

INSTITUTIONAL DISTRESSED DEBT RESEARCH

**Performance Plus Advisors, Inc.
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Distressed Debt Research**

**AMBAC FINANCIAL GROUP
AMBAC ASSURANCE**

A TALE OF TWO PLANS

SEE IMPORTANT DISCLOSURES

Ambac Financial Group

Ambac Financial Group is a holding company whose principal operating subsidiary is Ambac Assurance Corporation, a Wisconsin domiciled financial guarantee insurance company. Its business was the issuance of financial guarantee insurance policies to support public finance and structured finance.

On November 8, 2010, Ambac filed Chapter 11 Bankruptcy. Ambac has halted all new business and has placed its remaining business in "run off", meaning it is only taking in premium payments and paying out claims. The insurance regulator in Wisconsin has taken Ambac Assurance's risky obligations and moved them into a Segregated Account with policy holders being awarded Surplus Notes, bearing interest at 5.1% in exchange for their claims. The Segregated Account is supported by the Surplus Notes and the aggregate excess of loss reinsurance agreement backed by the General Account.

Plan # 1 – Plan of Reorganization

On 7/6/2011 Ambac Financial Group filed a Plan of Reorganization for its Chapter 11 Bankruptcy. In a debt for equity exchange, holders of senior note claims are to receive new common stock set forth in the plan. Holders of general unsecured claims are to receive new common stock and warrants. Holders of subordinated note claims will receive warrants. On September 21, 2011 Ambac Financial filed an Amended Plan of Reorganization with the consent of the Wisconsin regulator, signing a Mediation Agreement on the use of NOL's and other issues. Ambac Assurance will get approximately \$3.8 billion in NOL's. Secured claims will be repaid in full. General unsecured claims will get a 8.5 percent to 13.2 percent recovery. Senior notes will get a 11.4 percent to 17.6 percent recovery. Subordinated notes will receive a .5% to .8% recovery. Ambac Financial Group will continue to own Ambac Assurance. The Plan voting deadline has been extended to January 4, 2012. The Bankruptcy Court hearing relating to confirmation of the Plan is scheduled for January 19, 2012.

Ambac Financial Debt

Senior Note Claim

ABK.GA	Ambac Financial Group 9 3/8 due 8/1/2011
ABK.GL	Ambac Financial Group 9 ½ due 2/15/2011
ABK.GB	Ambac Financial Group 7 ½ due 5/1/2023
ABK.GH	Ambac Financial Group 5.95 due 12/5/2035
ABK.GJ	Ambac Financial Group 5.95 due 2/28/2103
ABK.GK	Ambac Financial Group 5.88 due 3/14/2103

Subordinated Note Claim

ABK.GI	Ambac Financial Group 6.15 due 2/7/2087
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Third Quarter 2011 Results

Compared to the third quarter of 2010

- Net premiums earned declined \$41 million to \$102 million
- Net investment income increased \$11.8 million to \$81.6 million
- Net loss and loss expenses incurred were down \$225.6 million, resulting in a net benefit of \$60.2 million
- Other (loss) income declined \$191.9 million to a loss of \$5 million
- Income on variable interest entities (“VIE”s) increased \$28.6 million to \$55 million
- Net losses in the financial services segment, primarily relating to derivative product losses, increased \$135 million to \$211.9 million
- Provision for income taxes increased \$74.9 million to \$75 million
- Corporate interest and other expenses declined \$41.8 million to \$1.8 million, primarily as a result of lower interest expense, as Ambac no longer accrues interest on its debt listed under Liabilities Subject to Compromise, following its bankruptcy filing on November 8, 2010
- Unrestricted cash, short-term securities and bonds at the holding company (Ambac Financial Group, Inc.) decreased \$5 million to \$46.3 million.

Is There Value at Ambac Financial Group?

On March 24, 2010 Ambac Assurance at the request of OCI (State of Wisconsin) established a Segregated Account. The purpose of the Segregated Account is to separate segments of Ambac Assurance's liabilities. The total assets, total liabilities and total surplus of the Segregated Account are reported as discrete components of Ambac Assurance's statutory filings. Statutory capital surplus was \$476 million as of 6/30/2011 and \$273 million on 9/30/2011.

There will be residual value to Ambac Financial Group only to the extent that funds remain at Ambac Assurance after the payment of claims under outstanding financial guaranty policies and the redemption, repurchase or repayment in full of the Surplus Notes. The value of Ambac Financial Group's equity investment in Ambac Assurance will depend upon the performance of the "run off" of the insured portfolio.

Summary & Recommendation

Under the current plan Ambac's debt will be exchanged for common stock. The new common stock's value will be created when any residual value from the "run off" of the Segregated Account takes place. We currently rate the Senior Note claims as **Neutral**, trading at approximately 12 cents on the dollar.

The following Senior Note claims are currently trading at approximately 12

9.375% due 2011

9.5% due 2011

7.5% due 2023

5.95% due 2035

The following Senior Note claims (\$25) par are trading at approximately \$2.10

5.88% due 2103

5.95% due 2103

Volatile capital markets and a slowing economy amplify uncertainty and could further weaken or derail a restructured Ambac. Legal issues and tax issues could become a detriment and delay or complicate the restructuring. The performance of the company's insured portfolio is expected to be volatile and could take up to twenty years to "run off". Liabilities in the Segregated Account must be satisfied before equity can flow freely to the holding company.

