

Equity Research

November 22, 2016

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Financials

Assured Guaranty Ltd.

Reiterate Buy, Raising PT to \$41 (from \$37); Prospects Improving for Special Dividend, More New Business

We are reiterating our Buy recommendation on Assured Guaranty (AGO) while increasing our price target to \$41 (from \$37) based on 0.60x our YE17E adjusted book value (ABV) per share of \$72.16, minus \$4.37 per share representing the estimated impact of potential losses related to AGO's insured exposure to Puerto Rico's debt.

- With AGO having approximately \$2.6bn in excess capital above the amount required by Standard & Poor's for the company to maintain a "AAA" level of capital under its models, we believe it is well positioned to receive approval from its regulator, the New York State Department of Financial Services (NYDFS), for a special dividend from its operating subsidiaries to its holding company that would enable it to maintain a robust share repurchase program. As AGO trades at just 0.52x the company's ABV per share as of September 30, the company's buybacks are highly accretive.
- While AGO's insured exposure to Puerto Rico's debt – \$4.786bn in net insured exposure as of September 30 – has been viewed as an impediment to the approval of such a dividend, we believe the framework established by the U.S. government to provide financial oversight to the island and the election of pro-creditor Governor-elect Ricky Rossello earlier this month should make it easier for the NYDFS to sign off on it.
- We also believe expectations of higher interest rates driven in part by expectations of fiscal expansion under President-elect Trump translate into better prospects for the penetration of municipal bond insurance, which is likely to increase materially and for AGO to write a significant amount of new business. Insofar as municipalities purchase bond insurance as a means of reducing their borrowing costs, the low interest rates that have been the norm since the financial crisis have undermined the value proposition of the product.
- Valuation:** Our new price target of \$41 for AGO is based on 0.60x our YE17E adjusted book value (ABV) per share of \$72.16, minus \$4.37 per share representing the estimated impact of potential losses related to AGO's insured exposure to Puerto Rico's debt.

AGO

\$34.69

12 month target

\$41.00

BUY

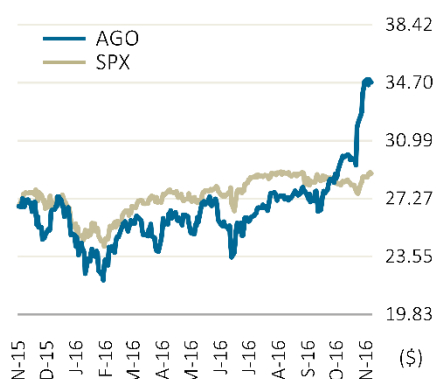
52 week range

\$22.04 - \$34.93

Market Cap (m)

\$4,613

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
Operating Income	140	278	164	117	699	113	139	508	80	840	340
Oper. Inc. Per Share	0.89	1.83	1.12	0.83	4.69	0.83	1.03	3.83	0.62	6.30	2.81

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

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

- ▶ The penetration rate of municipal bond insurance stands at about 6%, a far cry from the rate of more than 57% that the industry reached in 2005. Standard & Poor's has estimated that with higher interest rates the industry could insure 20% to 30% of the new issue par in the U.S. public finance market. While nine insurers split up the market in 2005, only AGO, MBIA (MBI, Buy, \$14 PT) and Build America Mutual (Private) are writing new business today. Given its clear position of leadership in the space, AGO stands to be the most significant beneficiary of the industry's revitalization.
- ▶ AGO's share repurchases are a core aspect of its plan for value creation as the company since January 2013 has bought back 34% of its shares outstanding. Its buybacks slowed through the first three quarters of 2016 to \$190mm – a pace less than half of that achieved in 2014 and 2015 when the company bought back \$590mm and \$555mm, respectively, in stock.
- ▶ However, AGO in conjunction with its 3Q16 report announced a \$250mm increase in its repurchase authorization in conjunction with the report, bringing its current buyback capacity to \$345mm. With the approval of AGO's initial request for a special dividend and the additional requests that are almost certain to follow, the company should be able to return to and sustain an annual level of share buybacks north of \$500mm.
- ▶ We also believe AGO is likely to continue to consolidate the remaining inactive bond insurers, with each acquisition likely to be nicely additive to the company's ABV. AGO in its 3Q16 report demonstrated how accretive such acquisitions can be when it posted a 7.2% sequential increase in ABV per share to a record \$66.34. Of the \$4.48 in ABV per share that AGO added during 3Q16, the company's acquisition of inactive bond insurer CIFG, announced on April 13 and closed on July 1, accounted for \$3.85.

