Assured Guaranty Ltd. (AGO)
May 7, 2021
First Quarter 2021 Earnings Call

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Thank you operator. And thank you all for joining Assured Guaranty for our First Quarter 2021 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 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.

I'm pleased to say that in the first quarter of 2021 we continued to benefit from the value proposition that our financial guaranty provides in challenging times, which was further recognized last year as well. Driven by our highest first-quarter new business production in U.S. public finance since we acquired AGM in 2009, Assured Guaranty generated $86 million of PVP, 69% above last year's first-quarter PVP and more than in all but one first quarter since 2009.

Key shareholder value measures also reached new highs at quarter-end of $79.44 for adjusted operating shareholders' equity per share and $116.56 for adjusted book value per share, as we continued our successful capital management program. Additionally, adjusted operating income per share of $.55 was 53% higher than in the first quarter of 2020.

The first quarter of this year is the fourth consecutive quarter in which we saw our total net par outstanding increase, demonstrating fundamental organic growth in our core business. This is a positive sign for our effort to restore the size of our insured portfolio and the related, predictable, base of future earnings embedded in our insured transactions. We generally expect to see an upward trend in our portfolio size as quarterly run-off diminishes and we continue to originate new business.

The U.S. municipal bond market was very strong in the first three months of 2021. Par volume sold in the primary U.S. municipal bond market reached its highest first-quarter level since the Great Recession, $104.5 billion, of which industry insured par neared $8.5 billion, setting a 12-year record for first-quarter insured volume. Strong demand for bond insurance led to 76% more insured par sold than in last year's first quarter, significantly outperforming the 19% increase in total municipal issuance. The insurance penetration rate of 8.1% during the first quarter 2021 was higher than the 2020 full-year rate of 7.6% and higher than every first quarter and annual penetration rate since 2009.

Assured Guaranty widened its lead in new issue market share during the first quarter. Our 65% share of insured municipal par sold was better than our market share in any quarter since 2014. The $5.5 billion of new issue par sold with our insurance in the quarter was the highest amount we insured in any first quarter since 2010. It was almost two-and-a-half times our insured par in last year's first quarter, and our primary-market transaction count of 252 was up 57%. These year-over-year quarterly comparisons were influenced by the pandemic-related market disruption in first quarter of 2020, but in what may be a more meaningful comparison, our first-quarter insured par sold was almost 20% higher than in the fourth quarter of 2020.

During this year's first quarter, we insured $100 million or more on eight different transactions, with aggregate insured par totaling $2.25 billion. Large transactions tend to

attract institutional investors, and our leadership in this category reflects a growing appetite for Assured Guaranty's insurance in the institutional market.

Even as there have been signs of a recovering economy and better-than-expected municipal revenues, the persistence of the global pandemic – and what it has taught the market about economic unpredictability – have shown that investors have good reason to remain concerned about downgrade risk, trading value stability and liquidity, which our guaranty has the potential to address. We believe those concerns, combined with an appreciation of our overall value proposition, were behind our ability in the first quarter to insure $1.5 billion of par on 27 transactions assigned double-A underlying ratings by at least one of the two leading rating agencies. The stable outlooks on Assured Guaranty's own double-A ratings provide an extra level of comfort for investors in these high-quality bonds.

In international infrastructure finance during the first quarter, we executed two international transactions, neither of which created any new risk exposure. One transaction was an extension of the Debt Service Reserve guarantee that we provided to Welsh Water in 2019 as a substitute for their bank liquidity facilities. The other involved converting a convention center project financing that we insured years ago into a direct obligation of a sub-sovereign. Additionally, we made progress on important new transactions, two of which have already closed since quarter-end, generating over $23 million of international PVP in the second quarter.

While the pandemic delayed a number of projects, it also had the effect of widening credit spreads and therefore creating opportunities for us. We believe the U.K. and other governments' efforts to provide stimulus through infrastructure investment will require a significant amount of private financing to be fully successful, and that we will have a part to play in that. We have a robust pipeline of potential infrastructure opportunities and have been receiving an increased variety of new business inquiries. We also believe investor appetite for our product remains strong in our international markets, and we have continued our efforts to maintain and expand our relationships.

Our structured finance and international underwriting groups are collaborating on various portfolio guaranty transactions. We believe this is an area we can help institutions optimize the capital associated with their infrastructure portfolios, using principles that can be applied to other asset types as well. Additionally, the structured finance group is currently processing or in discussions for potential transactions in diverse categories including rail assets, trade receivables, life insurance, CLOs, equipment leases, and subscription finance facilities for private equity funds.

