Assured Guaranty Ltd. (AGO)

November 3, 2017

Third Quarter 2017 Earnings Call

Robert Tucker, Senior Managing Director, Corporate Communications and Investor Relations

Thank you operator. And thank you all for joining Assured Guaranty for our 2017 third 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 the 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 most directly comparable to the non-GAAP financial measures referenced in this presentation, along with the reconciliations between such GAAP and non-GAAP financial measures, in our current Financial Supplement and Equity Investor 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.

In the third quarter of 2017, Assured Guaranty continued to execute successfully our strategic plan of

- market leadership in the municipal bond industry
- developing new opportunities in international infrastructure finance
- executing our alternative strategies in the recapture of reinsurance program, and
- effective capital management

all resulting in per-share records for shareholders' equity, non-GAAP operating shareholders' equity and non-GAAP adjusted book value.

This week, to further advance our capital management program, our board of directors authorized an additional $300 million of share repurchases. From 2013 through November 2, 2017, we have repurchased 41% of the shares outstanding for a total of $2.2 billion dollars, while maintaining our strong claims-paying resources.

Across the entire range of our financial guaranty business year-to-date, the present value of new business production, or PVP, totaled $212 million through September 30, up 64% from the nine months of last year.

Focusing in on the U.S. public finance market, for the first nine months, new issue volume lagged last year's volume by 16%, but the insured market declined by only 9%, resulting in a 16% increase in Assured Guaranty's penetration of the total market. Year-to-date, we insured $9.8 billion of primary-market par sold through September. We also increased our year-to-date market share to 58% of insured par sold, in part by providing $100 million or more of our insurance on each of 14 new issues, totaling approximately $1.9 billion of insured par. For all of our primary- and secondary-market U.S. public finance transactions closed from January through September, PVP increased by approximately 54%.

Turning to the international infrastructure market, we continue to have good market traction with investors and strong credibility in the market generally. In the medium and longer term, we expect infrastructure to be a core part of U.K. government-backed economic growth, and we believe Brexit, more likely than not, will be neutral or even positive for the flow of infrastructure opportunities in the U.K. Nearer term, we expect to find refinancing opportunities in the P3 sector given continued low rates and the proof we have shown the market of our value proposition. We also continue to be active in the secondary market, where we closed transactions in the third quarter involving bonds of a U.K. water company and a euro issuance for a European utility.

As we move forward on diversifying our new business production, we also continue to pursue our alternative strategies. These fall into the following main categories –

- loss mitigation
- capital management
- acquisitions of legacy monolines or their insured portfolios

- investments in asset management firms that benefit from our core competencies and credit experience and have risk profiles in line with ours
- and commutations, where we reassume financial guaranty business we previously ceded to unaffiliated reinsurers.

Commutations not only increase our unearned premium reserve but also may result in commutation gains. In September, we reassumed the entire book of business we had ceded to a major reinsurer and a portion of our cessions to another reinsurer. These reassumptions totaled $3.5 billion of par and resulted in a $255 million addition to pre-tax income in the third quarter and an addition of $62 million to our unearned premiums.

Also in September, we completed our first investment in the asset management field, purchasing a minority interest in Wasmer, Schroeder & Company, a highly regarded, independent investment advisory firm that specializes in fixed-income management. WSC focuses on municipal and taxable Separately Managed Accounts for high net worth individuals, wealth management groups and institutions. It has approximately $8 billion under management and a national presence, with clients in all 50 states.

This alliance is a great strategic fit that capitalizes on the core competencies of both companies, especially in connection with our public finance business, where both companies conduct credit analysis and maintain strong industry relationships. It should raise both companies' profiles among retail investors. We expect to support the continued growth of WSC as it seeks acquisitions of other fixed income SMA investment managers. We have also committed $100 million to an investment account that will be managed by WSC.

We continue to evaluate additional opportunities in the asset management arena that meet our criteria of synergy, attractive ROI and comparable risk profiles.

As for the legacy monolines, a number of financial guaranty portfolios with significant unearned premiums remain available, and we believe we are the most likely party to acquire or assume one or more of those portfolios.

We also continue to execute our capital management program, which includes share repurchases as well as appropriate allocations of capital at the subsidiary level. Our MAC subsidiary's insured portfolio has amortized materially over the last number of years, and to rebalance assets during the third quarter, MAC repurchased $250 million of its own shares from its holding company, which is jointly owned by AGM and AGC. The cash from the repurchase was distributed to AGM and AGC in proportion to their ownership shares. This provides additional liquidity for AGM and AGC to upstream dividends.

