

## Equity Research

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## Industry Report

## Financials

### MBIA, Assured Guaranty

#### Puerto Rico House Passes Bill to Balance Budget, Could Pave Way for Crucial Bond Offering

We believe the primary reason why municipal bond insurers MBIA (MBI, Buy, \$13 PT) and Assured Guaranty (AGO, Buy, \$41 PT) are trading at steep discounts to their adjusted and operating book values is concern about prospective losses associated with the companies' insured exposures to Puerto Rico's debt. So when Puerto Rico's House of Representatives last evening passed a bill that would balance the budget by raising sales taxes to 11.5% from 7% before a transition to a value-added tax after nine months by a 26-24 margin - an outcome that some observers had stated was unlikely after the House had voted down a value-added tax on April 30 - and sent the bill to the Commonwealth's Senate in which it is expected to pass on Friday, that was very positive news for MBI and AGO.

- ▶ A balanced budget for FY16, which begins July 1, has been seen as a precondition for the issuance by Puerto Rico Infrastructure Finance Authority (PRIFA) of \$2.9bn in new bonds backed by oil taxes, the proceeds of which would be used to shore up the financial positions of both the Puerto Rico Highway and Transit Authority (PRHTA) and the Commonwealth in general while providing the beleaguered island with more time to address its economic and fiscal challenges. Moreover, Puerto Rico has a \$640mm debt service payment due on July 1, and its liquidity had dipped to \$1.02bn as of April 30, awareness of which has heightened investor concerns.
- ▶ Insofar as MBI and AGO had \$4.5bn gross insured exposure and \$4.9bn net insured exposure, respectively, to Puerto Rico's debt as of March 31, it is understandable that both stocks are trading as if they are second derivatives of the perceived likelihood that the Commonwealth will default on its debt. MBI in particular has been particularly vulnerable to changes in sentiment regarding the likely outcome of Puerto Rico's debt situation, so we believe its shares should respond to a more significant extent to the increased clarity provided by the House's vote last evening.
- ▶ We believe the House's vote also should benefit Ambac Financial Group (AMBC) given that it has approximately \$2.5bn of insured exposure to Puerto Rico's debt. A significant portion of that amount, \$712mm is associated with PRHTA, which would benefit disproportionately from PRIFA's prospective bond issuance insofar as it would facilitate a repayment of \$2.2bn owed by PRHTA to Puerto Rico's Government Development Bank.

## **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.

**NEUTRAL** – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

**NOT RATED** – A stock that is not rated but that is covered by BTIG.

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BUY: 57% NEUTRAL: 39% SELL: 4%

Stocks in coverage as of the end of the most recent calendar quarter (March 31, 2015): 142

The percentage of Investment banking services is calculated as of March 31, 2015. Distribution of investment Banking Relationships: BUY: 83% NEUTRAL: 17% 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-Specific Regulatory Disclosures**

#### **Assured Guaranty Ltd. (AGO)**

##### **Valuation**

Our price target of \$41 for AGO is based on 0.75x the company's ABV of \$ 54.66 per share as of March 31.

##### **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 Eurozone countries

#### **Ambac Financial Group, Inc. (AMBC)**

##### **Valuation**

Based on our Adjusted Book Value (ABV) per share multiple valuation for Ambac Financial Group and our recovery analysis, we do not 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.

#### **MBIA, Inc. (MBI)**

##### **Valuation**

Our \$13 price target for MBI is based on 0.50x the company's adjusted book value per share of \$25.78 (ABV) as of March 31.

##### **Risks**

The primary risks to our recommendation include potential deterioration related to structured-product insurance exposures and municipal-bond insurance exposures.

# 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

# 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		Mark Palmer	NEUTRAL
26-Feb-15	25.22		Mark Palmer	NEUTRAL
02-Mar-15	24.93		Mark Palmer	NEUTRAL
30-Mar-15	24.55		Mark Palmer	NEUTRAL
11-May-15	22.75		Mark Palmer	NEUTRAL
12-May-15	24.20		Mark Palmer	NEUTRAL

# 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		Mark Palmer	NEUTRAL
15-Aug-14	10.49	12	Mark Palmer	BUY
12-May-15	9.09	13	Mark Palmer	BUY

## Other Disclosures

Additional Information Available Upon Request

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from the following:

Ambac Financial Group, Inc. (AMBC), Assured Guaranty Ltd. (AGO), MBIA, Inc. (MBI)

BTIG LLC has received compensation for investment banking services in the past 12 months from the following:

MBIA, Inc. (MBI)

BTIG LLC had an investment banking services client relationship during the past 12 months with the following:

MBIA, Inc. (MBI)

BTIG LLC managed or co-managed a public offering of securities in the past 12 months:

MBIA, Inc. (MBI)

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