

Equity Research

June 26, 2017

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Financials

MBIA, Inc.

S&P's Downgrade of National to 'A' from 'AA-' Likely to Put Pressure on MBI to Sell to AGO

Standard & Poor's this afternoon downgraded MBIA's (MBI) municipal bond insurance unit, National Public Finance Guarantee Corp., by two notches to 'A' from 'AA-', an action that significantly diminishes the unit's ability to write new business and which we believe increases the likelihood that MBI will seek to sell itself. The natural buyer of the company would be peer Assured Guaranty (AGO, Buy, \$49 PT), which has been clear about its intention to consolidate the industry's remaining firms.

- ▶ S&P also downgraded MBI's holding company by two notches to 'BBB' from 'A-'. Both National and the holdco had been on CreditWatch Negative with the rating agency since June 6.
- ▶ Despite the downgrades, **we reiterate our Buy recommendation on MBI and price target of \$14** based on 50% of the company's adjusted book value (ABV) per share of \$33.69 as of March 31 adjusted for estimated losses of \$4.69 per share related to its insured exposure to Puerto Rico's debt (see page 3). The primary source of MBI's value to shareholders – and prospectively to AGO – lies in National's existing insured portfolio, while the company's prospects for writing a significant amount of new business had represented a source of positive optionality that did not have a material impact on our valuation of the stock.
- ▶ S&P credit analyst David Veno attributed the downgrade of National to the limited market acceptance of its insurance and lack of pricing power relative to peers AGO and Build America Mutual (BAM, Private). As we stated after S&P placed National on CreditWatch Negative on June 6, such a rationale is ironic insofar as it has been the unit's rating one notch below the 'AA' ratings assigned by the agency to AGO and BAM that has been the primary reason for its limited market penetration.
- ▶ **Valuation:** Our \$14 price target on MBI is based on 50% of our estimate of the company's ABV per share of \$33.69 adjusted for estimated losses of \$4.69 per share related to the company's insured exposure to Puerto Rico's debt.

MBI

\$8.53

12 month target

\$14.00

BUY

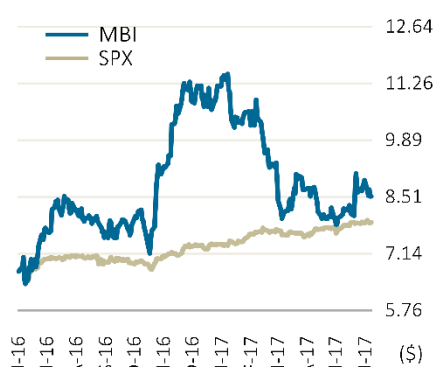
52 week range

\$6.41 - \$11.49

Market Cap (m)

\$1,109

Price Performance



Source: IDC

Estimates

	1Q16 A	2Q16 A	3Q16 A	4Q16 A	FY16 A	1Q17 A	2Q17 E	3Q17 E	4Q17 E	FY17 E	FY18 E
Diluted EPS (Adj.)	0.12	0.11	0.04	(0.05)	0.23	0.07	0.04	0.05	0.06	0.23	0.25
Operating Income	16	15	5	(6)	30	9	5	6	7	28	29

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

- ▶ Not surprisingly, MBI President and Chief Operating Officer Bill Fallon in a statement described S&P's action as "frustrating and disappointing" and noted that National had a sizeable cushion - last estimated by management as greater than \$1.7bn – over the level required to maintain a 'AAA' level of capital under S&P's capital model. We agree that MBI's new business results and prospects appear to have more to do with its potential equity value than its creditworthiness.
- ▶ Fallon last month had told us that he believed National would be in position for an upgrade in 2018, adding that he thought there was an outside chance for the unit to be upgraded this year. Given this change in circumstances, we believe MBI's Board of Directors is likely to recognize that the best means of maximizing value for the company's shareholders would be to entertain an offer from AGO.
- ▶ We believe an AGO acquisition of MBI would be a solid "win-win" outcome as the former would be able to add the equivalent of a large amount of new business at a time when low interest rates have curtailed demand for municipal bond insurance, while the latter would be given a means of unlocking as much of its inherent value as possible. We think our price target of \$14 for MBI would also represent a fair bid for the company.
- ▶ S&P also concluded the review of BAM it had begun on June 6 by affirming its 'AA' rating. That action served as additional confirmation that National is now at a significant competitive disadvantage and that a sale would represent the best way forward for MBI, in our view.

