

## Equity Research

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## Financials

### Ambac Financial Group, Inc.

#### While Investors Await Catalyst, AMBC Posts Emphatic 3Q16 Earnings Beat Driven by Self-Help Initiatives

Ambac Financial Group (AMBC) with the 3Q16 report it released yesterday after the market close continued to lay the groundwork for a fuller valuation for its stock as it once again created substantial value through various self-help initiatives.

- ▶ AMBC reported 3Q16 operating earnings per share of \$3.23, significantly outpacing the consensus estimate of \$0.68 and our estimate of \$0.84. The company during the quarter also reported a 7.3% sequential increase in its adjusted book value (ABV) per share to \$32.12.
- ▶ The earnings beat was enabled in part by AMBC's 23% sequential reduction in operating expenses during 3Q16 to \$21.5mm that was driven in part by a reduction in headcount.
- ▶ AMBC also reduced its risk book by 8.4% to \$86.4bn while reducing its adversely classified credits by 3.4% to \$17.4bn. The company also invested \$287mm in the company's insured securities during the quarter.
- ▶ **We are reiterating our Neutral rating on AMBC.** While we continue to believe that significant additional appreciation in AMBC shares would require a catalyst in the form of either a settlement of the company's representation and warranty (R&W) litigation with Bank of America (BAC) or the announcement of a deal that would facilitate the exit of its Segregated Account from rehabilitation, the company's strong performance in accelerating the run-off of its insured portfolio over multiple quarters has fulfilled a prerequisite for the significant jump in its stock price that its investors have been awaiting.
- ▶ **Valuation:** Based on our ABV per share multiple valuation and our recovery analysis, we believe AMBC's valuation is within +/- 15% from current levels over the next 12 months. BTIG does not put price targets on Neutral-rated stocks.

AMBC

\$17.75

### NEUTRAL

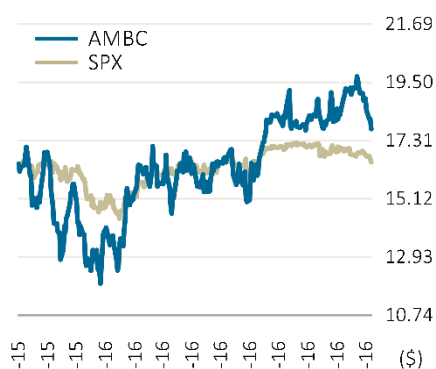
52 week range

\$11.94 - \$19.72

Market Cap (m)

\$805

#### Price Performance



Source: IDC

## Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 A	3Q16 A	4Q16 E	FY16 E	FY17 E
Sales	155	231	88	171	645	17	107	145	139	408	520
Net Income (Adj.)	215	282	(391)	387	493	9	58	101	72	241	216
Diluted EPS (Adj.)	4.57	6.05	(8.65)	8.56	10.72	0.21	1.29	2.22	1.56	5.25	4.70

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

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

- ▶ AMBC's loss and loss expenses was a benefit of \$69.2mm during 3Q16, including a \$38.7mm increase in its estimate of R&W subrogation recoveries on insured RMBS. The company also recorded a \$36.3mm benefit in student loan loss and loss expenses incurred as management's risk remediation efforts resulted in an improved outlook for those insured exposures. AMBC posted \$6.5mm in domestic public finance loss and loss expenses due to an increase in its reserves against its \$2.085bn of net insured exposure to Puerto Rico's debt as of September 30.
- ▶ AMBC announced that its Board of Directors had authorized a \$10mm increase in its warrant repurchase program. Including the 62,582 warrants the company bought back during 3Q16 for \$0.49mm, the company had \$12.55mm remaining under its authorization to repurchase additional warrants. AMBC as of September 30 had bought back 922,682 warrants for \$7.48mm, leaving 4,116,319 warrants outstanding.

