

Equity Research

May 9, 2016

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Financials

MBIA, Inc.

Despite Headwinds, MBI's Adjusted Book Value Increases by 7% Sequentially in 1Q16 Due to Buybacks

The amount of new municipal bond insurance that MBIA (MBI, Buy, \$13 PT) wrote during 1Q16 remained tepid due to the headwind associated with the persistent low interest rate environment, and its gross insured exposure of \$3.86bn to Puerto Rico's debt as of March 31 remains an overhang as the Commonwealth approaches potential defaults on nearly \$2bn in debt on July 1.

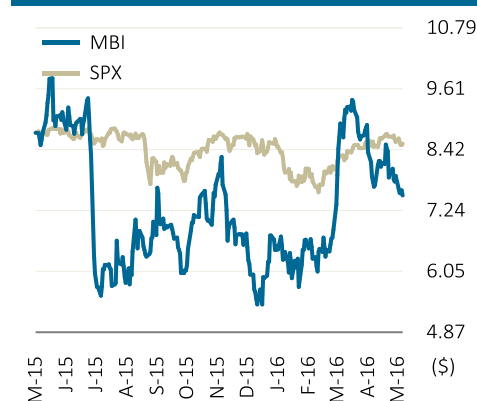
- ▶ Even so, MBI during 1Q16 demonstrated its ability to engineer shareholder value amidst such challenges as it boosted adjusted book value (ABV) per share by \$2.05, or almost 7%, sequentially to \$31.74. As such, shares of MBI now trade at just 0.24x that per share ABV.
- ▶ **We are reiterating our Buy recommendation on MBI and price target of \$13** based on 50% of the company's ABV per share of \$31.74 adjusted for estimated losses of \$5.14 per share related to its insured exposure to Puerto Rico's debt. (See MBIA Puerto Rico Insured Exposures and Loss Estimates on page 3.)
- ▶ We note that when we use the steep haircuts to various Puerto Rico debt issues that were included in the Commonwealth's latest proposal to creditors – as this was the Commonwealth's offer, we believe it can be viewed as a worst-case scenario – to calculate the impact on MBI, the result is a loss per share of \$7.42 of ABV. Applying a 0.50x multiple to the \$24.32 in ABV that would remain under that scenario results in a stock price of \$12.16, which is 62% higher than MBI's current share price.
- ▶ MBI reported 1Q16 operating earnings per share of \$0.12, in line with the consensus estimate while beating our estimate of \$0.09.
- ▶ **Valuation:** Our \$13 price target on MBI is based on 50% of our estimate of the company's ABV per share of \$31.74 adjusted for estimated losses of \$5.14 per share related to the company's insured exposure to Puerto Rico's debt.

MBI **\$7.53**
12 month target \$13.00

BUY

52 week range \$5.41 - \$9.81
Market Cap (m) \$990

Price Performance



Source: IDC

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.37	0.36	(0.23)	0.54	1.08	(0.58)	0.03	0.01	0.01	(0.56)	0.15
Operating Income	68	63	(35)	82	178	(78)	3	1	1	(73)	18

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

Source: Company Research Estimates and Company Estimates

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

- ▶ National Public Finance Guarantee Corp., MBI's municipal bond insurance unit, wrote \$158mm gross par amount of new insurance during 1Q16, flat with the prior quarter but up from \$38mm in 1Q15.
- ▶ We believe that by the time MBI releases its 2Q16 results in August, there could be quite a bit more clarity on Puerto Rico's debt situation. The U.S. House Natural Resources Committee is set to release its latest iteration of H.R. 4900, otherwise known as the PROMESA bill, tomorrow, with a vote likely to be scheduled for a week later. Investors will be watching for any change to the debt restructuring provision in the bill, as the retention of collective action clauses (CACs) would be relatively more benign for MBI and its peers, while the debt cramdowns favored by the Obama Administration would be less so.
- ▶ Next month, the U.S. Supreme Court is expected to release its ruling on Puerto Rico's appeal of its Recovery Act, which had been invalidated by a U.S. district court and San Juan, with that decision upheld by the U.S. Court of Appeals First Circuit. If the law were to be reinstated it would provide the Commonwealth with a bankruptcy-like framework it could apply to the debt of its public corporations.