MBIA: Puerto Rico Insured Exposures and Loss Estimates

Discount rate	3.00%
Assumed tax rate	35%
Diluted shares outstanding	130.00
Estimated PV impairment per share	\$7.97
Current reserves per share on National balance sheet for PR	\$0.75
Net estimated reserve strengthening per share after reserve assumption per share	\$7.22
Net after tax reserve per share	\$4.69

Present value impairment of principal and interest (in \$mm)	Assumed Impairment	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%	7.6	5.8	8.3	5.3	6.2	5.5	5.1	4.7	4.3	4.0	1.9	1.8	1.6	1.5	1.4	2.0	1.8	1.7	1.5	1.4	-	-	-	-	-	-	-	-	-	73.3	0.56
Puerto Rico Commonwealth GO	16.5%	7.9	15.4	23.9	33.7	12.1	5.9	5.5	5.1	4.7	4.3	2.9	2.7	2.5	2.3	2.1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	130.9	1.01
Puerto Rico Commonwealth GO Public Buildings Authority	16.5%	1.5	3.3	4.2	1.7	1.6	3.9	3.6	3.4	3.1	2.8	2.0	1.9	1.7	1.6	1.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	37.9	0.29
Puerto Rico Highway and Transportation Authority Transportation Revenue (PRHTA)	40.0%	8.0	15.6	12.2	11.9	11.5	14.8	14.1	13.0	12.0	11.0	15.9	14.1	13.0	12.0	11.0	26.0	23.9	22.1	20.4	18.8	2.4	2.2	2.0	1.9	1.7	0.0	0.0	0.0	0.0	311.5	2.40
Puerto Rico Sales Tax Financing Corporation (COFINA)	20.0%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	16.8	15.5	14.4	13.3	12.2	89.8	83.9	75.2	70.0	391.1	3.01
Puerto Rico Highway and Transportation Authority Highway Revenue (PRHTA)	40.0%	7.9	2.3	6.1	6.1	1.3	0.8	1.2	1.1	1.0	1.0	0.9	2.4	2.2	2.1	1.9	1.7	0.1	0.0	0.0	0.0	0.0	-	-	-	-	-	-	-	-	40.4	0.31
University of Puerto Rico System Revenue	40.0%	2.6	2.6	2.7	2.4	2.4	2.3	3.7	3.4	3.2	2.9	2.7	1.8	1.7	1.6	1.4	1.3	0.3	0.3	0.3	0.2	0.2	-	-	-	-	-	-	-	-	40.1	0.31
Inter American University of Puerto Rico Inc.	40.0%	1.0	1.0	1.0	0.9	0.9	1.0	0.9	0.8	0.8	0.7	0.5	0.5	0.4	0.4	0.4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	11.2	0.09
Total		36.6	46.0	58.5	62.0	36.0	34.2	34.0	31.5	29.0	26.7	26.8	25.1	23.2	21.4	19.7	31.0	26.1	24.1	22.3	20.5	19.4	17.7	16.4	15.1	13.9	89.8	84.0	75.2	70.0	1,036.4	7.97

