Assured Guaranty Ltd. (AGO)
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First Quarter 2017 Earnings Call

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Thank you operator. And thank you all for joining Assured Guaranty for our 2017 first quarter financial results conference call.

Today's presentation is made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

The presentation may contain forward-looking statements about our new business and credit outlooks, market conditions, credit spreads, financial ratings, loss reserves, financial results or other items that may affect our future results.

These statements are subject to change due to new information or future events. Therefore, you should not place undue reliance on them, as we do not undertake any obligation to publicly update or revise them, except as required by law.

If you are listening to a replay of this call, or if you are reading a transcript of the call, please note that our statements made today may have been updated since this call.

Please refer to the Investor Information section of our website for our most recent presentations, SEC filings, most current financial filings, and for the risk factors.

This presentation also includes references to non-GAAP financial measures. We present the GAAP financial measures directly comparable to non-GAAP financial measures referenced in this presentation, along with the reconciliations between such GAAP and non-GAAP financial measures, in our Financial Supplement and Equity Presentation, which are on our website at AssuredGuaranty.com.

Turning to the presentation, our speakers today are Dominic Frederico, President and Chief Executive Officer of Assured Guaranty Ltd., and Rob Bailenson, our Chief Financial Officer. After their remarks, we will open the call to your questions. As the webcast is not enabled for Q&A, please dial in to the call if you would like to ask a question.

I will now turn the call over to Dominic.

Dominic Frederico, President and Chief Executive Officer

Thank you, Robert, and welcome to everyone joining today's call.

Assured Guaranty began 2017 with a truly great first quarter. Non-GAAP operating shareholders' equity per share of $52.51 and non-GAAP adjusted book value per share of $71.51 again reached

new highs. Operating income of $273 million for the quarter was more than double that of first quarter 2016, and the present value of new business production, or PVP, totaled $99 million, the highest quarterly PVP since the fourth quarter of 2010.

Included in these impressive first quarter results is the impact of completing AGC's January 10 acquisition of MBIA-UK, now called Assured Guaranty (London). Rob will give you details on the income and balance sheet effects of this important acquisition, which reinforces our presence in the European infrastructure market and signals our continued commitment to that market while further diversifying our insured portfolio.

We have been the only guarantor to remain engaged in Europe, and that commitment has begun to produce meaningful returns. We are clearly seeing renewed demand for our guaranty in the U.K., which we attribute to greater market understanding of the value we have demonstrated, favorable interest rate conditions for refinancing infrastructure debt, and the benefits our guaranty provides for investors subject to Solvency II capital requirements.

In December of 2016 and the first quarter of 2017, we guaranteed three bond issues in the U.K. student accommodation sector alone, where our guaranty is extremely useful in creating long-term inflation-linked bonds. These bonds match project lives and attract insurance companies and pension funds looking to match their long-term liabilities.

Additionally, on March 31st, our U.K. office issued a guarantee for an oversubscribed, 261 million pound, 20-year Private Finance Initiative refinancing for St. James's Hospital in Leeds. This was our largest U.K. transaction since 2008.

Including additional transactions in the U.K. utility sector, international public finance transactions produced $40 million of PVP in the first quarter of this year. This is more international production in one quarter than in any full year since 2008.

In the public U.S. municipal bond market, where new issue par volume sold was 10% below that of first quarter 2016, monolines insured 6% of total par issuance, including more than 28% of the new issue par sold by single-A issuers. Assured Guaranty increased its share of the total insured par sold to 57%, up from 54% in the first quarter of 2016. We continued to lead the industry by insuring nearly $3 billion of par volume from more than 180 small, medium and large new issues sold in the quarter. Our par insured on new issues sold in the quarter was approximately 150% of the par insured by the next most active bond insurer.

Importantly, we continued to see increased demand for Assured Guaranty's insurance on larger municipal offerings. With an industry-leading $12 billion in claims-paying resources, we have unparalleled ability to insure larger transactions without any single transaction representing material exposure relative to our claims-paying resources. During the first quarter, we were selected to insure more than $100 million of par on each of five different public transactions. Now, we can't predict the timing of deals of this size, but I can tell you we have already exceeded that number in the second quarter.

Use of our municipal bond insurance on large deals is one sign of growing institutional appreciation of the benefits we offer. Another is the growth of our secondary market business. As more institutional investors recognized the value of our product over the last year, demand for our secondary market municipal bond insurance has grown significantly; the $711 million of secondary market par we insured in the first quarter of this year was nearly double our secondary market volume in the first quarter a year ago.

In aggregate, our primary and secondary insured par sold totaled $3.7 billion for the first quarter.

Municipal transactions closed in the period produced a strong $52 million of PVP following the previous quarter's $72 million. These consecutive quarters were our two best for municipal PVP in more than three years.