Income Statement

Assured Guaranty Ltd Earnings 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
Present value of new business production (PVP)	242.7	209.9	140.0	168.0	36.0	26.0	41.0	76.0	179.0	38.0	41.0	41.4	41.8	162.2	50.7	50.7	50.7	50.7	202.8
Net earned premiums (NEP)	920.1	853.0	752.0	570.0	142.0	219.0	213.0	192.0	766.0	183.0	214.0	231.0	180.3	808.3	182.8	163.2	156.7	150.1	652.8
Net realized investment gains (losses)	(18.0)	1.2	52.0	(60.0)	16.0	(9.0)	(27.0)	(6.0)	(26.0)	(13.0)	10.0	(2.0)	-	(5.0)	-	-	-	-	-
Realized gains and settlements on credit derivatives	106.1	(15.7)	(26.4)	23.0	21.0	8.0	6.0	(53.0)	(18.0)	8.0	24.0	15.0	-	47.0	-	-	-	-	-
Incurred losses on credit derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-credit impairment FV gains (losses) on credit derivatives	459.0	3.0	3.0	800.0	103.0	82.0	80.0	481.0	746.0	(68.0)	39.0	6.0	-	(23.0)	-	-	-	-	-
Net change in FV of credit derivatives	565.1	(15.7)	(26.4)	23.0	21.0	8.0	6.0	(53.0)	(18.0)	8.0	24.0	15.0	-	47.0	-	-	-	-	-
Fair value gain (loss) on committed capital securities	35.1	(17.6)	10.0	(11.0)	2.0	23.0	(15.0)	17.0	27.0	(16.0)	(11.0)	(23.0)	-	(50.0)	-	-	-	-	-
Financial guaranty variable interest entity (VIE) revenue	(151.4)	209.8	346.0	255.0	(7.0)	5.0	2.0	38.0	38.0	18.0	4.0	(11.0)	-	11.0	-	-	-	-	-
Other income	63.4	107.3	(10.0)	14.0	(9.0)	269.0	(3.0)	(6.0)	251.0	34.0	18.0	256.0	-	308.0	-	-	-	-	-
Net investment income	390.7	404.4	393.0	403.0	101.0	98.0	112.0	112.0	423.0	99.0	98.0	94.0	96.4	387.4	97.3	96.8	96.3	95.9	386.3
Total revenue	1,804.9	973.1	1,516.6	1,994.0	369.0	695.0	368.0	775.0	2,207.0	245.0	396.0	566.0	276.6	1,506.6	280.1	260.0	253.0	246.0	1,039.1
Loss and loss adjustment expenses	470.8	523.3	154.0	126.0	18.0	188.0	112.0	106.0	424.0	90.0	102.0	(9.0)	75.0	258.0	50.0	50.0	50.0	50.0	200.0
Deferred acquisition costs	30.9	13.9	12.0	25.0	4.0	6.0	5.0	5.0	20.0	4.0	5.0	4.0	4.0	17.0	4.0	4.0	4.0	4.0	16.0
FSAH acquisition-related expenses	0.0	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.0
Interest expense	99.1	92.1	82.0	92.0	25.0	26.0	25.0	25.0	101.0	26.0	25.0	26.0	26.0	103.0	26.0	26.0	26.0	26.0	104.0
Financial guaranty VIE expense	0.0	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating expenses	193.0	211.8	218.0	220.0	56.0	66.0	54.0	55.0	231.0	60.0	63.0	65.0	65.0	253.0	65.0	65.0	65.0	65.0	260.0
Total expenses	793.8	841.1	466.0	463.0	103.0	286.0	196.0	191.0	776.0	180.0	195.0	86.0	170.0	631.0	145.0	145.0	145.0	145.0	580.0
Income before income taxes	1,011.1	132.0	1,050.6	1,531.0	266.0	409.0	172.0	584.0	1,431.0	65.0	201.0	480.0	106.6	875.6	135.1	115.0	108.0	101.0	459.1
Provision for income taxes	250.3	22.5	334.0	443.0	65.0	112.0	43.0	155.0	375.0	6.0	55.0	1.0	26.7	88.7	35.1	29.9	28.1	26.3	119.4
Tax rate	24.8%	17.0%	31.8%	28.9%	24.4%	27.4%	25.0%	26.5%	26.2%	9.2%	27.4%	0.2%	25.0%	10.1%	26.0%	26.0%	26.0%	26.0%	25.0%