Estimated amortization of principal and interest (in \$mm)	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	152.1	120.3	176.7	114.8	140.1	126.8	121.1	115.3	109.5	103.8	50.9	48.6	46.2	43.9	41.6	60.9	58.1	55.4	52.6	49.8	-	-	-	-	-	-	-	-	-	1,788.7
Puerto Rico Commonwealth GO	48.0	96.0	153.7	223.1	82.5	44.5	39.6	37.7	35.8	33.9	23.8	22.7	21.7	20.6	19.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	900.0
Puerto Rico Commonwealth GO Public Buildings Authority	9.2	20.7	27.3	11.3	11.3	27.5	26.3	25.0	23.8	22.5	16.3	15.6	14.9	14.1	13.4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	279.2
Puerto Rico Highway and Transportation Authority Transportation Revenue (PRHTA)	19.9	40.2	32.4	32.4	32.4	42.8	42.0	40.0	38.0	36.0	53.5	48.7	46.3	44.0	41.7	101.3	96.0	91.5	86.9	82.3	10.7	10.2	9.7	9.2	8.7	0.0	0.0	0.0	0.0	1,096.9
Puerto Rico Sales Tax Financing Corporation (COFINA)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	151.5	144.6	137.7	130.8	124.0	940.0	905.2	835.6	800.7	4,170.1
Puerto Rico Highway and Transportation Authority Highway Revenue (PRHTA)	19.7	5.8	16.3	16.8	3.6	2.5	3.6	3.5	3.3	3.1	3.0	8.3	7.9	7.6	7.2	6.8	0.2	0.2	0.2	0.2	0.2	-	-	-	-	-	-	-	-	120.0
University of Puerto Rico System Revenue	6.6	6.7	7.2	6.7	6.7	6.7	11.0	10.5	10.0	9.5	9.0	6.3	6.0	5.7	5.4	5.1	1.3	1.2	1.1	1.1	1.0	-	-	-	-	-	-	-	-	124.8
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	1.7	1.6	1.5	1.5	1.4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	33.3
Total	258.2	292.4	416.1	407.6	279.1	250.6	246.2	234.5	222.9	211.2	158.2	151.8	144.6	137.4	130.2	174.1	155.6	148.2	140.8	133.4	163.4	154.8	147.4	140.0	132.7	940.1	905.2	835.6	800.8	8,513.0

