

Equity Research

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Financials

MBIA, Inc.

MBI Secures Financing to Address January Maturity on Zohar II Notes, Removing Significant Overhang

MBIA (MBI) this morning announced that it has secured senior financing of up to \$325mm from holders of the Surplus Notes of MBIA Insurance Corp. (Corp.), its structured product insurance unit, which together with \$38mm in subordinated financing from its holding company and \$60mm in the unit's own resources will enable Corp. to address the January 20, 2017 maturity on the Zohar II CDO notes that it insured.

- ▶ We have noted on several occasions that MBI equity would not be directly impacted if the company had not been able to satisfy the Zohar II maturity given the amendment of the indentures on its holding company debt in December 2012 that removed the possibility of a cross-default in the event of a seizure of Corp. by its regulator, the New York State Department of Financial Services. Nevertheless, we believe the potential for the seizure of the unit due to an inability by Corp. to address claim payments stemming from a default on the Zohar II notes has weighed on MBI shares as the maturity date has approached, and that the announcement of the plan to address the maturity should remove the overhang on the stock.
- ▶ **We are reiterating our Buy recommendation on MBI and price target of \$14** based on 50% of the company's ABV per share of \$32.39 as of September 30 adjusted for estimated losses of \$4.19 per share related to its insured exposure to Puerto Rico's debt. We believe MBI shares are very inexpensive at 0.29x the company's ABV and that the removal of the Zohar II overhang should provide a significant boost to the stock.
- ▶ The full amount of the Zohar II maturity is \$770mm. In addition to the amounts mentioned above, MBI as part of its agreement to sell MBIA UK to Assured Guaranty (AGO, Buy, \$41 PT) would acquire \$347mm in Zohar II notes.
- ▶ **Valuation:** Our \$14 price target on MBI is based on 50% of our estimate of the company's ABV per share of \$32.39 adjusted for estimated losses of \$4.19 per share related to the company's insured exposure to Puerto Rico's debt.

MBI

\$9.49

12 month target

\$14.00

BUY

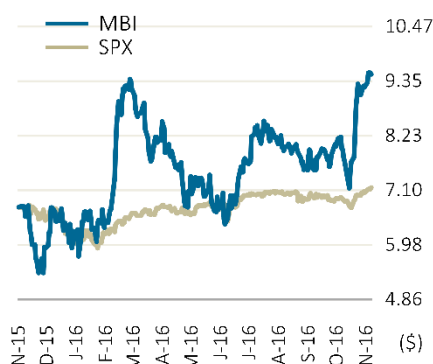
52 week range

\$5.41 - \$9.52

Market Cap (m)

\$1,248

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
Diluted EPS (Adj.)	0.37	0.36	(0.23)	0.54	1.08	(0.58)	(0.20)	0.23	0.05	(0.51)	0.35
Operating Income	68	63	(35)	82	178	(78)	(27)	31	7	(67)	45

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

- ▶ While the sale of MBIA UK remains subject to regulatory approval, MBI stated in its announcement this morning that it expected the deal to close by January 20.
- ▶ The financing provided by the Surplus Note holders would be secured by the potential recoveries on Corp.'s insured exposures on the class A-1 and A-2 notes issued by Zohar CDO 2003-1, Limited Zohar I and the Zohar II notes.
- ▶ The total amount of Zohar notes expected to be in default as of January 20 would be \$1.3bn. According to a report attached to an 8-K filed by MBI this morning, Houlihan Lokey (Private) believes the collateral provided by the assets underlying Zohar I and Zohar II should be sufficient to cover the \$325mm senior financing provided by the Surplus Note holders.

