

## Equity Research

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## Industry Report

## Financials

### Bond Insurers

#### Senate Invokes Cloture on PROMESA, Paving Way for Final Vote; Enactment Positive for AGO, MBI, AMBC

The U.S. Senate this morning passed a critical procedural vote to limit debate on the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), a key milestone in the bill's path toward enactment that we view as a positive for bond insurers MBIA (MBI, Buy, \$14 PT), Assured Guaranty (AGO, Buy, \$35 PT), and Ambac Financial Group (AMBC, Neutral). The legislation would remove the potential for a chaotic debt restructuring that would add significant uncertainty to the situation.

- ▶ The Senate's less-close-than-expected 68-32 vote – a 60-vote supermajority had been required to invoke cloture – cleared the way for passage of the bill in a vote to occur either later today or tomorrow and for President Obama to sign the bill into law before July 1, when Puerto Rico faces a debt payment of approximately \$2bn.
- ▶ Senate Minority Leader Harry Reid in expressing support for PROMESA prior to the vote explained that if the bill did not pass then hedge funds that hold Puerto Rico's debt would "sue [the Commonwealth] to death." PROMESA would put a stay on litigation through February 15, 2017. That date would be extended by 75 days if the Oversight Board created by the law certified that additional time would be needed for a voluntary debt restructuring, and it could be extended by another 60 days if the U.S. District Court finds that yet more time is required for a voluntary deal to be reached.
- ▶ With that said, *Caribbean Business* reported that AMBC CEO Nader Takavoli during a panel discussion about PROMESA yesterday said that if the Oversight Board does not do what it is supposed to do – shrinking the size of Puerto Rico's government being one thing – then the company would challenge the stay on litigation.
- ▶ AGO management during a BTIG-hosted meeting with investors earlier this month said they believed it was likely that the expiration of the stay on litigation would motivate Puerto Rico's government to seek consensual agreements with creditors before it was lifted, particularly with regard to the public corporations.
- ▶ While PROMESA may not be perfect from the standpoint of the bond insurers, we believe investors should consider what it would not do. It would not provide for the automatic cramdowns of bondholders for which some members of the White House staff had been pushing.

- ▶ PROMESA's collective action clauses would require that Puerto Rico and its creditors attempt to reach a consensual agreement before the financial oversight board established by the bill would decide what to do next.
- ▶ That is not to say that PROMESA removes the possibility of bondholder cramdowns, as it does not. If a consensual agreement is not reached by Puerto Rico and the creditors of a particular debt issuing entity, then the oversight board could bring the courts into play, with a cramdown being a possible outcome. Moreover, the bill does not include provisions from the bankruptcy code designed to protect creditors: the requirements that petitioning issuers demonstrate insolvency and that they present their proposals in good faith.
- ▶ With that said, Section 201(b)(1)(N) of PROMESA provides that any Fiscal Plan approved by the oversight board "shall respect the relative lawful priorities or lawful liens, as may be applicable, in the constitution, other laws, or agreements of a covered territory or covered territorial instrumentality in effect prior to the date of enactment of this Act." Moreover, Section 301(b)(7) provides that any plan of reorganization be consistent with the Fiscal Plan.
- ▶ So PROMESA appears to create a background in which the bond insurers may have a somewhat fair chance to maximize their recoveries on their insured exposures to Puerto Rico's debt. The caveat is that while the means through which the seven oversight board members would be nominated and approved has been outlined, the actual members of the board are not yet known. Insofar as they would wield substantial power to determine the outcome of the restructuring, that is a considerable unknown.
- ▶ Nevertheless, we continue to believe that the math is favorable to AGO and MBI even in a dire outcome in Puerto Rico. Even if we input the haircuts incorporated in Puerto Rico's most recent proposal to bondholders into our AGO model, the company would have its FY16E adjusted book value (ABV) per share of \$64.07 reduced by \$5.19. Applying a reasonable multiple of 0.60x to the ABV that would remain brings us to our price target of \$35.
- ▶ Meanwhile, in applying Puerto Rico's latest proposal to MBI's insured exposures, the result would be a loss per share of \$4.26 from its \$31.74 in ABV. Applying a 0.50x multiple to the ABV that would remain in that scenario brings us to our target price of \$14.