Speaking of share repurchases, as of yesterday, we have bought back 11.3 million shares for a total of $451 million this year, and expect to reach $500 million or more by the end of the year.

One thing the third quarter helped spotlight was the potential risk to uninsured bondholders from natural disasters, while on the other hand, if you own bonds we insure, your bonds have maintained strong valuation and you know with certainty that you are going to receive your interest and principal in a timely manner. Time and again, we have seen cases where bonds we insured held their trading value while nearly identical uninsured bonds' valuations declined significantly. This divergence was very evident in Puerto Rico bonds, and it was even more pronounced after Hurricane Maria.

To be clear, Assured Guaranty does not take property or casualty risk. P&C insurers will be injecting money into the hurricane-affected areas as those types of claims are made, as will FEMA and other federal agencies. However, Assured Guaranty does have to consider the short- and long-term economic impacts of natural disasters on municipalities whose bonds we insure. In the past, we have paid hurricane-related claims that provided liquidity when, for example, technical or communications obstacles prevented a municipality from funding a payment. Those claim payments were ultimately reimbursed by the obligors. To date, we have had no claims in Florida, Texas or California based on their natural catastrophes, which has historically been our experience.

Puerto Rico, of course, is a special case. A number of its obligors were already in default when Hurricanes Irma and Maria hit, and some had already sought bankruptcy-like protection under Title III of PROMESA. Given the suffering Puerto Ricans have endured, and continue to endure, restoring water and power, among other things, are the most immediate and pressing concerns, and we support all recovery efforts.

While we continue to be confident that all of our various legal rights are valid and enforceable against Puerto Rico, its Oversight Board and certain of its public corporations, we have withdrawn two of our lawsuits for now. One challenged the use of the Oversight Board's fiscal plan, and the other challenged the failure of PREPA, the electric power authority, to apply pledged revenues to the payment of its bonds. Although we expect to be successful in these cases, there is no reason for any party to expend resources litigating them until the Oversight Board indicates its new plans in the aftermath of the storm and service is restored to all customers of PREPA.

It is encouraging that the federal government has approved a $36.5 billion disaster relief package that, along with help for other locales, includes significant aid for Puerto Rico. We do have concerns about the potential for inappropriate diversions of that aid and call on all responsible parties to maintain strong controls.

One example of this relates to PREPA. We and other creditors have been seeking to exercise our legal right to have a receiver appointed for PREPA, one with substantial experience managing an electric utility. The controversy over the Whitefish contract only reinforces the need for independent, strong professional management. The Oversight Board has now essentially acknowledged this need by asking Judge Swain to authorize a revitalization coordinator "to assume the powers of a chief executive officer at PREPA." While at this point we are still reviewing the experience of the person they have selected, the fact that they are trying to install an independent manager shows that they have recognized the importance of the point we have been making, which is one that we have the legal right to require and were denied.

The new conditions in Puerto Rico give the Oversight Board an opportunity to correct its legal and economic mistakes. The fiscal plan it certified must be reevaluated not only in light of the hurricane damage but also in light of the plan's failure to comply with PROMESA and the laws and constitutions of the United States and Puerto Rico. Especially at this critical juncture, the island should not be bogged down in lengthy and expensive litigation, in which it is unlikely to prevail.

Make no mistake, neither access to the capital markets nor sufficient private investment in Puerto Rico is going to be possible while the board appointed to establish fiscal responsibility on the island supports a fiscal plan that shows little regard for creditors' rights. Additionally, many Puerto Rico bonds are held by individual retail investors in the 50 states and Puerto Rico, either directly or through mutual funds, and treating them unfairly could have broad repercussions in the $3.8 trillion municipal bond market that would raise the cost of all U.S. municipalities' future borrowing. It's important to understand that when municipalities talk about not meeting obligations to bondholders, the people who will be impacted are predominantly U.S. citizens who also are U.S. taxpayers and, as importantly, U.S. voters. Some of our elected officials and their nominees to control boards and other groups seem to ignore this important fact.

The pre-Maria fiscal plan violated PROMESA and thwarted the law's intent by disregarding the lawful priorities and liens set forth in the Puerto Rico constitution, failing to differentiate essential and non-essential services, and elevating virtually all non-debt spending above debt service. Relying on this type of fiscal plan structure is a sure way to eliminate the capital market access that is one of the primary purposes of the Oversight Board under PROMESA.

Puerto Rico and the Oversight Board should take this opportunity to work collaboratively with creditors to reach consensual agreements.

One could argue that, if priorities and liens had been respected and if the PREPA restructuring support agreement had been approved, and an experienced receiver put in to manage PREPA, it would have had access to capital market funds to address some of the emergency recovery efforts and we might not have 70% of the Puerto Rico population still without power.