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 2Q16A	Sep-16 3Q16A	Dec-16 4Q16E	Dec-16 2016E	Mar-17 1Q17E	Jun-17 2Q17E	Sep-17 3Q17E	Dec-17 4Q17E	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	44.0	42.0	41.0	172.0	40.1	39.3	38.5	37.8	155.8
Refunding premiums earned	148.0	232.0	153.0	139.0	46.0	40.0	37.0	50.0	173.0	30.0	29.0	35.0	34.7	128.7	34.3	34.0	33.6	33.3	135.2
Total premiums earned	605.0	604.0	457.0	397.0	101.0	91.0	84.0	96.0	372.0	75.0	73.0	77.0	75.6	300.6	74.4	73.3	72.2	71.1	290.9
Net investment income	408.0	214.0	166.0	179.0	37.0	37.0	38.0	40.0	152.0	39.0	37.0	39.0	38.2	153.2	38.6	39.0	39.4	39.8	156.7
Fees and reimbursements	27.0	61.0	21.0	40.0	1.0	2.0	1.0	2.0	6.0	1.0	1.0	22.0	5.0	29.0	5.3	5.3	5.3	5.3	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)	(2.0)	(4.0)	-	(20.0)	-	-	-	-	-
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)	(6.0)	20.0	-	-	-	-	-	-	-
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)	(8.0)	16.0	-	(20.0)	-	-	-	-	-
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)	14.0	38.0	-	(17.0)	-	-	-	-	-
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)	3.0	(2.0)	-	-	-	-	-	-	-
<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	5.0	5.0	-	25.0	-	-	-	-	-
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)	(7.0)	8.0	-	-	-	-	-	-	-
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	118.0	203.0	118.8	471.8	118.3	117.5	116.8	116.1	468.7
Losses and loss adjustments	(81.0)	50.0	117.0	133.0	(6.0)	46.0	39.0	44.0	123.0	22.0	77.0	50.0	15.0	164.0	13.5	13.5	13.5	13.5	54.0
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	10.0	10.0	9.5	39.5	8.6	8.1	7.7	7.3	31.7
Operating	309.0	382.0	327.0	195.0	35.0	32.0	35.0	38.0	140.0	35.0	30.0	32.0	32.1	129.1	32.2	32.2	32.3	32.4	129.1
Interest	300.0	283.0	236.0	210.0	50.0	50.0	49.0	50.0	199.0	50.0	49.0	49.0	48.5	196.5	47.3	46.1	45.0	43.8	182.2
<i>Expenses of consolidated VIEs</i>																			
Operating	29.0	17.0	11.0	8.0	4.0	3.9	3.0	3.0	13.9	4.0	3.0	3.0	2.9	12.9	2.9	2.8	2.7	2.6	11.0
Interest	62.0	55.0	45.0	39.0	10.0	9.0	10.0	10.0	39.0	12.0	4.0	4.0	4.0	24.0	4.0	4.0	4.0	4.0	16.0
Total expenses	683.0	837.0	782.0	629.0	106.0	153.9	147.0	158.0	564.9	133.0	173.0	148.0	112.0	566.0	108.4	106.8	105.2	103.7	424.0
Pre-tax income (loss)	(2,239.0)	1,598.0	427.0	641.0	112.0	91.1	(55.0)	139.0	287.1	(101.0)	(55.0)	55.0	6.8	(94.2)	9.9	10.8	11.6	12.4	44.6
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)	(28.0)	24.0	-	(27.0)	-	-	-	-	-
Net income (loss)	(1,319.0)	1,234.0	261.0	569.0	68.0	63.1	(35.0)	82.0	178.1	(78.0)	(27.0)	31.0	6.8	(67.2)	9.9	10.8	11.6	12.4	44.6
Diluted EPS	(6.69)	6.33	1.35	3.02	0.37	0.36	(0.23)	0.54	1.08	(0.58)	(0.20)	0.23	0.05	(0.51)	0.08	0.08	0.09	0.10	0.35
Diluted shares outstanding	197.02	194.90	193.92	188.27	182.74	173.20	155.20	151.50	165.66	135.81	132.68	132.04	130.04	132.64	129.04	128.04	127.04	126.04	126.04

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$9.49; Analyst: Mark.Palmer)

ASSURED GUARANTY LTD. (AGO, Buy, \$41.00 PT; Current Price: \$35.43; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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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 \$32.39 adjusted for estimated losses of \$4.19 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	N/A	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	N/A	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

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