Importantly, in relation to our financial strength and stability, our disciplined and diversified approach to writing new business, along with our loss mitigation activities, has helped to reduce the below-investment-grade percentage of our insured portfolio to just 3.2% of net par outstanding.

About half of our BIG exposure is to Puerto Rico obligors, and there has been considerable positive news out of Puerto Rico. As I mentioned on our last call, we conditionally agreed in February to support a revised GO and Public Buildings Authority Plan Support Agreement with the Oversight Board and other creditors of the Commonwealth and PBA. We did so with the express understanding that the government parties would work with us to make that agreement part of a more comprehensive solution that also addressed related Puerto Rico credits, including what are known as the clawback credits, such as revenue bonds of the Highways and Transportation Authority and the Convention Center District Authority.

A big step towards such a resolution took place on April 12, when we, the Oversight Board and others agreed in principle to a framework for settling our insured exposures to the HTA and CCDA credits, subject to definitive documentation of an HTA/CCDA Plan Support Agreement. We have now finalized that documentation, as announced on May 5th, and have reaffirmed our support for the GO/PBA PSA.

It will still be months until Plans of Adjustment incorporating these PSAs and the PREPA RSA are approved and implemented, but with these settlements, we have agreed to terms on over 93% of our Puerto Rico net par exposure. Outside of these agreements, the Company has only $241 million of additional Puerto Rico net par exposure, almost all of which relates to credits that have not missed any principal or interest payments.

Lastly, once again we have reassessed the potential impact of COVID-19 on our insured portfolio especially in light of the $1.9 trillion federal stimulus package enacted during the first quarter. And that review further indicated that the pandemic has not given us a reason to establish significant new loss reserves, and we do not expect any ultimate losses from first-time municipal bond insurance claims that arise specifically from COVID-19.

In addition to having a great quarter in the financial guaranty business, we made good progress in the asset management business. The CLO market blossomed during the first quarter, with total supply, including new issues, refis, resets and re-issues, setting quarterly records of $106.3 billion in the United States and €26 billion in Europe.

AssuredIM issued one CLO in each of those markets during the period. We also reset a CLO, which extended its life and therefore its fees, and we sold $71 million of CLO equity from our legacy funds. We reduced our total non-fee earning CLO AUM to $2.4 billion from the $3.6 billion three months earlier, while increasing total CLO AUM by almost half a billion dollars to $14.3 billion. CLO management fees for the quarter were more than double those of last year's first quarter.

The outlook for this business is positive. We recently opened three CLO warehouses, and remain focused on raising more third-party capital.

I would like to take this opportunity to welcome three new directors to our Board of Directors. Michelle McCloskey, Lorin Radtke and Courtney Shea. They bring varied backgrounds as leaders in public finance, structured finance and investment

management, and their insights and wealth of experience will be of great value to our board's strategic decision-making.

Looking toward the rest of this year, we expect strong investor demand for municipal bonds, exemplified by the approximate $30 billion of inflows that municipal bond mutual funds and ETFs took in during the first quarter. We believe high demand for municipal bonds is likely to be met by issuers' need to raise more capital for infrastructure development in order to amplify the benefit of infrastructure funding likely to come from Washington, as well as by their desire to refinance and borrow while interest rates remain low. As long-term yields rise, long-term municipals may become an attractive, and safer, alternative to corporate bonds, especially for high net worth investors wary of potential tax increases. We believe this mix of market conditions will provide us with many public finance opportunities, large and small.

As financing activities revive around the world, we have already seen a pickup since quarter-end in our international financial guaranty business, and we expect to complete some large structured finance transactions as the year progresses. We also believe you will see significant growth in our asset management business.

We have been through a lot in the past 14 months. We believe the challenges of this period have made the market even more aware of the resilience of our business model, the dedication and professionalism of our employees, and the benefits of our financial guarantees. As always, we are committed to creating value on behalf of our shareholders, as well as for our clients and the investors who place their trust in our credit discipline and financial strength.

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 would like to start by highlighting our two key metrics for new business production - PVP and third party inflows of assets under management.

As Dominic mentioned, first quarter US public finance PVP was our strongest first quarter since 2009 and was the largest component of our $86 million first quarter PVP. Strong PVP results over the last several quarters has helped us maintain our deferred premium revenues - our storehouse or future premium earnings - at approximately $3.8 billion since the end of 2019.

In the asset management segment, total third-party inflows of $873 million was primarily driven by CLO issuance which helped to increase our fee-earning AUM by 11% in the first quarter of 2021 from $12.9 to $14.4 billion.