The third component of our new business engine, structured finance, produced $7 million of PVP by closing transactions in the aviation finance sector and an insurance reserve financing. We have mandates in aviation and other asset sectors going forward, and continue to see opportunities to provide capital management solutions driven by regulatory and credit concerns.

Another way we increase our reservoir of future earnings is by reassuming previously ceded business. These transactions also generally produce commutation premiums that are immediately recognized as income. We increased both unearned premiums and income in the first quarter by executing a large reassumption of a diversified insured portfolio.

We continue to look for additional opportunities of this type, as well as terminations, wrapped bond purchases for loss mitigation purposes, attractive acquisition targets and strategic investments in financial firms whose business is compatible with ours.

Now to one of our favorite topics, Puerto Rico: There have been important developments since our last call. The best news is that, after agreeing to re-open negotiations over the Restructuring Support Agreement for PREPA, we came away with a modified agreement that allows for full implementation, is fair to the various parties and shows the Puerto Rico government and the Oversight Board that the consensually negotiated RSA construct provided the best way forward for PREPA.

Under the agreed modifications, our responsibilities are substantially similar to the previous version of the agreement: We will provide a surety to support a new issue of securitized bonds, extend the maturity on the relending bonds we purchased from PREPA in 2016 by five years, commit to purchase $18 million of relending bonds in July of 2017 alongside other creditors, and provide $120 million in principal payment deferrals in 2018 through 2023, which will be paid back over ten years. The coupons on these relendings and deferrals range from 7.5% to 9.5%. All of these amounts will be supported by a securitization structure with an automatic rate true-up segregated from PREPA's credit risk.

As we've said before, we favor a constructive approach to resolving Puerto Rico's difficulties as opposed to having costly and time consuming litigation that will further exacerbate Puerto Rico's

challenges. We believe the Oversight Board appointed under the federal PROMESA legislation should facilitate execution of the modified RSA under Title VI of PROMESA.

Unfortunately, neither Puerto Rico nor the board has shown a commitment to the law or to reaching other consensual agreements. On Wednesday of this week, the Commonwealth – with the prior approval of the Oversight Board - filed for protection under Title III of PROMESA – which is to say they filed for bankruptcy.

We promptly filed an adversary complaint seeking a declaratory judgment that Puerto Rico's certified Fiscal Plan violates various sections of PROMESA and the Contracts, Takings and Due Process Clauses of the U.S. Constitution. The complaint also asks the court to enjoin the Commonwealth and the Oversight Board from taking any action based on the illegal Fiscal Plan.

Among other things, the plan fails to meet the PROMESA requirement that it "respect the relative lawful priorities or lawful liens" established under the commonwealth's constitution, laws and agreements. Specifically, the plan violates the Commonwealth's Constitutional Debt Priority Provision, which provides that G.O. bonds have priority over all government expenses.

The plan does not distinguish between essential and non-essential public services. Instead, the plan presumes that all non-debt expenses are paid before any payments are made for debt service. The plan therefore provides approximately $18 billion in average annual non-debt expenses and asks the creditors to believe that every last penny is necessary to maintain essential public services. PROMESA provides that a fiscal plan should ensure the funding of essential public services, but it is impossible for the Oversight Board to meet this standard without first determining what services are essential and what services are not. This approach leaves so little available for debt payments that a consensual resolution will not be possible.

Also, the plan as constructed undermines investors' confidence in Puerto Rico's commitment to paying debt and respecting creditors' rights, which can only defeat PROMESA's stated goal of restoring fiscal responsibility and returning the Commonwealth to the capital markets. The actions of the Oversight Board will not accomplish its mission, which we share, of long-term stability and economic growth for Puerto Rico. How could the board approve a plan that fails to respect the rule of law and continues to ignore the creditor protections provided under PROMESA, the Puerto Rico Constitution and the U.S. Constitution without incurring costly and time-consuming litigation?

Before I finish my comments, I must mention another favorite topic, Moody's, who has not agreed to our request that they withdraw AGC's rating, despite our terminating the rating agreement with Moody's in January 2017. We continue to pursue the matter with Moody's. Meanwhile, just last week, Moody's released a new credit opinion on AGC based again on subjective, non-quantifiable and elusive standards, such as its theoretical opinion about AGC's strategic position within our company. The Moody's rating tells an investor little if anything about AGC's ability to meet its insured obligations, its financial strength and its strategic position in the market.

The current A3 stable Moody's rating fails to reflect the improvement in AGC's financial strength and insured portfolio since Moody's first incorrectly assigned that rating in January of 2013. The

latest credit opinion acknowledges many improvements but the rating has not improved commensurately. From September 30, 2012 to December 31, 2016, AGC's qualified statutory capital increased by 55%, while its statutory net par insured outstanding decreased by 48%, and its leverage ratio of statutory net debt service to claims-paying resources improved from 37:1 to 19:1, clearly representative of a financially strong financial guarantor.