BTIG Estimates and Company Reports

Income Statement

MBIA Operating Model (\$ Millions)	Dec-14 2014A	Dec-15 2015A	Mar-16 1Q16A	Jun-16 2Q16A	Sep-16 3Q16A	Dec-16 4Q16A	Dec-16 2016A	Mar-17 1Q17A	Jun-17 2Q17E	Sep-17 3Q17E	Dec-17 4Q17E	Dec-17 2017E	Dec-18 2018E
Scheduled premiums earned	258.0	199.0	45.0	44.0	42.0	37.0	168.0	28.0	27.4	26.9	26.4	108.7	100.2
Refunding premiums earned	139.0	173.0	30.0	29.0	35.0	38.0	132.0	21.0	24.7	24.2	23.7	93.6	90.2
Total premiums earned	397.0	372.0	75.0	73.0	77.0	75.0	300.0	49.0	52.1	51.1	50.1	202.3	190.5
Net investment income	179.0	152.0	39.0	37.0	39.0	37.0	152.0	52.0	42.6	43.0	43.4	180.9	178.0
Fees and reimbursements	40.0	6.0	1.0	1.0	22.0	4.0	28.0	2.0	2.0	2.0	2.0	8.0	8.4
Realized gains (losses) and other settlements on insured derivatives	(444.0)	(28.0)	(14.0)	(2.0)	(4.0)	(20.0)	(40.0)	(31.0)	-	-	-	(31.0)	-
Unrealized losses on insured derivatives	903.0	157.0	(14.0)	(6.0)	20.0	21.0	21.0	(22.0)	-	-	-	(22.0)	-
Other than temporary impairments recognized in AOCI	-	-	-	-	-	-	-	-	-	-	-	-	-
Net change in fair value of insured derivatives	459.0	129.0	(28.0)	(8.0)	16.0	1.0	(19.0)	(53.0)	-	-	-	(53.0)	-
Net gains (losses) on financial instruments at fair value and foreign exchange	78.0	63.0	(69.0)	14.0	38.0	101.0	84.0	17.0	-	-	-	17.0	-
Investment losses related to other-than-temporary impairments	(99.0)	(9.0)	(1.0)	-	-	-	(1.0)	-	-	-	-	-	-
Other-than-temporary impairments recognized in AOCI	84.0	(5.0)	2.0	-	-	(4.0)	(2.0)	(2.0)	-	-	-	(2.0)	-
Net investment losses related to other-than-temporary impairments	(15.0)	(14.0)	1.0	-	-	(4.0)	(3.0)	(2.0)	-	-	-	(2.0)	-
Other net realized gains (losses)	26.0	17.0	(1.0)	3.0	(2.0)	(279.0)	(279.0)	31.0	-	-	-	31.0	-
<i>Revenues of consolidated VIEs</i>													
Net investment income	50.0	86.0	15.0	5.0	5.0	6.0	31.0	6.0	-	-	-	6.0	-
Net gains (losses) on financial instruments at fair value and foreign exchange	50.0	42.0	(1.0)	(7.0)	8.0	-	-	(33.0)	-	-	-	(33.0)	-
Net gains (losses) on extinguishment of debt	6.0	(1.0)	-	-	-	-	-	8.0	-	-	-	8.0	-
Total revenues	1,270.0	852.0	32.0	118.0	203.0	(59.0)	294.0	77.0	96.7	96.1	95.5	365.2	376.9
Losses and loss adjustments	133.0	123.0	22.0	77.0	50.0	71.0	220.0	94.0	18.0	17.8	17.6	147.5	68.8
Amortization of deferred acquisition costs	44.0	50.0	10.0	10.0	10.0	10.0	40.0	7.0	6.7	6.3	6.0	26.0	20.0
Operating	195.0	140.0	35.0	30.0	32.0	40.0	137.0	29.0	29.1	29.1	29.2	116.4	117.6
Interest	210.0	199.0	50.0	49.0	49.0	49.0	197.0	48.0	45.6	44.5	43.3	181.4	162.8
Expenses of consolidated VIEs													
Operating	8.0	13.9	4.0	3.0	3.0	4.0	14.0	2.0	2.0	1.9	1.9	7.7	7.0
Interest	39.0	39.0	12.0	4.0	4.0	5.0	25.0	17.0	5.0	5.0	5.0	32.0	20.0
Total expenses	629.0	564.9	133.0	173.0	148.0	179.0	633.0	197.0	106.3	104.6	103.1	511.0	396.3
Pre-tax income (loss)	641.0	287.1	(101.0)	(55.0)	55.0	(238.0)	(339.0)	(120.0)	(9.6)	(8.6)	(7.6)	(145.7)	(19.4)
Provision (benefit) for income taxes	72.0	109.0	(23.0)	(28.0)	24.0	27.0	-	(48.0)	-	-	-	(48.0)	-
Net income (loss)	569.0	178.1	(78.0)	(27.0)	31.0	(265.0)	(339.0)	(72.0)	(9.6)	(8.6)	(7.6)	(97.7)	(19.4)
Diluted EPS	3.02	1.08	(0.58)	(0.20)	0.23	(2.01)	(2.55)	(0.55)	(0.08)	(0.07)	(0.06)	(0.80)	(0.17)
Operating EPS	0.98	0.51	0.12	0.11	0.04	(0.05)	0.23	0.07	0.04	0.05	0.06	0.23	0.25
Diluted shares outstanding	188.27	165.66	135.81	132.68	132.04	131.91	133.11	131.40	126.60	124.60	122.60	122.60	114.60

Source: BTIG Estimates and Company Documents

BTIG Covered Companies Mentioned in this Report

MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$8.53; Analyst: Mark.Palmer)

ASSURED GUARANTY LTD. (AGO, Buy, \$49.00 PT; Current Price: \$40.65; 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

Ratings Definitions

BTIG LLC's ("BTIG") ratings, effective June 12, 2017, are defined as follows:

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

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

NEUTRAL – A security which is not expected to appreciate or depreciate meaningfully over the next 12 months.

NOT RATED – A security which is not rated but that is covered by BTIG.

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BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. **Stocks under coverage as of the end of the most recent calendar quarter (March 31, 2017): 268**

Distribution of BTIG's Research Recommendations (as of March 31, 2017):

BUY: 54.5%; NEUTRAL: 41.4%; SELL: 4.1%

Distribution of BTIG's Investment Banking Services (as of March 31, 2017):

BUY: 17.1%; NEUTRAL: 3.6%; SELL: 0%

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

MBIA, Inc. (MBI, Buy, \$14.00 PT)

Valuation: Our \$14 price target on MBI is based on 50% of our estimate of the company's ABV per share of \$33.69 adjusted for estimated losses of \$4.69 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 the company's ability to write new business and regulatory risks.

