	46.79	47.49	46.53	49.00
GAAP Book Value per Share - Diluted	\$29.81	\$37.28	\$37.89	\$30.42	\$40.41	\$40.51	\$38.24	\$37.79	\$37.79	\$36.85	\$32.48	\$34.47	\$33.56	\$33.56	\$32.68
Adjusted Book Value per Share - Diluted	\$7.47	\$24.70	\$29.44	\$24.25	\$31.47	\$30.86	\$28.52	\$27.61	\$27.61	\$27.53	\$29.61	\$31.72	\$31.19	\$31.19	\$31.44

Source: BTIG Estimates and Company Documents



BTIG Covered Companies Mentioned in this Report

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, \$26.00 PT; Current Price: \$19.99; Analyst: Giuliano.Bologna)

Appendix: Analyst Certification and Other Important Disclosures

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

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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)

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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
02-Aug-19	18.36	26	Giuliano Bologna	Buy

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