The plain fact is that each of our operating subsidiaries is rated in the double-A category at S&P Global Ratings and the Kroll Bond Rating Agency. Based on S&P's capital model as of year-end 2016, we estimate that our companywide excess capital to be approximately $2.8 billion at the AAA level.

Clearly, with our excess capital increasing, we can continue our share buyback program to produce better shareholder returns while maintaining the high level of financial strength our policyholders enjoy and expect. Additionally, we expect to repurchase more common shares in 2017 than we did last year, closer to the $500-million-plus levels of 2014 and 2015. Since January 1, we've repurchased shares totaling $269 million, and as previously disclosed, our board authorized another $300 million in February for share repurchases. We currently have $280 million of authorization available.

As is evident in our earnings release, we are off to a very good start in 2017. We continue to lead the public finance insurance market while maintaining appropriate pricing levels relative to risk. With the Fed indicating that two more interest rate increases are likely, demand for our bond insurance should grow. In Europe, our infrastructure transactions are becoming larger, more frequent; and worldwide we have structured finance opportunities in many sectors. A number of potential acquisitions of legacy guarantors or their insured portfolios are still available, and we are the most logical purchaser.

We continue to look for opportunities in the alternative investment/asset management segment, and we see these opportunities…we are pleased at the opportunities and the diversity that they represent.

I'm looking forward to updating you each quarter.

I will now turn the call over to Rob.

Robert Bailenson - Chief Financial Officer

Thank you, Dominic, and good morning to everyone on the call.

As Dominic mentioned, we had a great quarter. We recorded operating income of $273 million in the first quarter of 2017, which represents a $150 million increase over the $123 million reported for first quarter 2016.

All of our key strategic initiatives - acquisitions, commutations, loss mitigation, capital management and new business production - contributed significantly to our success this quarter.

The MBIA UK acquisition was a key contributor to operating income for the quarter as well as the growth in adjusted book value. The acquisition generated approximately $61 million of operating income, or 48 cents per share in the first quarter, which includes the bargain purchase gain as well as quarterly results, net of acquisition expenses.

The acquired portfolio consists predominantly of long-dated European infrastructure transactions, resulting in an increase of $2.52 in adjusted book value per share, and drove ABV to another record of $71.51 per share by the end of the quarter.

I would also like to note that the increase in net investment income in the first quarter of 2017 is attributable to a non-recurring amount of accretion related to the Zohar II Notes used to fund the MBIA UK acquisition.

With respect to commutations, in the first quarter we executed an agreement to reassume a previously ceded book of business, adding over $1 billion in par to our insured portfolio. This book of business is comprised primarily of US and European public finance transactions. The commutation generated operating income of $73 million on a pretax basis.

Partially offsetting these increases was a decline in net premiums earned due to lower refundings and terminations. Total accelerated net earned premiums were $58 million in the first quarter of 2017, compared with $89 million in the first quarter of 2016.

Operating loss and loss adjustment expenses in the first quarter of 2017 was $41 million, and economic development was a loss of $47 million, including $11 million caused by the decrease in discount rates. The primary driver of loss development was an increase in expected losses for Puerto Rico, offset in part by a benefit attributable to the settlement of litigation related to two life reinsurance securitizations.

The effective tax rate on operating income in the first quarter of 2017 was 11% in the aggregate, and 13% excluding the non-taxable bargain purchase gain. This compares with 22% in the first quarter of 2016. The decline in the effective tax rate compared with the first quarter of 2016 was attributable to the non-taxable bargain purchase gain in 2017 and the higher proportion of income in non-taxable jurisdictions in 2017 versus 2016.

The non-GAAP measures I am quoting today are based on the recently changed calculation of non-GAAP metrics. Last quarter we agreed with the SEC to change the calculation of our non-GAAP measures by including the effect of consolidating FG VIEs. Operating income for the first quarter 2017 includes an after tax gain of $5 million, and the first quarter of 2016 was revised to now include an after tax gain of $10 million related to FG VIE consolidation.

Please keep in mind that we continue to remove the effect of FG VIE consolidation in the internal core metrics that we use to assess financial performance. Under that calculation, we had $216 million for the first quarter of 2017 and $113 million for the first quarter of 2016.

I will now address our holding company liquidity and capital management activities. As of April 30, we had $67 million in cash and investments at the Bermuda holding company and $227 million at the US holding companies.

In the first quarter of 2017, we repurchased 5.4 million shares for $216 million, at an average price of $39.83 per share. As of May 4, 2017, cumulative share repurchases since January 2013 represent a 39% reduction in shares outstanding. These repurchases have contributed approximately $9.83 per share to operating shareholders' equity, and $16.97 to adjusted book value per share.

The MBIA UK acquisition, the commutation and reassumption of previously ceded business, our strong new business production in the first quarter, and the continuation of our share repurchase program reflect our continued success in executing our strategic initiatives.

I'll now turn the call over to the operator to give you the instructions for the Q&A period.

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