Net income	760.8	109.5	808.0	1,088.0	201.0	297.0	129.0	429.0	1,056.0	59.0	146.0	479.0	80.0	764.0	100.0	85.1	79.9	74.7	339.7
Realized losses on investments, after tax	(20.0)	(4.5)	40.0	(34.0)	9.0	(8.0)	(22.0)	(4.0)	(25.0)	(9.0)	9.0	(1.2)	-	-	-	-	-	-	-
Unrealized (losses) gains on credit derivatives, after tax	247.5	(486.6)	(40.0)	500.0	66.0	-	(3.0)	295.0	358.0	(43.0)	32.0	(2.4)	-	-	-	-	-	-	-
Unrealized gains (losses) on capital securities, after tax	22.8	(12.2)	7.0	(7.0)	1.0	15.0	(9.0)	10.0	17.0	(10.0)	(11.0)	(13.9)	-	-	-	-	-	-	-
Foreign exchange gains (losses) on revaluation of premiums receivable	(3.5)	15.2	(1.0)	(15.0)	(9.0)	9.0	(7.0)	(3.0)	(10.0)	(2.0)	(17.0)	(1.2)	-	-	-	-	-	-	-
Non-economic fair value adjustment and net interest margin of VIEs	2.9	62.4	193.0	153.0	(6.0)	3.0	6.0	14.0	17.0	10.0	(6.0)	(10.3)	-	-	-	-	-	-	-
Operating income	511.1	548.2	609.0	491.0	140.0	278.0	164.0	117.0	699.0	113.0	139.0	508.0	80.0	840.0	100.0	85.1	79.9	74.7	339.7
Net income/share	4.1	0.53	4.41	6.48	1.28	1.96	0.88	3.03	7.15	0.43	1.08	3.61	0.62	5.74	0.79	0.69	0.67	0.65	2.80
After-tax realized losses on investments	(0.1)	(0.0)	0.2	(0.2)	0.06	(0.05)	(0.15)	(0.03)	(0.2)	(0.07)	0.07	(0.01)	-	-	-	-	-	-	-
After-tax unrealized (losses) gains on credit derivatives	1.4	(2.6)	(0.1)	3.1	0.42	0.00	(0.02)	2.08	2.5	(0.32)	0.24	(0.02)	-	-	-	-	-	-	-
Unrealized gains (losses) on committed capital securities	0.1	(0.1)	0.0	(0.0)	0.01	0.10	(0.06)	0.07	0.1	(0.07)	(0.08)	(0.10)	-	-	-	-	-	-	-
Forex gains (losses) on revaluation of premiums receivable	(0.1)	0.1	(0.0)	(0.1)	(0.06)	0.06	(0.05)	(0.02)	(0.1)	(0.01)	(0.13)	(0.01)	-	-	-	-	-	-	-
Effect of consolidating VIE	(0.9)	0.3	1.0	0.9	(0.04)	0.02	0.04	0.10	0.1	0.07	(0.04)	(0.08)	-	-	-	-	-	-	-
Operating income/share	\$3.24	\$2.79	\$3.26	\$2.83	\$0.89	\$1.83	\$1.12	\$0.83	\$4.69	\$0.83	\$1.03	\$3.83	\$0.62	\$6.30	\$0.79	\$0.69	\$0.67	\$0.65	\$2.81
Book value per share	\$25.52	\$25.74	\$28.07	\$35.48	\$36.90	\$38.30	\$39.72	\$42.85	\$42.85	\$45.05	\$46.36	\$50.00	\$51.02	\$51.02	\$52.26	\$53.44	\$54.65	\$55.89	\$55.89
Operating book value per share	\$28.54	\$30.05	\$33.83	\$36.56	\$37.47	\$39.65	\$40.85	\$42.02	\$42.02	\$43.88	\$44.59	\$48.61	\$50.09	\$50.09	\$51.77	\$53.40	\$55.05	\$56.73	\$56.73
Unearned premium reserve less DAC, after tax	\$18.75	\$16.83	\$15.83	\$16.08	\$16.16	\$17.71	\$17.66	\$17.84	\$17.84	\$17.64	\$16.48	\$16.46	\$16.15	\$16.15	\$15.87	\$15.66	\$15.46	\$15.28	\$15.28
Present value of future installment premiums	\$2.03	\$1.14	\$0.80	\$0.67	\$0.63	\$1.02	\$1.01	\$0.82	\$0.82	\$0.67	\$0.69	\$1.17	\$1.13	\$1.13	\$1.11	\$1.08	\$1.06	\$1.04	\$1.04
Adjusted book value per share	\$49.32	\$47.17	\$49.58	\$52.34	\$53.28	\$57.39	\$58.51	\$59.64	\$59.64	\$61.12	\$60.94	\$65.43	\$66.55	\$66.55	\$67.91	\$69.28	\$70.70	\$72.16	\$72.16
Weighted average diluted shares	183.4	190.7	187.0	173.7	156.8	151.6	146.5	141.5	149.1	135.7	134.8	132.8	129.8	133.3	126.3	122.8	119.3	115.8	121.1