## 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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**Distribution of BTIG's Research Recommendations (as of March 31, 2016):**

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### Company Valuation and Risk Disclosures

Company Name	Ticker	Rating	Target Price (\$)	Closing Price (\$) - 28-Jun-16	Market Cap (m)
Ambac Financial Group Inc.	AMBC	Neutral	N/A	15.07	\$712.64
Assured Guaranty Ltd.	AGO	Buy	35	23.82	\$3,318.62
MBIA Inc.	MBI	Buy	14	6.53	\$923.90

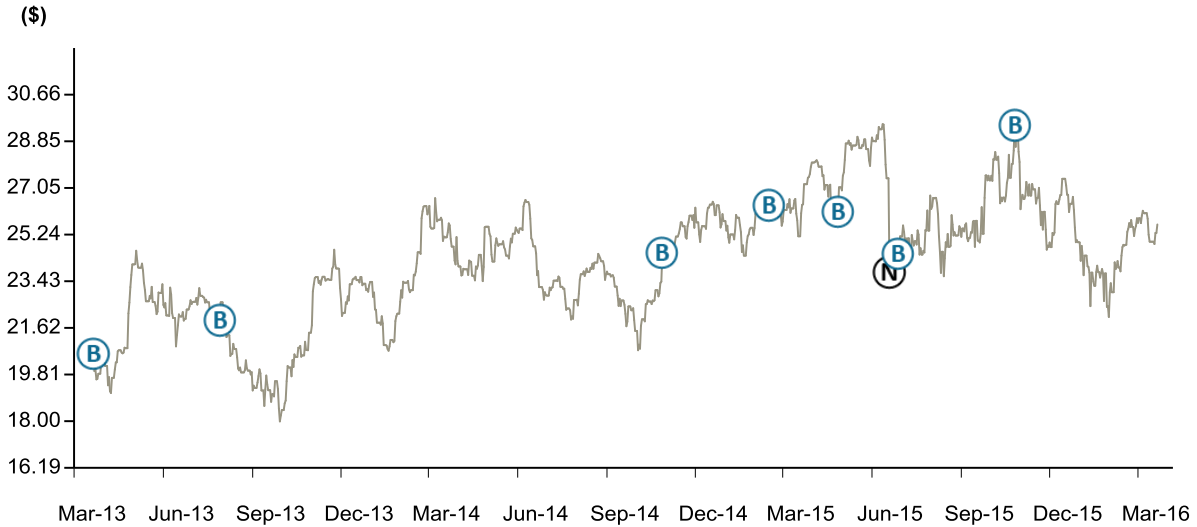
Source: BTIG Estimates and FactSet Data

### Assured Guaranty Ltd. (AGO, Buy, \$35 PT)

**Valuation:** Our \$35 price target is based on 0.60x our YE16E adjusted book value (ABV) per share of \$64.07, minus \$5.19 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
05-Dec-11	12.23	35	Mark Palmer	Buy
29-Feb-12	16.80	37	Mark Palmer	Buy
07-Aug-12	11.72	35	Mark Palmer	Buy
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		Mark Palmer	Neutral
08-Jul-15	24.49	34	Mark Palmer	Buy
05-Nov-15	29.47	35	Mark Palmer	Buy

### 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
21-Jun-16	6.82	14	Mark Palmer	Buy

**Ambac Financial Group, Inc. (AMBC, Neutral)**

**Valuation:** Based on our Adjusted Book Value (ABV) per share multiple valuation for Ambac Financial Group and our recovery analysis, we do not believe that Ambac's valuation is within +/- 15% from current levels over the next 12 months. BTIG does not put price targets on Neutral-rated stocks.

**Risks:** The primary risks to achieving our recommendation 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, and that declines in value of investment portfolio could impede Ambac's ability to pay its liabilities.

**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		Mark Palmer	Neutral

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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)

**BTIG LLC managed or co-managed a public offering of securities in the past 12 months for:** MBIA, Inc. (MBI)

**Other Disclosures**

**Additional Information Available Upon Request**

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