Assured Guaranty Ltd. (AGO)
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Third Quarter 2021 Earnings Call

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Thank you operator. And thank you all for joining Assured Guaranty for our Third 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.

In a successful third quarter of 2021, Assured Guaranty's new business production generated $96 million of PVP. This is our second highest result for a third quarter in the last decade.

At the nine-month mark, our year-to-date PVP totaled $263 million, which puts us on pace with last year's outstanding production. The business was well distributed across our U.S. public finance, international infrastructure and global structured finance markets for both the third quarter and nine months.

In terms of shareholder value, as of September 30, 2021, on a per share basis, shareholders' equity, adjusted operating shareholders' equity and adjusted book value all reached record highs of $88.42, $82.89 and $122.50, respectively.

Year-to-date, Assured Guaranty has earned $197 million of adjusted operating income, about the same as in last year's first three quarters, notwithstanding a $138 million after-tax loss on debt extinguishment. This accelerated recognition of an expense resulted from the voluntary early redemption of certain senior notes. These redemptions and the issuance of lower-coupon debt will reduce next year's debt service by $5.2 million. Rob will provide more detail on the debt issuance later.

During the third quarter, total municipal bond issuance was strong, with $121 billion of new par issued, the second highest third-quarter volume in a dozen years. For the first three quarters, new par issued of $343 billion exceeded that of the comparable period in 2020, which was a record year. Insurance penetration continued its upward trend, reaching 8.5% for both the third quarter and nine months, the highest levels for a third quarter and any nine-month period in more than a decade.

This was achieved even though the interest rate environment remained challenging. Although benchmark yields moved a bit higher during the quarter, they remained low by historical standards, and credit spreads compressed to the tightest levels in a decade.

In this environment, Assured Guaranty continued to lead the municipal bond insurance industry with a third-quarter market share approaching two-thirds of the insured par sold in the primary market, as we guaranteed 270 transactions for a total of $6.7 billion in insured par.

At the nine-month mark, we had guaranteed more than 60% of insured new issue par sold this year. The $17.9 billion we insured in the primary market was 19% higher than in the first nine months of 2020 and 88% more than in the first nine months of the most recent pre-pandemic year, 2019. It was in fact our highest primary-market insured par for the first nine months in a decade.

We have continued to benefit from institutional investors' preference for Assured Guaranty's insurance on larger transactions. During the third quarter, we insured 17 transactions with $100 million or more in insured par, which brings our total year-to-date transaction count in this category to 38, just one deal short of the number we insured in all of 2020.

Also in the third quarter, we continued to add value on double-A credits, insuring $836 million of par on 27 deals that each have at least one rating in the double-A category from either S&P or Moody's. The 83 municipal issues we insured in this category through September of this year aggregated to more than $3 billion of insured par, compared with $2 billion in the first nine months of last year.

U.S. public finance usually generates a large percentage of our PVP each quarter, and its $55 million of third-quarter PVP is no exception. But we have a uniquely diversified approach to producing new business.

Our international infrastructure business has been a reliable contributor to our production in every quarter for more than five years. It produced $17 million of PVP in the third quarter of 2021. One significant transaction was a £113 million student accommodation issue by the University of Essex. We have a substantial pipeline of high and medium probability transactions for the rest of this year and the first half of next, and the transaction inquiries we are receiving are increasingly diverse. Over the longer term, we believe infrastructure will continue to be a significant international market for us. In the UK alone, the government has put out a paper anticipating as much as £650 billion of public and private infrastructure spending over the next 10 years.

In global structured finance, third-quarter PVP was very strong, $24 million, bringing the year-to-date total to $35 million. We closed on a large insurance securitization in the third quarter, and our CLO activity has been accelerating. We guaranteed two Euro-denominated CLOs in the third quarter. Our guarantees help CLOs attract new investors which might otherwise be discouraged by the higher capital requirements on uninsured CLOs, and we are seeing more opportunities to help investors reduce the capital consumed by both existing structured finance exposures and new investments.

