Assured Guaranty Ltd. (AGO)
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First Quarter 2023 Earnings Call

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Thank you operator. And thank you all for joining Assured Guaranty for our First Quarter 2023 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.

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If you are listening to a replay of this call, or if you are reading the 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 and 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 a reconciliation 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.

Assured Guaranty's new business production was outstanding in the first quarter of 2023. In terms of PVP, it was our most successful first quarter in over a decade. We closed $112 million of PVP in the quarter, up 62% from first quarter 2022 and double the first quarter average for the previous 10 years. We benefited from a strong start to the year for both global structured finance, which wrote its largest amount of first-quarter PVP in over a decade, and international public finance, where first-quarter PVP was the best in five years.

Adjusted operating income per share came in at $1.12 for the first quarter. As of March 31st, our key non-GAAP valuation measures again reached record levels on a per-share basis, with adjusted operating shareholders' equity at $94.58 and adjusted book value at $143.04. Shareholders' equity per share at quarter-end was $88.07, compared with $85.80 for the previous quarter.

Significantly, on April 5th, we announced that we reached an agreement with Sound Point Capital Management, which, when implemented, will combine the asset management portfolios of Assured Investment Management and Sound Point to create what we expect to be the CLO market's fifth largest asset manager by AUM.

Our first quarter production results show the strategic execution of our uniquely diversified, three-pronged business approach, which includes the U.S. public finance, international infrastructure and global structured finance markets.

In the first quarter, the largest contribution to PVP came from global structured finance, which contributed $60 million of PVP – primarily from an insurance securitization and an excess-of-loss guaranty of a minimum amount of billed rent on a diversified portfolio of real estate properties. We were also active in whole business securitization and in subscription finance, which is a promising new market for us.

In international public finance, we generated $30 million of PVP by guaranteeing several regulated utility transactions, as well as a long-term sale and leaseback financing for the Glasgow City Council.

Our U.S. public finance business was adversely affected by comparatively low new issuance volume during the first quarter of 2023. Aggregate U.S. municipal market volume was 23% below that of first quarter of 2022. However, bond insurance market penetration of 7.7% of par issued remained close to the 8% total for all of 2022 and significantly higher than the ten-year annual average of 6.4%.

We continued to lead the U.S. municipal bond insurance market with 60% of insured new issue par sold in the first quarter. We guaranteed 124 transactions with $3.4 billion of aggregate insured par.

We also continued to benefit from institutional investor demand for Assured Guaranty's insurance on larger transactions. In the first quarter, we insured 8 transactions with insured par of $100 million or more, which totaled approximately $1.6 billion.

Among AA credits – defined as those credits S&P and/or Moody's rate in the double-A category on an uninsured basis – Assured Guaranty insured 15 primary-market transactions for a total of almost $800 million of insured par during the quarter. We think the fact that investors are willing to accept a lower yield to gain the protection of our guaranty is a testament to the breadth of benefits in our value proposition, beyond simply default protection.

Related to asset management and our agreement with Sound Point, we believe the transaction, which we expect to close in the third quarter, will be immediately accretive to earnings per share, return on equity and book value per share.

The combination of AssuredIM with Sound Point is subject to certain consents and regulatory approval and will create an asset management firm that is expected to have approximately $47 billion in total assets under management, with a CLO portion that would rank fifth in AUM among global CLO managers, based on year-end numbers. Under the agreement, we will own 30% of the combined entity at closing.

We will contribute to Sound Point our Assured Investment Management business, with certain exceptions, such as, Assured Healthcare Partners. After closing, we will also engage Sound Point as the sole alternative investment manager for AGM and AGC, which are committed to invest, over time, a total of $1 billion to alternative investment strategies managed by Sound Point. That total of $1 billion includes alternative investments and commitments currently being managed by AssuredIM that will be transferred to Sound Point as part of the transaction. At year-end 2022, nearly $400 million of AGM and AGC alternative investments were managed by AssuredIM.

To give you a further idea of the scale of this new platform, using year-end 2022 amounts, AssuredIM would add approximately $15.2 billion of AUM to Sound Point's $32 billion for a total of $47.2 billion. The CLO components are $14.5 billion from AssuredIM and $21.4 billion from Sound Point as of year-end.

This arrangement should further advance our strategic diversification into the asset management business. We have said that we were looking for alternative accretive growth strategies to maximize the value to shareholders of our asset management business, and to generate a growing earnings stream independent of our insurance premiums. We believe our arrangement with Sound Point will accelerate the growth in our earnings from asset management.