Keep in mind that our loss mitigation efforts have been highly effective over the years. We helped craft solutions in distressed municipalities that limited our losses while allowing us to assist issuers in returning to the capital markets - and where the outcomes for bondholders were far more favorable than borrowers' initial proposals would indicate. Given our legal and contractual rights, we believe the outcome in Puerto Rico is likely to follow this pattern.

Another credit that has been in the news is Hartford, Connecticut, which has a structural disadvantage because, as the state capital, half of the property in Hartford is tax-exempt. Connecticut recently enacted a budget containing assistance for Hartford, and we are optimistic that the state and city will work together to address the city's long-term financial challenges. We are prepared to work constructively with the city and other stakeholders to help return Hartford to a sustainable financial footing.

We proved the value of our product and the resilience of our enterprise through the most difficult economic decade since the 1930s. Now, with domestic and global conditions improving, interest rates rising and pent-up demand for infrastructure development almost everywhere, we expect steady, long-term performance from our core business. At the same time, we have flexibility to make accretive acquisitions and prudent, profitable investments and to distribute excess capital to our shareholders.

Our success will be based, as always, on our proven, profitable business model and our demonstrated abilities to form a realistic vision of future possibilities, to define strategies for achieving our goals and to execute those strategies effectively. This is how, for three decades, we have built value for our policyholders and shareholders, and it's how we intend to build ever-greater value in the future.

Before I end, I want to acknowledge Jim Michener, who has been our general counsel and secretary of Assured Guaranty Ltd. since our IPO in 2004. Jim has chosen to leave that role at the end of the year, but I'm happy to say that he will continue to serve as my Senior Advisor until the end of next year. Jim has been deeply involved in every important initiative we have undertaken as a public company, and I thank him sincerely for doing so much to help make us the leading financial guarantor during his years as general counsel.

Succession planning is something we take very seriously, and we are fortunate that Ling Chow, who has worked alongside Jim for many years and has superbly led the legal operations of our U.S. subsidiaries as our U.S. General Counsel, is on hand to take on the additional responsibilities of corporate General Counsel. After 15 years at Assured Guaranty, Ling knows our business and knows the job, and I am proud to recognize Ling in her new role.
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.

Operating income was $156 million for the third quarter of 2017, compared with $497 million for the third quarter of 2016. The results in both periods include significant gains attributable to our strategic initiatives.

This quarter we commuted previously ceded portfolios, resulting in the reassumption of $3.5 billion of par, and $62 million of unearned premium revenue, generating a pretax commutation gain of $255 million, or $165 million after-tax. The third quarter of 2016 included an after-tax gain of $293 million related to the acquisition of CIFG Holdings. Excluding these amounts, the decrease in operating income was attributable to higher loss expense in the U.S. Public Finance sector and lower earned premiums.

Economic loss development during the third quarter of 2017 was a loss of $204 million, primarily due to Puerto Rico. This was offset in part by a benefit in US RMBS resulting from improvements in the performance of the underlying collateral. Increases in risk free rates used to discount losses resulted in a benefit of $6 million, which is also included in economic loss development.

Net earned premiums and credit derivative revenues were $194 million in the third quarter of 2017, compared with $249 million in the third quarter of 2016. The decrease was due primarily to lower refundings and terminations, which were $87 million in the third quarter of 2017, compared with $126 million in the third quarter of 2016.

The third quarter of 2017 had an effective tax rate of 34 percent, compared with 3 percent for the third quarter of 2016. The relatively high rate in 2017 was due to commutation gains in the U.S., and loss expense in the Bermuda companies. The 2016 tax rate was relatively low due primarily to the non-taxable bargain purchase gain from the CIFG Acquisition.

During the third quarter of 2017, we repurchased 1.8 million shares for $80 million, at an average price of $43.29 per share. This brings our total share repurchases to over 79 million shares since the beginning of 2013, or 41% of our outstanding shares. The cumulative impact of these repurchases has contributed approximately $11.48 per share to operating shareholders' equity, and over $19 to adjusted book value per share.

And as Dominic mentioned, the Board of Directors authorized an additional $300 million in common share repurchases, bringing our current remaining authorization to $398 million.

As of October 31, 2017, we had cash and investments available for liquidity needs and capital management activities of $47 million at the Bermuda holding company, and we also had $114 million at the U.S. holding companies.

The successful execution of commutations and continued share repurchases has led to new records for non-GAAP operating shareholders' equity per share and adjusted book value per share of $55.87 and $74.78, respectively.

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

Q&A to Follow