MBIA, Inc. (MBI)
(S)



Note: Closing Price and Target Price have been adjusted for corporate actions.

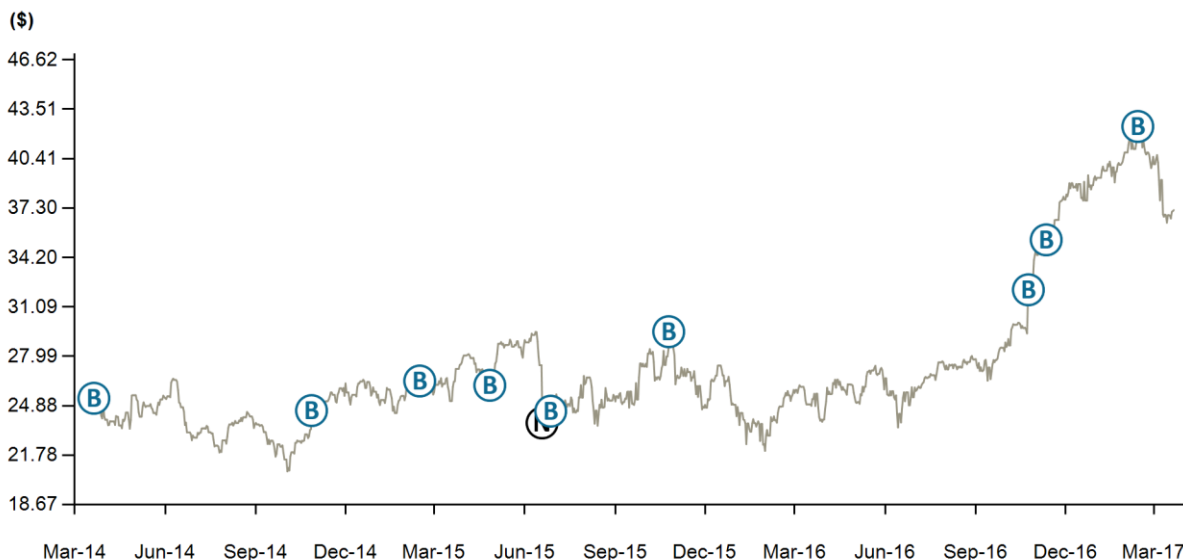
Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
30-Nov-11	9.70	22.50	Mark Palmer	Buy
30-Jun-14	11.04	N/A	Mark Palmer	Neutral
15-Aug-14	10.49	12	Mark Palmer	Buy
12-May-15	9.09	13	Mark Palmer	Buy
29-Jun-15	6.37	N/A	Mark Palmer	Neutral
23-Jul-15	6.29	10	Mark Palmer	Buy
05-Nov-15	8.28	11	Mark Palmer	Buy
01-Mar-16	7.93	13	Mark Palmer	Buy
21-Jun-16	6.82	14	Mark Palmer	Buy

Assured Guaranty Ltd. (AGO, Buy, \$49.00 PT)

Valuation: Our \$49 price target is based on 0.65x our YE18E adjusted book value (ABV) per share of \$79.87, minus \$4.08 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
22-Nov-16	35.24	41	Mark Palmer	Buy
23-Feb-17	42.38	49	Mark Palmer	Buy

Company-Specific Regulatory Disclosures

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from: Assured Guaranty Ltd. (AGO), MBIA, Inc. (MBI)

BTIG LLC has received compensation for investment banking services in the past 12 months from: Assured Guaranty Ltd. (AGO), MBIA, Inc. (MBI)

BTIG LLC had an investment banking services client relationship during the past 12 months with: Assured Guaranty Ltd. (AGO), MBIA, Inc. (MBI)

Other Disclosures

Additional Information Available Upon Request

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