

Equity Research

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Financials

MBIA, Inc.

Reiterating Buy, Increasing PT to \$14 (from \$13) Based on Lower Estimate of Losses on Puerto Rico's Debt

Shares in MBIA (MBI) were weaker during the past couple of trading sessions apparently because of the disclosure that discussions between Puerto Rico and its creditors about a voluntary debt exchange had broken down. We did not view the breakdown as surprising, but rather as indicative of the back and forth between an issuer and its creditors that has been the norm in past negotiations involving distressed municipal debt.

MBI

\$6.71

12 month target

\$14.00

BUY

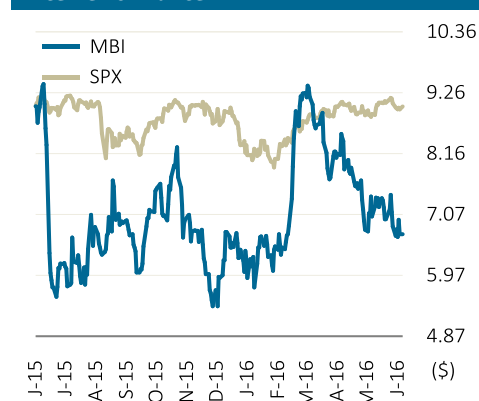
52 week range

\$5.41 - \$9.42

Market Cap (m)

\$882

Price Performance



Source: IDC

- ▶ At the same time, the Commonwealth in its latest proposal to general obligation (GO), COFINA senior and COFINA subordinated bondholders – and a counterproposal to certain GO bondholders – made specific offers with regard to the magnitude of the haircuts they wanted to impose. As such, we view Puerto Rico's proposal on the COFINA seniors and subs – 80 and 60 cents on the dollar for the accrued claims, respectively – and its counterproposal of 83.5 cents on the dollar for the accrued claim on the GOs as the new, likely worst-case scenario for the holders of those respective bonds.
- ▶ **We are reiterating our Buy recommendation on MBI while increasing our price target to \$14 (from \$13) based on 50% of our estimate of the company's adjusted book value (ABV) per share of \$31.74 adjusted for an estimated loss of \$4.26 per share related to the company's insured exposure to Puerto Rico's debt (see our loss estimate calculations on page 3).**
- ▶ Our previous estimate of MBI's loss per share on its Puerto Rico-related exposures had been \$5.14.
- ▶ **Valuation:** Our \$14 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 \$4.26 per share related to the company's insured exposure to Puerto Rico's debt

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

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

- ▶ Puerto Rico on June 14 provided a proposal to GO bondholders that included an offer to swap into a new bond at 81 cents on the dollar for their accrued claim versus its prior proposal of a base bond worth 78 cents on the dollar plus a capital appreciation bond described as being worth 2 cents on the dollar that together would have a net present value of 74 cents on the dollar. Then, in response to a counterproposal by certain GO bondholders, the Commonwealth on June 17 increased its offer to 83.5 cents on the dollar plus some unspecified amount of “growth” bonds whose value would be related to the future health of its economy.
- ▶ The slide deck that Puerto Rico disclosed this morning also provided a sense of where the other side of the bid-ask is, at least as far as certain GO bondholders are concerned. These bondholders on June 20 made a counterproposal of 89 cents on the dollar on the accrued claim in a new GO bond plus 11 cents on the dollar on the accrued claim in contingent convertible bonds.
- ▶ Meanwhile, Puerto Rico on June 14 offered COFINA senior bondholders a swap into a new bond at 80 cents on the dollar on their accrued claim versus its prior proposal of a base bond worth 61 cents on the dollar plus a capital appreciation bond described as being worth 4 cents on the dollar that together would have a net present value of 64 cents on the dollar.
- ▶ The COFINA senior bondholders on June 17 made a counterproposal that established the bid-ask spread in that negotiation, as they offered a 5% haircut such that they would receive a new bond worth 95% of the principal amount of the outstanding bonds.
- ▶ Puerto Rico on June 14 also offered COFINA subordinated bondholders a swap into a new bond at 60 cents on the dollar on their accrued claim versus its prior proposal of a base bond worth 43 cents on the dollar plus a capital appreciation bond described as being worth 6 cents on the dollar that together would have a net present value of 49 cents on the dollar.

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	\$7.55
Current reserves per share on National balance sheet for PR	\$1.00
Net estimated reserve strengthening per share after reserve assumption per share	\$6.55
Net after tax reserve per share	\$4.26

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	16.5%	-	27.7	12.0	17.0	26.0	32.8	9.5	8.8	8.2	7.5	6.9	6.6	6.1	5.6	5.2	4.8	0.1	0.1	0.0	0.0	0.0	-	-	-	-	-	-	-	-	-	-	185.0	1.35
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)	20.0%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.8	1.7	1.6	1.5	1.3	83.5	77.4	71.5	66.0	60.7	367.0	2.67
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		-	50.7	46.4	42.8	54.6	57.9	35.4	32.8	30.3	28.0	25.7	28.7	26.6	24.6	22.7	20.8	29.5	27.3	25.2	23.3	21.4	5.2	4.9	4.5	4.1	3.8	83.5	77.4	71.6	66.0	60.7	1,036.4	7.55

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	1,437.5
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 Estimates and Company Reports

Income Statement

MBIA Operating Model	Dec-11	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Dec-17
(\$ Millions)	2011A	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16A	2Q16E	3Q16E	4Q16E	2016E	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 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, \$14 PT)

Valuation: Our \$14 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 \$4.26 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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