We intend to jointly create a firm with competitive advantages, including:

- the large scale essential for leadership in the asset management business;
- proven success in managing credit-focused alternative investment strategies;

- well-established distribution channels; and
- a stable source of capital for growth opportunities in the asset management business.

Our desire to enter into this transaction with Sound Point was based on our confidence in Sound Point's proven ability to raise LP funds and to produce attractive alternative investment returns. We believe the addition of AssuredIM's AUM, and AGM and AGC's capital commitments, can further strengthen Sound Point and enhance the combined entity's profitability, as well as its ability to increase the investment returns of our insurance subsidiaries. This would further support their capacity to upstream dividends to the holding company and ultimately to shareholders.

Turning to Puerto Rico, our last remaining unsettled defaulted Puerto Rico exposure is the electric power authority, PREPA. The PROMESA court has again directed the parties to engage in good faith mediation in an effort to reach an agreement before the confirmation hearing scheduled for late July. We remain committed to negotiate a fair and reasonable settlement with PREPA but, if necessary, will protect and enforce our rights as bondholders through litigation in the Title III plan confirmation process.

Looking forward, I am optimistic about our prospects for this year and beyond. Both our international infrastructure and structured finance businesses have good pipelines of opportunities, and our U.S. public finance business should continue to benefit from the more steady transaction flow that is typical in that market.

Inflation and the last year of hawkish Fed action continue to have a significant impact on the municipal bond market. Compared with last year's first quarter, when the AAA 30-year municipal benchmark index averaged 2%, the average for this year's first quarter was 3.4%. Additionally, credit spreads, which can be equally if not more important to our business, widened significantly during 2022 and remained steady during the first quarter. We believe these factors should be positive for our business going forward.

Market volatility, economic and geopolitical uncertainty and recession fears tend to be conducive to greater investor demand for our product. Importantly, for over 35 years, our business model has proven its resiliency in unpredictable and stressful economic times by protecting our company's financial strength and shareholder value while we safeguard our policyholders and save money for issuers.

I believe there is a good chance the market is entering the kind of sustained interest rate and credit spread conditions that I have often said would allow for significant growth in our financial guaranty business – conditions that would likely give us more opportunities to add value as well as increased pricing flexibility.

Our insured portfolio and financial condition are as strong as or stronger than ever and we expect our new asset management approach to be highly beneficial.

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.

I am pleased to report first quarter 2023 adjusted operating income of $68 million, or $1.12 per share. This compares to adjusted operating income of $90 million or $1.34 per share in the first quarter of last year, which included a $63 million net benefit associated with the Puerto Rico settlements that occurred last March.

The largest component of adjusted operating income was the insurance segment – which contributed $117 million of adjusted operating income in the first quarter of 2023, compared with $133 million in the same period of last year. Excluding the benefit for Puerto Rico settlements from last year's results, Insurance segment adjusted operating income increased due to higher net asset values for alternative investments, higher investment income and the release of a litigation accrual.

Investment results from both the fixed maturity and the alternative investment portfolios performed very well in the first quarter of 2023, with total income from investments of $110 million, compared with $58 million in the first quarter of last year.

The available for sale portfolio generated net investment income of $82 million in the first quarter of 2023, up from $63 million in the first quarter of 2022. Higher income from floating rate assets, as well as higher interest rates and average balances in the short-term portfolio were the primary drivers of the increase.

Equity in earnings from alternative investments - predominantly generated by the AssuredIM CLO and Healthcare Funds - was a gain of $30 million in the first quarter of 2023, compared with a net loss of $1 million in the first quarter of last year. Annualized returns for the AssuredIM Funds were 10.7%, which is in line with our long-term expectation for these investments.

With respect to premiums and losses, the variance in both line items was primarily driven by the impact of the Puerto Rico settlements in March of last year, which resulted in net earned premium accelerations of $104 million and loss expense of $29 million.

Net earned premiums and credit derivative revenues were $84 million in the first quarter of 2023 compared with $219 million in the first quarter of last year. Excluding the first quarter 2022 effects of the Puerto Rico settlements, scheduled net earned premium and credit derivative revenues were relatively consistent quarter over quarter, as new business has kept pace with the scheduled amortization and refundings in the insured portfolio. Deferred premium revenue remained steady at approximately $3.7 billion, where it has been for the past year. Non-Puerto Rico accelerations were $4 million in the first quarter of 2023, compared with $26 million in the first quarter of last year, as refunding activity has slowed down in recent years.