In terms of adjusted operating income, we earned $43 million, or $0.55 per share, in the first quarter of 2021, compared with $33 million or $0.36 per share in the first quarter of 2020. While this represents a 30% increase year-over year, I want to highlight that our first quarter 2021 results included a one-time $13 million after-tax write-off of an intangible asset attributable to the insurance licenses of MAC, or Municipal Assurance Corp. MAC was our US muni-only insurance subsidiary, until we merged it into our larger New York insurance subsidiary, Assured Guaranty Municipal Corp, or AGM, on April 1, 2021. Excluding this write off, first quarter 2021 adjusted operating income would have been $56 million representing an increase of 70% over first quarter 2020.

The restructuring simplifies our capital and organizational structure, eliminates the cost of maintaining an additional legal entity, and is expected to increase future statutory net investment income and the regulatory dividend paying capacity of the remaining US insurance subsidiaries, over the next few years.

The Insurance segment's first quarter contribution to adjusted operating income was $79 million, compared with $85 million in the first quarter of 2020. Excluding the MAC license write-off, adjusted operating income would have been $92 million or an increase of $7 million.

Within the Insurance segment, total income from the investment portfolio increased by $18 million or 24%. The investment portfolio generates net investment income from its fixed maturity portfolio, and equity in earnings from investees from alternative investments carried under the equity method.

Our fixed maturity and short-term investments account for a large portion of the portfolio, generating net investment income of $73 million in first quarter 2021 compared with $83 million in first quarter 2020. The decrease in net investment income was primarily due to: lower average balances in the externally managed fixed-maturity investment portfolio, which declined due to dividends paid by the insurance subsidiaries that were then used for AGL share repurchases; lower short-term interest rates; and, lower income from our loss mitigation securities.

Equity in earnings of investees primarily include AssuredIM Funds and several other alternative investments managed by third parties. The AssuredIM Funds - primarily the CLO and asset-based funds, generated a gain of $10 million in first quarter 2021, compared with a loss of $10 million in the first quarter of 2020. Alternative investments managed by third parties generated gains of $9 million in the first quarter of 2021.

As a reminder, equity in earnings of investees is a function of mark-to-market movements attributable to the AssuredIM funds and therefore more volatile than the net investment income on the fixed maturity portfolio and will fluctuate from period to period.

As we shift our current fixed maturity long-term assets into these alternative investments, the related net investment income may decline. However, over the long term, we expect

the enhanced returns on the alternative investment portfolio to be over 10%, which exceeds the returns on the fixed maturity portfolio.

Scheduled net earned premiums were consistent at $107 million year-over-year as recent new business production substantially offset the decline in earnings on structured finance transactions. First quarter 2021 refundings resulted in accelerations of $16 million, compared with $15 million in first quarter 2020.

Loss expense was $30 million in first quarter 2021 compared with $18 million in first quarter 2020. First quarter 2021 includes loss expense on both public finance, particularly Puerto Rico, as well as US RMBS exposures. First quarter 2020 expenses consisted mainly of Puerto Rico loss expenses, offset by a benefit on US RMBS due in large part to increased excess spread.

Net economic loss development of $13 million in the first quarter of 2021 primarily consists of $11 million in loss development on U.S. RMBS, which was mainly attributable to lower excess spread, offset by benefits due to changes in discount rates, and improved performance and recoveries on previously charged-off loans in certain second lien transactions. The economic development attributable to change in discount rates for all transactions was a benefit of $48 million for first quarter 2021. Our expected losses as of first quarter 2021 reflect, in our scenarios, the terms of the Puerto Rico settlement agreement reached this week, which should also significantly reduce the future volatility of these reserves. These agreements, in addition to our previous PREPA agreement, represent over 93% of our net Puerto Rico par outstanding, or 46% of total below investment grade net par outstanding.

Turning to the Asset Management segment, adjusted operating income was a loss of $7 million in first quarter 2021, compared with a loss of $9 million in first quarter 2020. Our long-term view of the asset management segment is optimistic. Since the acquisition of AssuredIM, we have made great progress in advancing our strategic goals. We have: liquidated assets in wind-down funds; increased fee-earning CLO AUM through the issuance of new CLOs, and the sale of CLO equity from legacy funds; raised capital for new opportunity funds; and, achieved attractive returns on the funds we have established since the acquisition.

In first quarter 2021 the increase in management fees from CLOs and opportunity and liquid strategies, more than offset the decline in fees from our wind-down funds as our core strategies pick up momentum after a difficult 2020.

The Corporate division mainly consists of interest expense on the U.S. holding companies' debt, as well as board of directors' and other corporate expenses. Adjusted operating loss for the Corporate division was $29 million in first quarter 2021, compared with $39 million in the first quarter of 2020. First quarter 2020 included losses related to an investment impairment charge and a loss on the extinguishment of debt.