MBIA: Puerto Rico Insured Exposures and Loss Estimates

Discount rate	3.00%
Assumed tax rate	35%
Diluted shares outstanding	137.30
Estimated PV impairment per share	\$8.91
Current reserves per share on National balance sheet for PR	\$1.00
Net estimated reserve strengthening per share after reserve assumption per share	\$7.91
Net after tax reserve per share	\$5.14

Present value impairment of principal and interest (in \$mm)	Assumed Impairment	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	Total	Total per share
Puerto Rico Electric Power Authority	5.0%	-	6.8	8.7	5.5	7.8	5.0	6.1	5.6	5.2	4.8	4.4	2.2	2.0	1.9	1.7	1.6	2.0	1.8	1.7	1.6	1.4	-	-	-	-	-	-	-	-	-	-	77.8	0.57
Puerto Rico Commonwealth GO	25.0%	-	41.9	18.1	25.8	39.3	49.7	14.5	13.4	12.4	11.4	10.5	10.0	9.2	8.5	7.9	7.2	0.1	0.1	0.1	0.1	0.1	-	-	-	-	-	-	-	-	-	280.3	2.04	
Puerto Rico Highway and Transportation Authority Transportation Revenue (PRHTA)	40.0%	-	9.7	13.4	14.7	11.5	11.2	13.9	12.9	11.9	11.0	10.1	14.6	13.5	12.5	11.5	10.6	26.4	24.5	22.6	20.9	19.2	3.4	3.2	2.9	2.7	2.5	0.0	0.0	0.0	0.0	0.0	311.4	2.27
Puerto Rico Sales Tax Financing Corporation (COFINA)	25.0%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2.3	2.1	2.0	1.8	1.7	104.4	96.7	89.4	82.5	75.9	458.8	3.34
Puerto Rico Highway and Transportation Authority Highway Revenue (PRHTA)	40.0%	-	0.9	8.3	2.1	5.8	5.8	1.1	1.0	0.9	0.9	0.8	2.9	2.7	2.5	2.3	2.1	0.1	0.1	0.1	0.1	0.1	-	-	-	-	-	-	-	-	-	40.2	0.29	
University of Puerto Rico System Revenue	40.0%	-	2.2	3.1	2.5	2.6	2.3	3.8	3.5	3.3	3.0	2.8	1.8	1.7	1.6	1.4	1.3	0.9	0.9	0.8	0.7	0.7	-	-	-	-	-	-	-	-	-	40.9	0.30	
Inter American University of Puerto Rico Inc.	40.0%	-	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.8	0.7	0.7	0.7	0.6	0.6	0.5	0.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	11.5	0.08	
Puerto Rico Industrial Development Company	40.0%	-	2.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2.5	0.02	
Total		-	64.9	52.6	51.6	67.9	74.8	40.3	37.4	34.6	31.9	29.3	32.1	29.7	27.5	25.3	23.3	29.5	27.3	25.3	23.3	21.4	5.7	5.3	4.9	4.5	4.1	104.4	96.7	89.4	82.5	75.9	1,223.5	8.91