Overall, the quality of our insured portfolio has continued to improve, as the below-investment-grade portion of our insured portfolio declined by $300 million during the quarter and is within sight of falling below 3% of net par exposure.

Puerto Rico issues account for almost half of our below investment grade net par outstanding, and there have been important positive developments in the efforts to complete debt restructurings under PROMESA. Negotiated agreements for these restructurings apply to 95% of our par exposure to Puerto Rico entities, with the balance of our exposure remaining current on debt service payments. A logjam was broken on October 28th, when the Oversight Board agreed that the recently passed Commonwealth legislation, intended to authorize issuance of new exchange securities as part of the

Commonwealth's restructuring, met the board's conditions and a revised Plan of Adjustment could move forward to the confirmation hearing, which is scheduled to start November the 8th – three days from now. Meanwhile, the Commonwealth's revenues have exceeded expectations, and billions more have been received or are expected from federal coronavirus relief and disaster relief allocations. And the island may benefit further from the pending federal physical infrastructure bill and Build Back Better reconciliation bill.

On our last call, I mentioned S&P's affirmation in July of our double A, Stable Outlook, financial strength ratings it assigns to our insurance subsidiaries. This has been followed in October by KBRA's affirmation of its AA+ ratings of AGM, Assured Guaranty UK and Paris-based Assured Guaranty (Europe). Importantly, it also upgraded AGC to AA+ based on AGC's strengthened capital position relative to KBRA's conservative stress-loss modeling, along with separate analysis of AGC's Puerto Rico, RMBS and certain other exposures. KBRA also noted AGC's decreased insurance leverage, the substantial derisking of its insured portfolio and the positive movement toward resolution of Puerto Rico's Title III process. All the ratings have Stable Outlooks. By the way, the Puerto Rico settlement agreements were also deemed credit positive by Moody's in its Credit Opinion about AGM published in July.

On the asset management side of our business, we have been participating in a very active CLO market. We increased fee-earning CLO assets during the third quarter largely by launching one new CLO, which brought the number of CLOs we issued during the first nine months to four. These new CLOs were responsible for $1.7 billion of the $3.8 billion increase in fee-earning CLO assets since the year began. The remaining $2.1 billion of the increase resulted primarily from selling CLO equity previously held in AssuredIM funds and converting AUM from non-fee earning to fee earning during the year. We have shed virtually all of the CLO equity held by AssuredIM legacy funds, and 96% of our CLO AUM is fee earning now. We expect the CLO market to remain strong through year-end. We reset or refinanced three CLOs in the United States this quarter, adding up to a total of four CLOs in the U.S. and three CLOs in Europe that were reset or refinanced for the year through third quarter. Four of those transactions are managed on a sub-advisory basis. After the third quarter end, in October, we closed a new CLO in the United States. In addition, we currently have two open CLO warehouses, one in the U.S. and one in Europe. We are planning to open one additional CLO warehouse in the U.S. before the end of the year. Both CLOs and ongoing AssuredIM funds overall have performed well.

I look forward to a successful finish for Assured Guaranty this year. Our track record proves that our company was built to withstand severe disruptions in the financial markets, and our recent results strongly suggest that a growing number of investors appreciate the resilience of our business model, understand our value proposition, and recognize our financial strength. Those investors will be a source of our success for years to come, as we continue to protect our policyholders and create value for our clients and shareholders.

Now I'll turn the call over to Rob.

Robert Bailenson
Chief Financial Officer

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

This quarter we continued to make great progress on our capital management strategies. After issuing $500 million of 10-year Senior Notes at a rate of 3.15% in May, I am pleased to report that AGUS Holdings issued another $400 million of 30-year Senior Notes in August at an attractive rate of 3.6%.

Most of the proceeds of these debt offerings were used to redeem $600 million of long-dated debt obligations, and the remaining proceeds were designated for general corporate purposes, including share repurchases. The redemptions included $430 million of debt we assumed in 2009 as part of the FSAH acquisition, with coupons ranging from 5.6% to 6.9% and remaining terms of approximately 80 years, as well as $170 million of AGUS 5% Senior Notes due in 2024.

