William Blair & Company®

Equity Research

FINANCIAL
Financial Guaranty

March 06, 2008
Research Note

Ticker:	ABK
Market:	NYSE
Price:	$8.70
52-week:	($5-$96)

Stock Rating:
Market Perform

Company Profile:
Core Growth

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Ambac Financial Group, Inc.

Company to Pursue $1.5 Billion Capital Raising Plan

FINANCIAL SUMMARY

Fiscal Year Ends:	December	Dividend/Yield:	$0.84/9.7%
Long-term EPS Growth Rate:	15%	Market Value (mil.):	$883

FISCAL YEAR	2007A	2008E	2009E
ESTIMATES *			
Earnings Per Share	($0.23)	NA	NA
VALUATION			
Price/Earnings Ratio	NM	NA	NA

** Estimates reflect the adoption of FAS 123R.*

--Highlights

- During market hours on March 5, 2008, Ambac announced it will pursue an equity capital raise totaling $1.5 billion ($1.0 billion of common stock and $500 million of Equity Units—percentage ownership in senior notes convertible into common stock at a future date under certain conditions). The announcement put to rest speculation in the near term that has been circulating for weeks of a so-called “bail-out” plan from a bank-led consortium, which we viewed as a low probability outcome, given the complexity and potential for conflict of interest associated with such a structure. While we view Ambac's ability to secure any capital as positive and expect the plan to be executed, it does not alleviate the uncertainty surrounding the company’s ultimate mortgage-related losses, and demand for Ambac’s product will continue to remain significantly impaired in the near term, in our opinion. Management has stated it has written minimal new business so far in 2008. We attribute the market's negative reaction to, of course, the near-term prospects of a huge equity offering that has to get done, as well as hoped-for expectations of an alternative solution that would bring more clarity to Ambac's ultimate losses.

- Following the announcement, Fitch Ratings (Fitch) stated that it is continuing its review of Ambac’s capital position commenced on February 5, 2008, and maintains the company’s double-A rating with Ratings Watch Negative status. Fitch did state that a successful execution of the capital raise could lead to an affirmation of the company’s double-A rating with a Negative Outlook, but that a triple-A rating or Stable Outlook is unlikely, given the continued uncertainty surrounding ultimate mortgage-related losses for the company. Moody’s Investors Service (Moody’s) also commented on Ambac’s capital plan, viewing this equity/equity unit offering in conjunction with other strategic initiatives outlined by the company as positive, and stated that if the

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offering is successful it will likely affirm Ambac’s triple-A rating; however we believe a Stable Outlook would not be assigned in the near-to-intermediate term. Finally, Standard & Poor’s also stated that it would likely affirm Ambac's triple-A rating and assign a negative outlook if the offering proves successful.

- As previously announced Ambac stated it will reduce its quarterly dividend from $0.07 to $0.01 per share and suspend all new structured finance business for the next six months. The company expects the suspension of structured finance writings for six months to free up approximately $600 million in capital. Ambac will discontinue writing business in a number of sectors in the global structured finance markets where the risk dynamics are out of line with the company’s more stringent credit quality, as well as executing financial guaranty contracts in derivative form, due to investors’ growing anxiety associated with large negative mark-to-market losses on the company’s credit derivatives portfolios. While there is not much structured finance business to be written, we believe the decision to categorically not write any structured finance business and eliminate all derivative execution is not a good fundamental one, but management is desperate and attempting to eliminate anything that could be construed negatively by the market. The reality is that the market will continue to struggle with Ambac's ultimate RMBS-related loss exposures in the near term, despite any near-term "window-dressing."

- Our rating remains Market Perform. We have no earnings estimates for Ambac, given limited visibility regarding loss emergence patterns over the next few years and uncertainty about the severity of new business slowdown in the near-to-intermediate term. As a result of continued market turmoil, and lack of clarity regarding losses and ratings stability, the company will likely continue to trade at a meaningful discount to pro forma book value, in our opinion. We have not included any potential dilution from the equity unit offering within the attached pro forma book value per share calculation.

Ambac Financial
Pro Forma Book Value Per Share Estimate as of 12/31/07

Shareholders' equity as reported	2,275,826
Shareholders' equity as reported per diluted share	22.14
Shareholders' equity excluding OCI and aftertax negative cumulative mark-to-market on credit derivatives portfolio (less $1.1 billion credit impairment)	4,805,637
Per diluted share basis	**46.74**
Newly issued equity - estimate	1,104,000
Pro forma shareholders' equity - GAAP	3,379,826
Pro forma shareholders' equity per diluted share - GAAP	12.93
Pro forma shareholders' equity excluding OCI and aftertax negative cumulative mark-to-market on credit derivatives portfolio (less $1.1 billion credit impairment)	5,909,637
Pro forma per share	**22.60**
Diluted shares outstanding - current	102,811
Newly issued shares - $1,150 million at $7.25 - estimate	158,621
Pro forma diluted shares	261,432
Current share price	8.70
Discount to current value	61.5%
2008 estimated ROE	???

Source: William Blair & Company research

Additional information is available upon request.

Current Rating Distribution (as of 02/29/08)

Coverage Universe	**Percent**	**Inv. Banking Relationships***	**Percent**
Outperform (Buy)	57	Outperform (Buy)	12
Market Perform (Hold)	42	Market Perform (Hold)	6
Underperform (Sell)	1	Underperform (Sell)	1

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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