Loss expense in the first quarter of 2023 was $9 million, and economic development was $11 million. The primary driver of both measures was the change in risk-free rates used to discount losses.

With respect to operating expenses, the first quarter of 2023 ran higher than our normal run-rate due in part to severance and legal expenses related to the Sound Point transaction, and an additional UK value-added tax, which together totaled approximately $15 million. These unusual items affected each of the segments and the corporate division and were the primary driver of the increase in corporate division adjusted operating loss from $33 million to $44 million.

Turning to the asset management segment, we are committed to the Sound Point transaction, which we expect to close in the third quarter of this year. As a result, we have designated the transferring AssuredIM business, as well as the remaining healthcare business, as held-for sale on our balance sheet, and we have stopped amortizing the related intangibles.

From a reporting perspective, the transformation of our asset management business from a wholly owned business to a minority stake in a larger Sound Point combined entity, continues to give Assured Guaranty ongoing earnings based on asset management fees, and increases our ability to expand into alternative investments, while simplifying our reporting structure and financial statements.

Upon closing, we expect that we will deconsolidate most, if not all, of the CLOs and AssuredIM funds. The result will be a more straightforward one-line investment in Sound Point and in each of the funds using the equity method of accounting.

As Dominic mentioned, we have agreed, after closing, to invest $1 billion in Sound Point-managed alternative investments, subject to regulatory approval. This commitment includes almost $400 million of existing investments and commitments in AssuredIM CLO and asset-based funds that will transfer to Sound Point. Adding inception to date distributed gains, our current authorization for alternative investments through our investment subsidiary, AGAS, is $853 million and is available for investment in both Sound Point investment vehicles and the Assured Healthcare Partners strategy.

As we continue to shift more of the investment portfolio to alternative investments, net investment income from fixed-maturity securities may decline. However, over the long term, we expect returns on the alternative investment portfolio of over 10%, which exceeds the projected returns on the fixed-maturity portfolio.

In addition to meeting two of our key objectives in asset management and alternative investments with the Sound Point transaction, we continue to focus on our other long-term strategic initiatives to grow the company and enhance shareholder value. In the insurance segment, strong production in the international public finance and structured finance markets provide diversified sources of new business and are accretive to key book value metrics.

On the loss mitigation front, we continue to strategically divest the remaining recovery bonds and Contingent Value Instruments that we received last year as part of the resolution of the majority of our Puerto Rico insured exposures in order to maximize our economic benefit. We also continue to work towards resolution of our PREPA insured exposure.

As of May 5th, we have sold approximately 91% of the recovery bonds in the investment portfolio and 35% of the Contingent Value Instruments. Based on fair value, we have approximately $81 million in recovery bonds and $324 million in Contingent Value Instruments remaining in our investment portfolio.

In terms of holding company liquidity, we currently have cash and investments of approximately $165 million, of which $48 million resides in AGL. These funds are available for debt service and corporate operating expenses or for use in the pursuit of our strategic initiatives including potentially refinancing or redeeming debt and repurchasing shares to manage our capital.

As we said in our last call last quarter, we currently have $201 million of remaining authorization and expect to resume share repurchases in the second half of the year.

However, even without share repurchases in the first quarter of 2023, operating shareholders equity and adjusted book value per share reached new records of over $94 million and $143 million, respectively, due to positive adjusted operating income and strong new business production results for the quarter, demonstrating the value of all our initiatives.

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

QUESTION & ANSWER SESSION

Operator
[Operator Instructions]
Our first question comes from Thomas McJoynt from KBW. Thomas, your line is now open. Please go ahead.

Thomas McJoynt, *KBW*
Hey. Good morning, guys. Thanks for taking my questions. You did call out a number of – thanks, yeah, you did call out kind of a number of seemingly kind of one-off pieces like the litigation accrual release, the U.K. tax assessment and some of the Sound Point transaction costs. So a lot of moving pieces there, but some of them weren't quantified. So could you put any numbers around those just as we try to think of kind of the magnitude of the impact on the quarter?

Robert Bailenson
I would just say, Tommy, looking at expenses, the one-time items are approximately $15 million, and the release of the litigation accrual was about $20 million.

Thomas McJoynt
Got it. Thanks. And then just as a reminder, in the Asset Management segment, can you remind us, are most of the performance fees that you guys recognized loaded into the first quarter? So just like a higher seasonally, that's normally what has been the case or anything kind of unique there?