These debt refinancings had several benefits to the Company. First, we reduced the average coupon on redeemed debt from 5.89% to 3.35%, which will result in a $5.2 million annual savings until the next debt maturity date. We expect continued annual interest savings after that, though the amount of such savings will depend on the interest rate environment and the refinancing decisions we make at the time. Second, we reduced our 2024 debt refinancing need from $500 million to $330 million. And lastly, the debt proceeds we borrowed in excess of those used for redemptions will provide flexibility to execute other strategic priorities, including share repurchases, without significantly affecting our leverage or interest coverage ratios.

These debt redemptions resulted in a pretax loss on debt extinguishment of $175 million, or $138 million on an after-tax basis, consisting of two components: first, a $156 million acceleration of unamortized fair value adjustments that were originally recorded in 2009 as part of the FSA acquisition, and second, a $19 million make-whole payment to debt holders of the redeemed AGUS 5% Senior Notes.

It is important to note that $156 million of the $175 million loss was a non-cash expense. The amortization of these purchase adjustments had been slowly amortizing into interest expense since 2009 and were scheduled to continue to amortize into interest expense for another 80 years. The redemption of this debt merely accelerated the timing of that expense.

Despite this charge, our third quarter 2021 adjusted operating income was $34 million, or $.45 per share. The loss on debt extinguishment reduced adjusted operating income by $1.87 per share.

In the Insurance Segment however, adjusted operating income was significantly higher at $214 million for third quarter 2021, up from $81 million in the third quarter of 2020. The increase is primarily due to favorable loss development, which was a benefit of $94 million in the third quarter of 2021. The largest component of the economic benefit was attributable to a $65 million benefit in U.S. RMBS exposures that was mainly related to a benefit from higher recoveries on second lien charged-off loans and deferred first-lien principal balances. In addition, there was a $31 million benefit on public finance transactions due to mainly the refinement of the mechanics of certain terms of the Puerto Rico Support Agreements. The economic development attributable to changes in discount rates across all transactions was not significant in the third quarter of 2021.

Other components of the Insurance segment also performed well in third quarter 2021. The investment portfolio generated total income of $102 million, an increase from $95 million in third quarter 2020. The increase was mainly due to the performance of the alternative investment portfolio, including AssuredIM funds, which collectively generated $33 million in the third quarter of 2021, compared with $20 million in the third quarter of 2020.

Since the establishment of AssuredIM, the insurance subsidiaries have invested $380 million in AssuredIM Funds, which now have a net asset value of $465 million and have produced an inception to date return of almost 20%. As a reminder, equity in earnings of investees is a function of mark-to-market movements attributable to the AssuredIM funds and other alternative investments. It is more volatile than the net investment income on the fixed maturity portfolio and will fluctuate from period to period.

Our fixed-maturity and short-term investments account for the largest portion of the portfolio, generating net investment income of $69 million in third quarter 2021, compared with $75 million in third quarter 2020. The decrease in net investment income was primarily due to lower average balances in the loss mitigation investment portfolio.

As we shift fixed-maturity assets into alternative investments, net investment income from fixed-maturity securities may decline. However, over the long term, we are targeting enhanced returns on the alternative investment portfolio of over 10%, which exceeds the projected returns on the fixed-maturity portfolio.

In terms of premiums, scheduled net earned premiums were consistent relative to third quarter 2020, and accelerations due to refundings and terminations were $15 million in third quarter 2021, compared with $18 million in the third quarter of 2020.

In the Asset Management segment, we have continued to make great progress in advancing our strategic goals. This quarter, we increased fee-earning CLO AUM with the issuance of $598 million in new CLOs; we continued to liquidate assets in wind-down funds and now have less than a billion dollars of legacy AUM in those funds; and, using AssuredIM's investment management expertise, we have expanded investment strategies in the insurance segment. To date, we have recorded strong mark-to-market results on the funds established by AssuredIM.