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

ASSURED GUARANTY LTD. (AGO, Buy, \$41.00 PT; Current Price: \$34.74; Analyst: Mark.Palmer)

MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$9.25; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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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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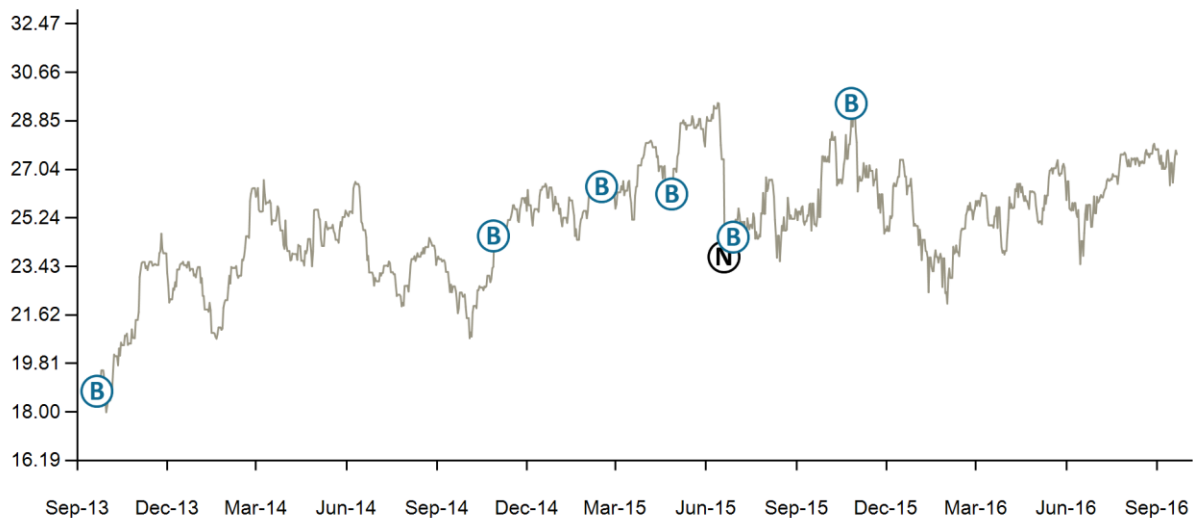
Assured Guaranty Ltd. (AGO, Buy, \$41 PT)

Valuation: Our new \$41 price target is based on 0.60x our YE17E adjusted book value (ABV) per share of \$72.16, minus \$4.37 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	N/A	Mark Palmer	Neutral
08-Jul-15	24.49	34	Mark Palmer	Buy
05-Nov-15	29.47	35	Mark Palmer	Buy
04-Nov-16	32.10	37	Mark Palmer	Buy

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