

Institutional Distressed Debt Research

Performance Plus Advisors, Inc.

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Distressed Debt Research

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. It's business was the issuance of financial guarantee insurance policies to support public finance, structured finance and international financial transactions.

On November 8, 2010, Ambac filed Chapter 11 Bankruptcy. Ambac has halted all new business and has placed it's 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 mortgage obligations and moved them into a Segregated Account with policy holders being awarded surplus notes, bearing interest at 5.1 percent in exchange for their claims. The Segregated Account is supported by the surplus notes and the aggregate excess of loss reinsurance agreement.

SEE IMPORTANT DISCLOSURES

History

Mortgage Guaranty Insurance Corporation in 1971 founded American Municipal Bond Assurance Corporation or Ambac. The first municipal bond insurance policy was to fund a medical building and sewage treatment facility in Juneau, Alaska. In 1981 Ambac moved to New York from Milwaukee, later becoming a Citibank subsidiary. Ambac went public in 1991. In 1997 Ambac bought Cadre and Construction Loan Insurance, later renamed Connie Lee Holdings, a guarantor of college bonds and hospital infrastructure bonds. In 1998 Ambac began concentrating on asset backed securities and international bonds. Ambac also entered the Japanese market through a joint venture with Yasuda Fire & Marine. In 2010, after missing an interest payment and failing to reach an agreement for a prepackaged bankruptcy proceeding, Ambac filed for Chapter 11 Bankruptcy. On March 24, 2010 the Ambac board voted to create a Segregated Account and consented to rehabilitation of that account by the Wisconsin Commissioner.

The Commissioner of Insurance of Wisconsin is the court appointed Rehabilitator who proposed a Plan of Rehabilitation for the Segregated Account of Ambac Assurance Corporation. The plan provides for a “run off” and or settlement of the liabilities allocated to the Segregated Account.

Recent Operating Results

First Quarter 2011:

Ambac’s first quarter 2011 net loss was \$819 million versus first quarter 2010 net loss of \$690 million. The net change in fair value of credit derivatives was negative \$8.9 million, improving from negative \$167 million. Variable interest entities (VIE) results were a loss of \$6.1 million versus a loss of \$492 million in the first quarter 2010. Statutory capital surplus of Ambac Assurance totaled \$822 million.

Second Quarter 2011:

Ambac Financial Group reported a second quarter 2011 net loss of \$102.4 million versus second quarter 2010 loss of \$57.6 million. Net premiums were \$99.3 million. Variable interest entities (VIE) increased with a gain of \$2.4 million versus loss of \$38.5 million in the comparable 2010 quarter. Cash amounted to \$51.3 million. Statutory capital surplus was \$476.4 million down from \$801.1 million on March 31, 2011. The loss of \$289.3 million was an increase in statutory loss and loss expenses related to Ambac Assurance's RMBS portfolio.

Plan of Rehabilitation

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 General Account. The initial cash and surplus note split will be 25% cash and 75% surplus notes. The disclosure statement provides information about the Plan of Rehabilitation. Unlike a disclosure statement and plan of reorganization in a Chapter 11 Bankruptcy, the only approval required is that of the Dane County Circuit Court. As of the date of this report, the plan is not effective.

General Account & Segregated Account

As of March 31, 2011 there were 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 par is adversely classified.

AMBAC Assurance Notes

Ambac's General Account issued \$2 billion of secured notes to the Segregated Account, which has the ability to demand payment of Ambac Assurance to pay claims and liabilities. Once the secured note has been exhausted, the Segregated Account has the ability to demand payment from the reinsurance agreement. All of Ambac's resources of the General Account are available to pay liabilities of the Segregated Account. These notes are currently not liquid.

Chapter 11 Bankruptcy-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 as set forth in the plan. Holders of general unsecured claims are to receive new common stock and warrants. Holders of subordinated notes claims will receive warrants.

Ambac in its recent 10 Q described its business as: "Ambac's principal business strategy is to reorganize its capital structure and financial obligations through the bankruptcy process and to increase the residual value of its financial guarantee business by mitigating losses or mitigate future losses, commutations of policies and repurchases of surplus notes issued in respect of claims and maximizing the return on its investment portfolio."

