

Equity Research

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Industry Report

Financials

Municipal Bond Insurers

Reality Check: Trump Can't Wipe Out Puerto Rico's Debt, Most of Which Is Held by Everyday Investors

President Trump during his visit to Puerto Rico yesterday in the wake of Hurricane Maria told Fox News' Geraldo Rivera that the Commonwealth's debt would need to be erased. "They owe a lot of money to your friends on Wall Street and we're going to have to wipe that out," Trump said. "You're going to say goodbye to that, I don't know if it's Goldman Sachs, but whoever it is you can wave goodbye to that."

- ▶ But does Trump have the ability, legal or otherwise, to dictate the outcome of Puerto Rico's debt restructuring? And would Wall Street banks be the biggest losers if the island's debt were to be wiped out?
- ▶ The process through which Puerto Rico's debt will be restructured was outlined in the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) which was enacted by the U.S. government in June 2016. PROMESA provided for the creation of the seven-member oversight board empowered to oversee the island's economy and to manage its more than \$70bn in debt. Since the oversight board last May opted to trigger Title III bankruptcy for most of Puerto Rico's debt-issuing entities, the debt-restructuring case has been overseen by Judge Laura Taylor Swain and the panel of five federal judges she appointed to act as mediators
- ▶ What influence could President Trump have on the debt-restructuring process? Under PROMESA, the President of the United States is the only person with the power to remove a member of the oversight board, which he could do if he could show cause for doing so. Inasmuch as the oversight board has been consistently anti-creditor throughout its tenure, the majority of its members are already on the same page with Trump in terms of their desire to impose steep haircuts on bondholders.
- ▶ So beyond providing verbal support for an oversight board that already appears predisposed to do what they can to cram down bondholders, Trump does not have the ability to wipe out Puerto Rico's debt. We also doubt that Trump's comments will hold much sway over Judge Swain, who was chosen for her role by U.S. Supreme Court Chief Justice Roberts and gained a reputation for fairness and fair treatment while serving as a bankruptcy judge and a U.S. District Court judge.

- ▶ Was Trump correct that Wall Street banks would absorb the bulk of the losses if Puerto Rico's debt was wiped out? Actually, Cate Long of Puerto Rico Clearinghouse estimates that less than 25% of the Commonwealth's debt is held by hedge funds with most of the rest owned by everyday investors either directly or through funds. "For the most part, Main Street America owns this debt," Long told CNN. "It's not as though these are vultures circling around the island."
- ▶ The upshot? Trump's comments may strike fear into some of these investors, particularly if they are not familiar with the facts surrounding Puerto Rico's debt restructuring. However, in terms of influencing bondholders' ultimate recoveries the interview did not change anything. What could influence those recoveries is the \$29bn request for aid for the island that the Trump Administration is reportedly finalizing, which could be a meaningful positive for bondholders. Also contributing to bondholders' prospects for a benign outcome was the mediating judges' stated intention to re-open the fiscal plan the oversight board certified in March that provided creditors with just 24 cents on the dollar on the annual debt payments owed to them over the next decade.
- ▶ As such, we believe any weakness in shares of municipal bond insurers Assured Guaranty (AGO, Buy, \$49 PT), MBIA (MBI, Buy, \$14 PT) and Ambac Financial Group (AMBC, Buy, \$26 PT) today due to concerns about how Trump's comments could impact the magnitude of the losses they will absorb on their insured exposures to Puerto Rico's debt should be viewed as a buying opportunity.

BTIG Covered Companies Mentioned in this Report

ASSURED GUARANTY LTD. (AGO, Buy, \$49.00 PT; Current Price: \$38.69; Analyst: Mark.Palmer)

MBIA, INC. (MBI, Buy, \$14.00 PT; Current Price: \$8.68; Analyst: Mark.Palmer)

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, \$26.00 PT; Current Price: \$17.68; 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

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 \$80.32, minus \$4.23 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	NA	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

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

Valuation: Our \$14 price target is based on 0.65x on our estimate of the company's pro forma ABV of \$26.26 adjusted for estimated losses of \$5.19 per share related to the company's insured exposure to Puerto Rico's debt. Our new valuation reflects our assumption that MBI will now realize no tax benefit on its Puerto Rico-related losses.

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)

(\$)



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	NA	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	NA	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
26-Jul-17	10.21	13	Mark Palmer	Buy
09-Aug-17	10.38	14	Mark Palmer	Buy

Ambac Financial Group, Inc. (AMBC, Buy, \$26.00 PT)

Valuation: Our \$26 price target for AMBC is based on a sum-of-the-parts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY19E.

Risks: The primary risks to achieving our recommendation and price target 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, declines in value of investment portfolio could impede Ambac's ability to pay its liabilities and Ambac Assurance Corp. may be unable to exit rehabilitation.

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	NA	Mark Palmer	Neutral
01-Mar-17	22.35	28	Mark Palmer	Buy
11-May-17	17.18	26	Mark Palmer	Buy

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