## Income Statement

Ambac Financial Group Inc. 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	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17
(\$ millions)	2011A	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16A	2Q16A	3Q16A	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E
Net premiums earned	405.97	414.60	313.77	246.36	65.72	60.88	71.54	114.46	312.60	52.80	41.40	53.22	50.56	197.98	48.03	45.63	43.35	41.18	178.18
Net investment income	354.80	382.90	231.89	300.95	72.98	64.75	64.20	64.36	266.29	60.82	70.76	90.92	86.37	308.87	84.21	83.79	83.37	82.95	334.33
Total other than temporary impairment losses	(90.36)	(15.66)	(47.42)	(26.63)	(10.36)	(1.39)	(31.74)	(23.20)	(66.69)	(48.07)	(18.88)	(15.91)	-	(82.86)	-	-	-	-	-
Portion of loss recognized in other comprehensive income	26.51	9.67	0.65	0.84	7.24	0.37	22.59	10.83	41.03	38.74	11.44	13.05	-	63.23	-	-	-	-	-
<b>Net other than temporary impairment losses recognized in earnings</b>	<b>(63.84)</b>	<b>(5.99)</b>	<b>(46.76)</b>	<b>(25.79)</b>	<b>(3.12)</b>	<b>(1.02)</b>	<b>(9.15)</b>	<b>(12.37)</b>	<b>(25.66)</b>	<b>(9.33)</b>	<b>(7.44)</b>	<b>(2.85)</b>	-	<b>(19.63)</b>	-	-	-	-	-
Net realized investment gains	17.35	72.10	50.53	58.78	54.10	(5.35)	2.11	2.62	53.48	1.10	14.90	11.75	-	27.75	-	-	-	-	-
<i>Change in fair value of credit derivatives:</i>																			
Realized gains and other settlements	17.00	13.71	12.29	3.04	0.42	0.41	1.69	0.27	2.79	0.25	0.23	0.23	-	0.71	-	-	-	-	-
Unrealized gains (losses)	31.03	(22.93)	193.37	20.86	(2.92)	9.89	35.26	(3.31)	38.92	12.61	3.72	1.51	-	17.84	-	-	-	-	-
<b>Net change in fair value of credit derivatives</b>	<b>48.03</b>	<b>(9.22)</b>	<b>205.66</b>	<b>23.91</b>	<b>(2.50)</b>	<b>10.29</b>	<b>36.95</b>	<b>(3.05)</b>	<b>41.70</b>	<b>12.87</b>	<b>3.96</b>	<b>1.73</b>	-	<b>18.55</b>	-	-	-	-	-
Derivative products	(280.82)	(125.00)	114.20	(181.09)	(37.77)	51.00	(65.08)	9.31	(42.54)	(83.42)	(36.33)	(14.51)	-	(134.27)	-	-	-	-	-
Net unrealized gains (losses) on extinguishment of debt	3.12	(177.58)	-	(74.72)	(0.09)	(1.25)	1.42	-	0.08	1.24	3.59	0.02	-	4.85	-	-	-	-	-
Other income	25.54	106.10	13.86	12.50	(0.79)	(1.16)	7.15	1.94	7.15	8.00	6.92	2.69	2.00	19.61	1.80	1.80	1.80	1.80	7.20
Income (loss) on variable interest entities	(214.37)	27.78	(10.30)	(32.21)	6.96	52.60	(21.44)	(6.56)	31.57	(27.16)	8.99	2.06	-	(16.12)	-	-	-	-	-
<b>Total revenues before expenses and reorganization items</b>	<b>295.76</b>	<b>685.69</b>	<b>872.85</b>	<b>328.67</b>	<b>155.49</b>	<b>230.75</b>	<b>87.69</b>	<b>170.73</b>	<b>644.66</b>	<b>16.90</b>	<b>106.73</b>	<b>145.03</b>	<b>138.93</b>	<b>407.59</b>	<b>134.04</b>	<b>131.22</b>	<b>128.52</b>	<b>125.93</b>	<b>519.71</b>
Losses and loss expense	1,859.46	683.63	(236.27)	(545.57)	(150.95)	(147.48)	(133.21)	(337.07)	(768.71)	(105.28)	(52.50)	(69.20)	(30.00)	(256.98)	(20.00)	(20.00)	(20.00)	(20.00)	(80.00)
Underwriting and operating expenses	141.31	139.03	113.30	101.47	37.43	38.09	25.01	54.36	154.88	50.89	39.01	44.55	44.33	178.79	44.11	43.89	43.67	43.45	175.12
Insurance intangible amortization	-	-	89.93	151.83	24.52	25.87	39.68	27.30	117.38	28.01	28.00	21.47	21.25	98.72	21.04	20.83	20.62	20.41	82.90
Interest expense	128.09	112.32	108.12	127.48	27.91	28.17	29.89	30.56	116.53	30.43	30.71	31.49	31.49	124.13	31.34	31.34	31.34	31.34	125.34
Goodwill impairment	-	-	-	-	-	-	514.51	-	514.51	-	-	-	-	-	-	-	-	-	-
<b>Total expenses before reorganization items</b>	<b>2,128.85</b>	<b>934.98</b>	<b>75.07</b>	<b>(164.79)</b>	<b>(61.09)</b>	<b>(55.34)</b>	<b>475.87</b>	<b>(224.85)</b>	<b>134.59</b>	<b>4.05</b>	<b>45.22</b>	<b>28.31</b>	<b>67.07</b>	<b>144.65</b>	<b>76.48</b>	<b>76.05</b>	<b>75.62</b>	<b>75.20</b>	<b>303.36</b>
<b>Pretax loss from continuing operations before reorganization items</b>	<b>(1,833.09)</b>	<b>(249.29)</b>	<b>797.78</b>	<b>493.46</b>	<b>216.58</b>	<b>286.10</b>	<b>(388.18)</b>	<b>395.58</b>	<b>510.07</b>	<b>12.85</b>	<b>61.51</b>	<b>116.72</b>	<b>71.85</b>	<b>262.94</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