Dominic Frederico
No, not loaded at all, Tommy. Whenever they're realized, then we recognize them. Unless there's a tax distribution, then you have to recognize something for the tax distributions. But typically, they don't recognize to realize, and that's any time we sell the asset.

Thomas McJoynt
Okay. You also called out in excess of loss guarantee on a minimum to build rent on a diversified portfolio of real estate properties. You, of course, have a lot of different mechanisms through which you guys lend your guarantee as long as it's the right price. Is this type of transaction new? I'm not sure I've heard of it before. And basically, do you plan to branch off into these types of transactions as you look for new growth sectors?

Dominic Frederico
In our structured finance, Tommy, it's becoming more bespoke than it used to be standardized. Remember, in the old days, it's basically mortgage business, credit cards, auto loans, and those businesses now go out without insurance. So you got to be a little bit more creative. This is an internally rated AA transaction, highly subordinated protection in the deal. It's a mixture of all sorts of properties, including residential, multifamily residential, office space, retail space and industrial space. And it's a really great portfolio. If we see other opportunities like this, we'd be more than happy to take them.

Robert Bailenson
And a lot of these transactions, Tommy, benefit the client for capital relief. So capital relief transactions are significant in the structural finance.

Dominic Frederico
And this is done for a financial institution.

Thomas McJoynt
Okay. Got it. Makes sense. And then just actually last one, if I could sneak it in here. Does your thinking still believe that in the second half of the year you should have that five-year audit completed? Do you think the opportunity to pursue special dividends becomes more likely? Is that still the right timing that we should be thinking about?

Robert Bailenson
Yes.

Dominic Frederico
Separate two issues there, Tommy. One is special dividend, one is share repurchase. We anticipate starting to do share repurchasing now after the call, after we clear blackout, because we've now got certainty over certain of the obligations that we were preparing for relative to Sound Point transaction and some other things that we were holding money for, so that will start. And then special dividend will be requested sometime this year. The amount of capital that we could retire this year will be predicated based on availability and special dividend.

Robert Bailenson
And we do expect the audit to be done in July.

Thomas McJoynt
Great. Thank you both.

Robert Bailenson
Thank you.

Operator
Our next question comes from Giuliano Bologna from Compass Point. Giuliano, your line is open. Please go ahead.

Giuliano Bologna, *Compass Point*
Hello. Good morning and congrats on another great quarter. One thing I'd be curious about related to the asset management transaction is you had some goodwill intangibles related to the Blue Mountain deal. And it sounds like the commentary implies that this will be at least flat, if not, positive from a book value perspective. Is it fair to assume that the fair value of the equity stake should exceed – at least meet or exceed the goodwill intangibles related to the Blue Mountain deal?

Robert Bailenson
Yeah. That's a good assumption.

Giuliano Bologna
And then thinking about the earnings, obviously, if you recognize it as an equity method investment, would it just flow through as kind of below the line item or just another income line on a net basis? And related to that, would you get distributions from the partnership quarterly or annually? Is there any sense of the timing there?

Robert Bailenson
It will be equity income and our investment in Sound Point, one line item. And there'll be equity income, as I said, for our investment in the funds. And we will get distributions from Sound Point up into the holding company.

Giuliano Bologna
That's great. Very helpful and I'll jump back in the queue.

Robert Bailenson
Thanks Giuliano.

Operator
Our next question comes from Jordan from Philadelphia Financial. Jordan, your line is now open. Please go ahead.

Jordan Hymowitz, *Philadelphia Financial*
Thanks, guys for taking my question and go 76ers. You said Dominic a minute ago that you expect to start buybacks as soon as the quiet period ends. Can I push that a little more? On the last call, you said you would be able to do without a special dividend, you may not be able to do quite $300 [million], but near $300 [million] in special dividends without a special buyback. Is that still the plan for this year?

Dominic Frederico
I don't think we've ever given a number, to be honest with you, Jordan. Obviously, we will do as much as we can based on availability and based on other…

Jordan Hymowitz
Well, $300 million in dividend paying capability or near that in the past, and you said we should have close to that this year.

Dominic Frederico
We have to figure out what to do with the money, Jordan. We've got the debt refinancing and we've got to think about whether we want to pay the debt off for refinancing. We've got some other things we got to do in terms of truing up the balance sheet with the ultimate merger with Sound Point. So there's some other calls on cash that we've got to look at as well. So as we figure out the availability, the amount, ex and with the special dividend, we will then start and continue to do our execution of our strategy of retiring capital.