AMBAC DEBT

ABK.GN	Ambac Assurance \$2 billion 5.1 % due 2020	price 30
	SENIOR NOTE CLAIM \$ 1,246 billion	
ABK.GA	Ambac Financial Group \$125 million 9 3/8 due 8/1/2011	12 - 13
ABK.GL	Ambac Financial Group \$255 million 9 ½% due 2/15/2011	12- 13
ABK.GB	Ambac Financial Group \$78 million 7 ½ % due 5/1/2023	12- 13
ABK.GH	Ambac Financial Group \$410 million 5.95% due 12/5/2035	12- 13
ABK.GJ	Ambac Financial Group \$201 million 5.95% due 2/28/2103	\$1.75
ABK.GK	Ambac Financial Group \$176 million 5.88% due 3/14/2103	\$1.75
	SUBORDINATED NOTE CLAIM	
ABK.GI	Ambac Financial Group \$445 million 6.15% due 2/7/2087	

Ambac Financial Group Inc. and Subsidiaries
Consolidated Balance Sheets 6/30/2011

Assets:

Investments:

Fixed income securities, at fair value (amortized cost of \$5,350,418 in 2011 and \$5,424,957 in 2010).....	\$5,872,977
Fixed income securities pledged as collateral, at fair value (amortized cost of \$134,309 in 2011 and \$120,918 in 2010).....	\$140,104
Short-term investments (amortized cost of \$1,066,353 in 2011 and \$991,567 in 2010).....	\$1,066,353
Other, at cost (approximates fair value).....	100
Total investments.....	\$7,079,534
Cash and cash equivalents.....	\$17,379
Restricted cash and cash equivalents.....	\$2,500
Receivable for securities sold.....	\$34,218
Investment income due and accrued.....	\$45,562
Premium receivables.....	\$1,924,925
Reinsurance recoverable on paid and unpaid losses.....	\$158,097
Deferred ceded premium.....	\$232,935
Subrogation recoverable.....	\$739,658
Deferred acquisition costs.....	\$238,225
Loans.....	\$20,271
Derivative assets.....	\$248,950
Other assets.....	\$127,174

Variable interest entity assets:

Fixed income securities, at fair value.....	\$2,023,513
Restricted cash and cash equivalents.....	\$48,319
Investment income due and accrued.....	\$4,087
Loans (includes \$14,442,912 in 2011 and \$15,800,918 in 2010 at fair value).....	\$14,651,253
Derivative assets.....	-----
Intangible assets.....	\$318,180
Other assets.....	\$25,649
Total assets.....	\$27,940,429

Liabilities and Stockholders' Deficit:

Liabilities:

Liabilities subject to compromise.....	\$1,706,518
Unearned premiums.....	\$3,408,568
Losses and loss expense reserve.....	\$6,444,519
Ceded premiums payable.....	\$121,887
Obligations under investment agreements.....	\$556,458
Obligations under investment repurchase agreements.....	\$34,040
Current taxes.....	\$23,435
Long-term debt.....	\$217,345
Accrued interest payable.....	\$114,451
Derivative liabilities.....	\$364,913
Other liabilities.....	\$101,156
Payable for securities purchased.....	\$17,849

Variable interest entity liabilities:

Accrued interest payable.....	\$3,465
Long-term debt (includes \$15,277,137 in 2011 and \$15,885,711 in 2010 at fair value).....	\$15,496,820
Derivative liabilities.....	\$1,371,856
Other liabilities.....	\$31,130
Total liabilities.....	\$30,014,410

Stockholder's deficit:

Ambac Financial Group Inc.:

Preferred stock.....	-----
Common stock.....	\$3,080
Additional paid-in capital.....	\$2,172,027
Accumulated other comprehensive income.....	\$509,300
Accumulated deficit.....	(\$5,001,201)
Common stock held in treasury at cost.....	(\$411,419)
Total Ambac Financial Group, Inc., stockholders' deficit.....	(\$2,728,213)
Non controlling interest.....	\$654,232
Total stockholders' deficit.....	(\$2,073,981)
Total liabilities and stockholders' deficit.....	\$27,940,429

Is There Value in AMBAC Financial Group?

On March 24, 2010 Ambac Assurance at the request of OCI (State of Wisconsin) established a Segregated Account. The Segregated Account is a separate insurer from Ambac Assurance and is subject to all filing requirements of Wisconsin insurers. 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 \$476.4 million as of 6/30/2011.

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

Under the current plan Ambac's debt will be exchanged for common stock. The exact amounts still to be determined. 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 debt as **Neutral**, trading at approximately 13 cents on the dollar. Our position could change once some of the uncertainties resolve and the specifics of the restructuring present themselves.

The following Senior Note claims are currently trading at approximately 13:

9.375% due 2011

9.5% due 2021

7.5% due 2023

5.95% due 2035

The following Senior Note claims (\$25) par are trading at approximately \$2.00

5.88 % due 2103

5.95 % due 2103

Volatile capital markets and an uncertain 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, Ambac Financial Group.

Too many questions and not enough answers, therefore, we rate these securities as **Neutral**. Prospective investors should look at statutory capital surplus to follow the progress of Ambac Financial Group. As of June 30, 2011, statutory capital surplus was \$476 million.

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

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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 8/27/2011

	Number of Companies	Percent of Total
Buy	2	25%
Neutral	5	50%
Sell	2	25%
Total	9	100%