Reorganization items	49.86	7.22	2.55	0.21	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Pre-tax loss from continuing operations</b>	<b>(1,882.95)</b>	<b>(256.51)</b>	<b>795.23</b>	<b>493.25</b>	<b>216.58</b>	<b>286.10</b>	<b>(388.18)</b>	<b>395.58</b>	<b>510.07</b>	<b>12.85</b>	<b>61.51</b>	<b>116.72</b>	<b>71.85</b>	<b>262.94</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
Provision for income taxes	77.42	2.85	8.17	9.56	1.71	3.92	2.84	8.90	17.36	3.44	3.16	15.28	-	21.88	-	-	-	-	-
<b>Net income (loss)</b>	<b>(1,960.37)</b>	<b>(259.35)</b>	<b>787.05</b>	<b>483.70</b>	<b>214.87</b>	<b>282.18</b>	<b>(391.02)</b>	<b>386.68</b>	<b>492.70</b>	<b>9.41</b>	<b>58.36</b>	<b>101.44</b>	<b>71.85</b>	<b>241.06</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
Noncontrolling interests	0.06	(2.68)	(0.46)	(0.38)	0.16	(0.52)	(0.04)	(0.31)	(0.71)	-	(0.29)	(0.04)	-	(0.33)	-	-	-	-	-
<b>Net income (loss) attributable to shareholders</b>	<b>(1,960.43)</b>	<b>(256.68)</b>	<b>787.52</b>	<b>484.07</b>	<b>214.71</b>	<b>282.70</b>	<b>(390.98)</b>	<b>386.98</b>	<b>493.41</b>	<b>9.41</b>	<b>58.65</b>	<b>101.47</b>	<b>71.85</b>	<b>241.39</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
<b>Net loss</b>	<b>(1,960.37)</b>	<b>(259.35)</b>	<b>787.05</b>	<b>483.70</b>	<b>214.87</b>	<b>282.18</b>	<b>(391.02)</b>	<b>386.68</b>	<b>492.70</b>	<b>9.41</b>	<b>58.36</b>	<b>101.44</b>	<b>71.85</b>	<b>241.06</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
Unrealized gains on securities	120.64	221.15	133.44	252.60	(17.45)	(113.84)	8.38	(20.06)	(159.73)	59.79	48.17	-	-	107.96	-	-	-	-	-
Loss: reclassification adjustment for net gain	(48.61)	54.90	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gain (loss) on foreign currency translation	1.53	(0.54)	42.74	(43.60)	(33.81)	40.49	(30.91)	(82.62)	(45.03)	(17.78)	(55.15)	-	-	(72.93)	-	-	-	-	-
Amortization of postretirement benefit	0.75	(3.79)	11.03	(0.82)	(0.03)	(0.22)	(0.22)	(0.66)	(0.69)	0.79	(0.26)	-	-	0.53	-	-	-	-	-
<b>Total other comprehensive income net of tax</b>	<b>171.53</b>	<b>161.92</b>	<b>187.21</b>	<b>208.19</b>	<b>(51.28)</b>	<b>(73.57)</b>	<b>(22.75)</b>	<b>(103.34)</b>	<b>(205.44)</b>	<b>42.80</b>	<b>(7.24)</b>	-	-	<b>35.56</b>	-	-	-	-	-
<b>Total comprehensive income (loss)</b>	<b>(1,788.84)</b>	<b>(97.43)</b>	<b>974.26</b>	<b>691.88</b>	<b>163.59</b>	<b>208.61</b>	<b>(413.77)</b>	<b>283.34</b>	<b>287.26</b>	<b>52.21</b>	<b>51.12</b>	<b>101.44</b>	<b>71.85</b>	<b>276.62</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
<i>Less: comprehensive income (loss) attributable to the noncontrolling interest</i>																			
Net income (loss)	0.06	(2.68)	(0.46)	(0.38)	0.16	(0.52)	(0.04)	(0.31)	(0.71)	-	(0.29)	(0.04)	-	(0.33)	-	-	-	-	-
Currency translation adjustments	0.05	(0.21)	0.67	(0.43)	(0.33)	0.40	(0.27)	(0.72)	(0.37)	-	-	-	-	-	-	-	-	-	-
<b>Total comprehensive income (loss) attributable to Ambac financial group</b>	<b>(1,788.95)</b>	<b>(94.55)</b>	<b>974.05</b>	<b>692.69</b>	<b>163.76</b>	<b>208.73</b>	<b>(413.45)</b>	<b>284.36</b>	<b>288.34</b>	<b>52.21</b>	<b>51.41</b>	<b>101.47</b>	<b>71.85</b>	<b>276.95</b>	<b>57.56</b>	<b>55.17</b>	<b>52.89</b>	<b>50.73</b>	<b>216.35</b>
<b>Diluted EPS</b>	<b>(\$6.48)</b>	<b>(\$0.85)</b>	<b>\$17.11</b>	<b>\$10.31</b>	<b>\$4.57</b>	<b>\$6.05</b>	<b>(\$8.65)</b>	<b>\$8.56</b>	<b>\$10.72</b>	<b>\$0.21</b>	<b>\$1.29</b>	<b>\$2.22</b>	<b>\$1.56</b>	<b>\$5.25</b>	<b>\$1.24</b>	<b>\$1.19</b>	<b>\$1.13</b>	<b>\$1.08</b>	<b>\$4.70</b>
Diluted shares outstanding	302.44	302.47	46.04	46.93	46.95	46.70	45.17	45.19	46.01	45.24	45.38	45.79	46.02	46.01	46.25	46.48	46.71	46.95	46.01
GAAP Book Value per Share - Diluted	(\$10.41)	(\$10.73)	\$21.25	\$35.66	\$39.14	\$43.83	\$36.06	\$43.33	\$43.33	\$44.46	\$45.46	\$47.53	\$49.09	\$49.09	\$50.33	\$51.52	\$52.65	\$53.73	\$53.73
Adjusted Book Value per Share - Diluted	\$1.02	(\$1.55)	\$59.07	\$60.35	\$61.91	\$65.54	\$67.68	\$71.67	\$71.67	\$70.83	\$70.21	\$70.43	\$71.99	\$71.99	\$73.24	\$74.42	\$75.55	\$76.64	\$76.64