On a consolidated adjusted operating income basis, the effective tax rate may fluctuate from period to period based on the proportion of income in different tax jurisdictions. In first quarter 2021, the effective tax rate was 15%, compared with 24.7% in first quarter 2020.

Turning to our capital management strategy, in the first quarter of 2021, we repurchased 2 million shares for $77 million, at an average price of $38.83 per share. Since then, we have continued the program and repurchased an additional 600,000 shares for $28 million. Since the beginning of our repurchase program in January of 2013, we have returned $3.8 billion to shareholders, resulting in a 64% reduction in total shares outstanding.

The cumulative effect of these repurchases was a benefit of approximately $30 in adjusted operating shareholders' equity, and $53 in adjusted book value per share, which helped drive these metrics to new record highs of over $79 in adjusted operating shareholders’ equity and over $116 in adjusted book value per share.

From a liquidity standpoint, the holding companies currently have cash and investments of approximately $218 million, of which $60 million resides in AGL. These funds are available for liquidity needs, or for the use in the pursuit of our strategic initiatives to either expand our business or repurchase shares to manage our capital.

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

QUESTION & ANSWER SESSION

Operator
[Operator Instructions] The first question comes from Tommy McJoynt with KBW.

Thomas McJoynt, *Keefe, Bruyette, & Woods (KBW)*
Hey, good morning, guys. So, congrats on the signing of the HTA agreement yesterday.

Dominic Frederico
Thank you.

Robert Bailenson
Thank you.

Thomas McJoynt
Yeah. So I wanted to ask about the terms of that HTA agreement have – first, the upfront cash and bond, and then, the clawback CVI instrument. Could you guys share your expectations on what you think the CVI instrument will add to your recovery beyond the 30% upfront on cash and bonds?

Dominic Frederico
Sure. The CVI is kind of like a moving target. So, there's two assumptions that you've got to make in principle, right, what is going to be the continued growth in the sales tax amount, and that really is predicated on the economy, so trying to factor in an economic growth factor, and you can pick whatever number you like. And then the second thing you ought to look at is the discount rate. As we get closer to the finalization of the agreement, there is also going to be the question whether this instrument will trade. And if it trades, that gives you a little bit better valuation principle. So, it's really, in our scenario, is picking discount rates and growth of the economy as we try to evaluate in our scenario analysis.

Remember, our reserves are still based on GAAP requirements, which says you got to map out scenarios and then probability weight them. So, in our scenario model, for HTA, one of the scenarios includes the settlement, plus an assumption relative to economic growth and discount rate on the cash flows, but there's also scenario that obviously change the settlement, make it worse, we can't really make it better, and of course, we changed the discount rates and the growth assumptions to make the reserve model work that you've got more than one scenario in the reserve model. So, there is a lot of moving parts there. As we get further along in the year, there'll be more clarity relative to the ways the instruments trade. And of course, at the time we're ready and comfortable, we'll start to disclose more of our assumptions, but at this point in time, we're not doing that.

Operator
And, was there a follow-up, Mr. McJoynt?

Thomas McJoynt
Yeah. Thank you. Yeah. So, now that we have made some good news, or good progress on Puerto Rico, what are your latest level of thoughts on your interest in consolidating the rest of the remaining run-off books of business available? And when we think about those opportunities, could you discuss whether you think you'd be able to structure any transactions using capital at the OpCo level rather than at the Holdco level? Obviously, there's a lot of capital trapped there at the operating company level, so it could be an efficient use of capital there. Any thoughts on that?

Dominic Frederico
Sure. So, let me answer them in the order that you gave us. So, number one, this has opened up the door for some more consolidation. And the answer is probably yes, it clears one of the hurdles. But there are still remaining hurdles, right, valuation is one, acceptance of other terms of conditions, what do we like in the portfolio, whether we'll see competition from third parties that will make basically kind of change our return assumption. So, there is a lot of factors, but this does clear one of the remaining hurdles or should go a long way to clearing the remaining hurdle of Puerto Rico exposure. Question number two, remind me again what that was?

Thomas McJoynt
Just whether you could structure anything using capital at the operating company level rather than at HoldCo?

Dominic Frederico
Yeah. So our goal is to use, in every case we can, trapped capital from the operating companies, because that obviously makes the most sense. As you're well aware, free capital at the holding company gives us a lot of flexibility for a multitude of purposes, including our dedication to capital management. So where possible, we will definitely use existing operating income -- existing operating capital that's trapped in the operating companies.