Estimated amortization of principal and interest (in \$mm)	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	Total	
Puerto Rico Electric Power Authority	-	139.2	183.9	120.3	176.7	114.8	145.1	138.5	131.9	125.3	118.7	60.7	57.9	55.1	52.4	49.6	63.7	60.8	57.9	55.0	52.1	-	-	-	-	-	-	-	-	-	-	-	1,959.6
Puerto Rico Commonwealth GO	-	172.7	77.0	112.8	177.0	230.4	69.1	66.0	62.8	59.7	56.5	55.2	52.7	50.2	47.7	45.1	0.5	0.5	0.5	0.5	0.4	-	-	-	-	-	-	-	-	-	-	-	1,337.2
Puerto Rico Highway and Transportation Authority Transportation Revenue (PRHTA)	-	25.0	35.6	40.2	32.4	32.4	41.6	39.7	37.8	35.9	34.0	50.4	48.1	45.9	43.6	41.3	105.9	101.1	96.3	91.5	86.6	15.8	15.1	14.4	13.7	13.0	0.1	0.1	0.1	0.1	0.1	0.1	1,137.5
Puerto Rico Sales Tax Financing Corporation (COFINA)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	17.1	16.3	15.6	14.8	14.0	900.3	859.4	818.5	777.5	736.6	-	4,170.1
Puerto Rico Highway and Transportation Authority Highway Revenue (PRHTA)	-	2.3	22.0	5.8	16.3	16.8	3.2	3.1	2.9	2.8	2.6	9.9	9.5	9.0	8.6	8.1	0.3	0.3	0.3	0.3	0.3	-	-	-	-	-	-	-	-	-	-	-	124.5
University of Puerto Rico System Revenue	-	5.6	8.3	6.7	7.2	6.7	11.4	10.9	10.4	9.9	9.4	6.3	6.0	5.7	5.4	5.1	3.8	3.6	3.4	3.2	3.1	-	-	-	-	-	-	-	-	-	-	-	132.0
Inter American University of Puerto Rico Inc.	-	2.6	2.6	2.6	2.6	2.6	2.8	2.7	2.6	2.4	2.3	2.3	2.2	2.1	2.0	1.8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	35.8
Puerto Rico Industrial Development Company	-	6.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6.5
Total																																	8,903.3