Source: BTIG Estimates and Company Documents

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## BTIG Covered Companies Mentioned in this Report

AMBAC FINANCIAL GROUP, INC. (AMBC, Neutral, \$N/A PT; Current Price: \$17.75; Analyst: Mark.Palmer)

## 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.

### Regulatory Disclosures

#### Analyst Stock Ratings Definitions

**BTIG LLC's ("BTIG") ratings, effective May 10, 2010, are defined as follows:**

**BUY** – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

**SELL** – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

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**Distribution of BTIG's Research Recommendations (as of September 30, 2016):**

**BUY: 54.6%; NEUTRAL: 41.8%; SELL: 3.6%**

**Distribution of BTIG's Investment Banking Services (as of September 30, 2016):**

**BUY: 78.9%; NEUTRAL: 15.8%; SELL: 5.3%**

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

### Company Valuation and Risk Disclosures

#### 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 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	N/A	Mark Palmer	Neutral

## Company-Specific Regulatory Disclosures

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from: Ambac Financial Group, Inc. (AMBC)

BTIG LLC has received compensation for investment banking services in the past 12 months from:  
Ambac Financial Group, Inc. (AMBC)

BTIG LLC had an investment banking services client relationship during the past 12 months with:  
Ambac Financial Group, Inc. (AMBC)

## Other Disclosures

Additional Information Available Upon Request

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