Prospective investors should look at statutory capital surplus to follow the progress of Ambac Financial Group. As of September 30, 2011, statutory capital surplus was \$273 million.

The recovery on the 6.15% due 2087 subordinated notes will be de minimis and should be avoided.

AMBAC ASSURANCE

Plan # 2 – Plan of Rehabilitation

On October 8, 2010, the Rehabilitator filed a Plan of Rehabilitation for the Segregated Account. The Plan provides for the orderly “run off” of the liabilities allocated to the Segregated Account. The Plan was confirmed by the court on January 24, 2011. Holders of policy claims will receive a combination of cash payments and a 5.1% note maturing in 2020 issued by the Segregated Account. The initial cash and Surplus Note split will be 25% cash and the 75% Surplus Notes. The disclosure statement provides information about the Plan of Rehabilitation.

General Account & Segregated Account & Surplus Notes.

There are approximately 12,000 policies representing \$241 billion in par in the General Account. The total amount of adversely classified par is \$6.9 billion or 3%. Approximately \$35 billion or 84% of the Segregated Account’s \$ 39 billion in par is adversely classified. Insurance claims unpaid are \$2.446 Billion.

Ambac Assurance Surplus Notes

The Ambac Segregated Account Surplus Notes were fashioned by the regulator as part of the rehabilitation proceeding. These Surplus Notes are a vehicle through which the Wisconsin regulator has arranged for Ambac to defer a portion of its claims by substituting a subordinated obligation for cash. Holders of Ambac policies receive Surplus Notes in partial satisfaction of their claims received, in lieu of cash. These Ambac obligations rank junior to their original claims. By way of background, Surplus Notes are debt instruments that may be issued by insurance companies. Proceeds of Surplus Notes are included in surplus of the insurer. Each payment of interest and principal is subject to regulatory approval, based on a finding that the insurer’s surplus after the particular payment will be sufficient to support policy holder obligations. Because interest and principal payments are expressly subject to regulatory approval, noteholders bear the risk that the regulator may block payments.

Summary & Recommendation

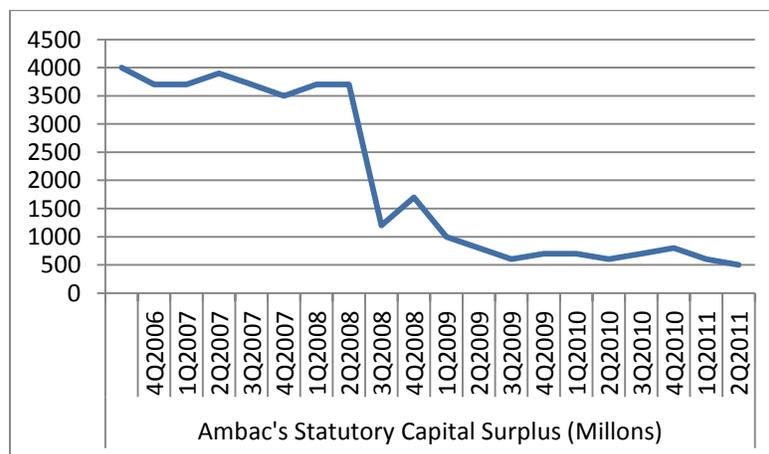
For accredited institutional investors that are willing to assume the risk, we rate the Ambac Assurance 5.1% notes due 2020 as a **BUY, approximate price 28-30**.

After reviewing projections of this “run off” our takeaway is that total cash & investments for Ambac could become \$8 billion to \$12 billion by 2020. Premium income and interest income projections seem to range from \$400 million annually to \$600 million. About \$5.5 Billion in Surplus Notes will be issued.

The Rehabilitation Plan provides holders of policy claims to receive 25% of the claim in cash and 75% in Surplus Notes issued by the Segregated Account.

All payments of principal and interest on the Segregated Account Surplus Notes are subject to the prior approval of the OCI. If the OCI does not approve the payment of interest on the Segregated Account Surplus Notes, such interest will accrue and compound annually until paid. (Ambac Assurance Corporation statement 9/30/2011, Notes to Financial Statements pg Q06.7)

Ambac Statutory Capital Surplus



3rd Quarter 2011 Statutory Capital Surplus \$ 273 million

Discloser - Certification

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RATING SYSTEM EXPLANATION

Buy: We generally expect “**Buy**” rated investment returns to be greater than or equal to plus + 20% from date of the original recommendation.

Neutral: We general expect “**Neutral**” rated investment returns to deviate plus or minus + or – 20% from the date of the original recommendation.

Sell: We generally expect “**Sell**” rated investment returns to be equal to or greater than minus – 20% from the date of the original recommendation.

ANALYST RATING DISTRIBUTION AS OF 12/14/2011

	Number of Companies	Percent of Total
Buy	3	33%
Neutral	5	50%
Sell	2	17%
Total	10	100%