Thomas McJoynt
Okay. Thank you. And just to sum it up, if you can kind of rank order your interest in terms of capital allocation between buybacks and consolidating the run-off businesses and perhaps growing the asset management business, how would you rank those?

Dominic Frederico
Well, I think it's like which of your children do you like the most, but at the end of the day I'd still say the most attractive of the three is capital management, because it's got the biggest return. I mean, where we still still trade at the discounts we are at is just spectacular opportunity for us to continue to retire that stock.

Thomas McJoynt
That makes sense. Thank you, guys.

Dominic Frederico
You're welcome.

Operator
The next question comes from Brian Meredith with UBS. Please go ahead.

Brian Meredith, *UBS*
Thanks. Good morning. And congrats on everything. I guess my one big question here is, one, Dominic or Rob, does the MAC consolidation at all free up any dividend capacity? And then two, as an add on to that, do we need to see the court finalization or court agreement in order to kind of go and get a special dividend?

Dominic Frederico
[Speech Overlap] Go ahead, Rob.

Robert Bailenson
I'll take the first part with MAC. Yeah. So, by taking out that trapped capital that was underneath our insurance companies and consolidating and merging that within AGM, you are now going to increase investment income at our two main operating subsidiaries. So, we do expect it to increase our dividend capacity this year modestly and next year more significantly, because there are different rules regarding how much you could dividend out between Maryland and New York, but it will increase our dividend capacity, Brian.

Brian Meredith
Okay. Great.

Dominic Frederico
And the second question, Brian?

Brian Meredith
Yeah. Just with respect to getting – asking for a special dividend, are you going to – would you want to wait until you get a final agreement from the courts on Puerto Rico before you do that? Do you think we're at point now that you can go ask the regulators for one?

Dominic Frederico
Well, let's go through the facts. So, fact number one is, we still believe capital management is most accretive transaction we can do. Number two, to get to our typical target of capital management, we need a special dividend. Number three, we've had some impediments to request or to get a special dividend granted or even considered, and the two being COVID and of course, Puerto Rico. As we resolve those through this year, I think it does create an environment where that conversation can begin to be held with the regulators that were responsible to.

Brian Meredith
Helpful. Thanks to you all. Appreciate it.

Robert Bailenson
Thanks, Brian.

Dominic Frederico
Thanks, Brian.

Operator
The next question comes from Geoffrey Dunn with Dowling & Partners. Please go ahead.

Geoffrey Dunn, *Dowling & Partners*
Thanks. Good morning, guys.

Robert Bailenson
Good morning, Geoff.

Dominic Frederico
Good morning, Geoff.

Geoffrey Dunn
With respect to both the GO PBA as well as the HTA CCDA transport agreements, I think I – am I right that unlike past deals here the recovery is solely the new bond and the CVIs, there is no other bond insurer considerations that we should be factoring into the ultimate estimate recoveries?

Dominic Frederico
Well you're leaving out one little piece, which is called cash. Remember cash is king. So, at the end of the day, there is a cash component to these settlements. Now, I think what you're referring to is opportunities do we have to basically make the settlement better by wrapping the bonds, you get a higher value from them, and at this point in time, we've not considered that fully at all. So, we're just allowing the settlement and the estimates of recoveries to take place based on what's actually apparent in the documents that's available to everyone to read.

Geoffrey Dunn
Okay. And then within the GOs, are you able to help us narrow down – I don't know if this is publicly available information or not, but narrow down, where in that recovery range of the deal your bonds fall?

Dominic Frederico
That's not that easy to figure out, right. Obviously, we have a good idea. We have an ability to see that. It's not been publicly disclosed. Remember, the problem we have with some of the statistics you're seeing is they include all creditors, not just bondholders or secured creditors, they obviously don't include the CVI in a lot of the published reports. So, they're only looking at cash and bonds, and in some cases, they're just looking at new bonds. Because if you look at from the Puerto Rican government point of view, they said they had, all right, so much debt for so much bonds and who do I want to convince or tell people I've got -- I now have new debt with new debt requirements, and I'm comparing the old bonds to the new bonds and kind of ignoring where cash and CVI falls out. So, the numbers do substantially move about. As we've said, we're very comfortable with the settlements, and I think that should give the market a pretty good indication of what we believe is our recovery rates.

Geoffrey Dunn
Okay. Great. Thank you.

Dominic Frederico
You're welcome.

Operator
This concludes the question-and-answer session. I would now like to turn the conference back over to Robert Tucker for closing remarks.

Robert Tucker
Thank you, operator, and 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
[Operator Closing Remarks]