BTIG Research Estimates and Company Reports

Income Statement

MBIA Operating Model (\$ Millions)	Dec-11 2011A	Dec-12 2012A	Dec-13 2013A	Dec-14 2014A	Mar-15 1Q15A	Jun-15 2Q15A	Sep-15 3Q15A	Dec-15 4Q15A	Dec-15 2015A	Mar-16 1Q16A	Jun-16 2Q16E	Sep-16 3Q16E	Dec-16 4Q16E	Dec-16 2016E	Dec-17 2017E
Scheduled premiums earned	457.0	372.0	304.0	258.0	55.0	51.0	47.0	46.0	199.0	45.0	43.1	41.3	39.5	168.8	148.4
Refunding premiums earned	148.0	232.0	153.0	139.0	46.0	40.0	37.0	50.0	173.0	30.0	29.7	29.4	29.1	118.2	113.6
Total premiums earned	605.0	604.0	457.0	397.0	101.0	91.0	84.0	96.0	372.0	75.0	72.8	70.7	68.6	287.1	261.9
Net investment income	408.0	214.0	166.0	179.0	37.0	37.0	38.0	40.0	152.0	39.0	40.0	40.4	40.8	160.1	167.2
Fees and reimbursements	27.0	61.0	21.0	40.0	1.0	2.0	1.0	2.0	6.0	1.0	5.0	5.0	5.0	16.0	21.0
Realized gains (losses) and other settlements on insured derivatives	(2,370.0)	(406.0)	(1,545.0)	(444.0)	(9.0)	(3.0)	(18.0)	2.0	(28.0)	(14.0)	-	-	-	(14.0)	-
Unrealized losses on insured derivatives	(440.0)	1,870.0	1,777.0	903.0	37.0	63.0	21.0	36.0	157.0	(14.0)	-	-	-	(14.0)	-
Other than temporary impairments recognized in AOCI	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net change in fair value of insured derivatives	(2,810.0)	1,464.0	232.0	459.0	28.0	60.0	3.0	38.0	129.0	(28.0)	-	-	-	(28.0)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	(99.0)	55.0	69.0	78.0	30.0	45.0	(55.0)	43.0	63.0	(69.0)	-	-	-	(69.0)	-
Investment losses related to other-than-temporary impairments	(125.0)	(58.0)	13.0	(99.0)	3.0	(9.0)	(1.0)	(2.0)	(9.0)	(1.0)	-	-	-	(1.0)	-
Other-than-temporary impairments recognized in AOCI	24.0	(47.0)	15.0	84.0	(4.0)	2.0	(2.0)	(1.0)	(5.0)	2.0	-	-	-	2.0	-
Net investment losses related to other-than-temporary impairments	(101.0)	(105.0)	28.0	(15.0)	(1.0)	(7.0)	(3.0)	(3.0)	(14.0)	1.0	-	-	-	1.0	-
Other net realized gains (losses)	21.0	8.0	(28.0)	26.0	20.0	(1.0)	(1.0)	(1.0)	17.0	(1.0)	-	-	-	(1.0)	-
<i>Revenues of consolidated VIEs</i>															
Net investment income	73.0	67.0	43.0	50.0	12.0	13.0	12.0	49.0	86.0	15.0	-	-	-	15.0	-
Net gains (losses) on financial instruments at fair value and foreign exchange	40.0	18.0	160.0	50.0	(10.0)	6.0	13.0	33.0	42.0	(1.0)	-	-	-	(1.0)	-
Net gains (losses) on extinguishment of debt	280.0	49.0	61.0	6.0	-	(1.0)	-	-	(1.0)	-	-	-	-	-	-
Total revenues	(1,556.0)	2,435.0	1,209.0	1,270.0	218.0	245.0	92.0	297.0	852.0	32.0	117.8	116.0	114.4	380.2	450.2
Losses and loss adjustments	(81.0)	50.0	117.0	133.0	(6.0)	46.0	39.0	44.0	123.0	22.0	12.0	12.0	12.0	58.0	43.2
Amortization of deferred acquisition costs	64.0	50.0	46.0	44.0	13.0	13.0	11.0	13.0	50.0	10.0	9.5	9.0	8.6	37.1	28.6
Operating	309.0	382.0	327.0	195.0	35.0	32.0	35.0	38.0	140.0	35.0	31.7	34.7	34.7	136.1	139.8
Interest	300.0	283.0	236.0	210.0	50.0	50.0	49.0	50.0	199.0	50.0	48.8	47.5	46.3	192.6	174.1
Expenses of consolidated VIEs															
Operating	29.0	17.0	11.0	8.0	4.0	3.9	3.0	3.0	13.9	4.0	3.4	2.9	2.8	13.1	10.6
Interest	62.0	55.0	45.0	39.0	10.0	9.0	10.0	10.0	39.0	12.0	9.0	9.0	9.0	39.0	36.0
Total expenses	683.0	837.0	782.0	629.0	106.0	153.9	147.0	158.0	564.9	133.0	114.3	115.1	113.5	475.9	432.3
Pre-tax income	(2,239.0)	1,598.0	427.0	641.0	112.0	91.1	(55.0)	139.0	287.1	(101.0)	3.4	0.9	0.9	(95.7)	17.9
Provision (benefit) for income taxes	(920.0)	364.0	166.0	72.0	44.0	28.0	(20.0)	57.0	109.0	(23.0)	-	-	-	(23.0)	-
Net income	(1,319.0)	1,234.0	261.0	569.0	68.0	63.1	(35.0)	82.0	178.1	(78.0)	3.4	0.9	0.9	(72.7)	17.9
Diluted EPS	(6.69)	6.33	1.35	3.02	0.37	0.36	(0.23)	0.54	1.08	(0.58)	0.03	0.01	0.01	(0.56)	0.15
Diluted shares outstanding	197.02	194.90	193.92	188.27	182.74	173.20	155.20	151.50	165.66	135.81	130.81	127.81	124.81	129.81	120.81

Source: BTIG Research Estimates and Company Documents

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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Company Valuation and Risk Disclosures

MBIA, Inc. (MBI, Buy)

Valuation: Our \$13 price target on MBI is based on 50% of our estimate of the company's ABV per share of \$31.74 adjusted for estimated losses of \$5.14 per share related to the company's insured exposure to Puerto Rico's debt.

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 ability to write new business.

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		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		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

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