As we've always said, it's still a very high priority in the company. And as we know, we've got some clarity where we're at today, we can start to buy back some shares. And like I said, the amount that we'll buy back this year will be predicated on the special dividend and these other factors that we're considering.

Robert Bailenson
And we do expect, as I said in my -- I do -- we do expect to buy back shares as part of our capital management strategy.

Jordan Hymowitz
Okay. And any prediction of the series? [Referencing Philadelphia 76ers-Boston Celtics series]

Dominic Frederico
I'd say I was shocked last night. And we're in Bermuda, so we're an hour ahead. So it was a little late to stay up for the game. But I was shocked at they won last night, that's for sure. But it's a continuation of the great Philadelphia sports story. Eagles, Phillies, now Sixers. Can't get any better than that.

Operator
Our next question comes from Brian Meredith from UBS. Brian, your line is now open. Please go ahead.

Brian Meredith, *UBS*
Thanks. So a couple of them here for you. First one, I'm just curious, the kind of one-timers we had in the quarter. Did any of this affect the Insurance operations? Just looking at the $67 million of insurance operating expenses, trying to figure out is there a run rate or is there anything onetime in that number?

Dominic Frederico
One thing would be there is the acceleration based on shares that were given to them, retired eligible employees, would be the acceleration in the expense line.

Robert Bailenson
And also the one-time items also included the VAT, value-added tax, expense that I talked about. But in total….

Brian Meredith
For the insurance ops. Okay.

Robert Bailenson
Yeah. But like I said, in total for the entire company it was $15 million of onetime items.

Brian Meredith
Got you. Thanks. I was just trying to figure out kind of a run rate underwriting profitability, kind of thinking about the insurance operations. Second question, I'm just curious, more for, I guess, a regulatory accounting perspective, does alternative investment income count with respect to the test on dividends out of the insurance operations with respect to investment income?

Dominic Frederico
Yeah. So think of it this way, the assets that are on the insurance companies' books, the balance sheet, the investment alternative investments, the higher returns do increase investment income in those companies, and therefore, increase our dividend capacity if that's a limiting factor. The GP management fees are outside, the Insurance company structures, that's free cash flow that's created for the company.

Robert Bailenson
As distributions -- as we distribute, the returns from the alternative investments from AGAS, up to the insurance companies, as Dominic said, that will increase the dividend capacity of the Insurance companies.

Brian Meredith
Great. That's helpful. And then, Dominic, last question just quickly here on PREPA. I mean you did talk about it, the court decision with respect to, I guess, revenues versus

net revenues. Maybe you could just try to put that in plain English for some of us. What does it mean as far as potentially getting a settlement here and rights and stuff?

Dominic Frederico
Remember, any utility has to pay their expenses, right? So you're basically left with the net revenue opportunity to pay back debt. If you remember in the Jefferson County, they try to stuff the kitchen sink into the expenses of the water authority, and we were able to get that countered and resolved without any impairment. Obviously, the judge seems to be making social decisions about legal decisions, that's fine. That's why there's court of appeals, and there's other avenues for us to pursue. They seem to want to press for mediation, which obviously makes some sense. We don't have the fight when it comes to confirmation time. But at the end of the day, I don't, I'm not seeing a whole lot of daylight here, so I think litigation is the course of action that we're going to take. And we're more than happy to basically protect our legal rights in this matter as a revenue bond for a special legal entity outside the Commonwealth's balances.

Brian Meredith
Do you think -- and so I guess the other thing just on PREPA, I guess, I think you've talked about this before. It does -- you don't have to sell a PREPA in order for you to get more comfortable with taking special dividends, it's simply just getting this audit done, correct?

Dominic Frederico
Yeah. If you remember, Brian, as we talked about, when we were first getting special dividends, that was just when Puerto Rico filed for bankruptcy. So we were able to get special dividends when the entire amount was up for grabs, we're just down to one exposure, which we believe may be economically defeased to our reserving process on the books, really makes it no brainer relative to the state, I believe.

Brian Meredith
Great. Makes sense. Thank you.

Dominic Frederico
Thanks, Brian.

Operator
We currently have no further questions. So I would like to hand the call over back to Robert Tucker. Please go ahead.

Robert Tucker
Thank you, operator. I'd like to thank everyone for joining us on today's call. If you have additional questions, please feel free to give us a call. Thank you very much.

Operator
Ladies and gentlemen, this concludes today's call. Thank you for joining. You may now disconnect your lines. Thank you.