The Asset Management segment adjusted operating loss was $7 million in third quarter 2021, compared to an adjusted operating loss of $12 million in the third quarter of 2020. However, asset management revenues increased 38% in third quarter 2021, compared with third quarter 2020 due mainly to the increase in CLO fee-earning AUM, and the recovery of previously deferred CLO fees in 2021. The COVID-19 pandemic and downgrades in loan markets had triggered over-collateralization provisions in CLOs in the second and third quarters of 2020, resulting in the deferral of CLO management fees. However, as of September 30, 2021, none of AssuredIM's CLOs were triggering over-collateralization provisions and therefore none of AssuredIM's CLO fees were being deferred.

Fees from opportunity funds were also up as AUM increased to $1.6 billion as of September 30, 2021, from $1 billion as of September 30, 2020.

Fees from the wind-down funds decreased as distributions to investors continued, and as of September 30, 2021, the AUM of the wind-down funds was $809 million, compared with $2.3 billion as of September 30, 2020.

The Corporate division typically consists mainly of interest expense on the U.S. holding companies' debt and corporate operating expenses. This quarter it also includes the debt extinguishment charge, which brought third quarter corporate results to a net loss of $169 million.

In third quarter 2021, the effective tax rate was a benefit of 57%, compared with a benefit of 33% in third quarter 2020. The overall effective tax rate on adjusted operating income fluctuates from period to period based on the proportion of income in different tax jurisdictions. The loss on extinguishment of debt in third quarter 2021 reduced income in the U.S. compared to other jurisdictions resulting in the low rate for the quarter, while third quarter 2020 benefited from the release of a reserve for uncertain tax positions.

Turning back to our ongoing capital management strategies, we repurchased 2.9 million shares for $140 million in third quarter 2021, at an average price of $47.76 per share. This brings year-to-date repurchases to $305 million as of September 30, 2021.

The continued success of this program helped to drive our per-share book value metrics to record highs.

Subsequent to the quarter close, we repurchased an additional 1.5 million shares for $77 million. Since the beginning of our repurchase program in January 2013, we have returned $4 billion to shareholders under this program, resulting in a 67% reduction in total shares outstanding.

The cumulative effect of these repurchases was a benefit of over $33 in adjusted operating shareholders' equity per share, and $58 in adjusted book value per share, which helped drive these metrics to new record highs of more than $82 in adjusted operating shareholders' equity per share, and $122 in adjusted book value per share.

From a liquidity standpoint, the holding companies currently have cash and investments of approximately $272 million, of which $86 million resides in AGL. These funds are available for liquidity needs, or for use in the pursuit of our strategic initiatives to either expand our business or repurchase shares to manage our capital. As of today, we have $220 million in remaining share repurchase authorization.

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 Geoffrey Dunn with Dowling & Partners. Please go ahead.

Geoffrey Dunn, *Dowling & Partners*
Thanks. Good morning. Let's see, first question, with respect to the Puerto Rico development, what were the key factors that prompted the favorable development? Is it largely more what happened after the end of the quarter with the bill being passed and the Oversight Board agreeing to the amended versions? And maybe getting some more clarity on timing, or was there more to the quarter that prompted your refinement?

Dominic Frederico
I guess you're talking about the reserve change in the quarter for Puerto Rico?

Geoffrey Dunn
Yes.

Robert Bailenson
And for public finance.

Dominic Frederico
So at the end of the day, the majority of public finance is Puerto Rico, but it was all mechanical, Geoff. So if you think about how we set reserves and scenario analysis and probability weighting, that's the same just as more facts became apparent about the exact structure of the deal, for instance, like the GDBs now the judge agreed that they were subordinated therefore the not in the calculation of secured creditor. It was more changes of those mechanical natures than anything else. So we still have our scenario modeling, we still have our probability weighting. So this is just a mechanical change to reflect what we think is going to be the final version of that potential PSA.

Geoffrey Dunn
Okay. And as you're getting more, well, I guess, as you're getting more clarity on Puerto Rico, what are your thoughts to exploring a special dividend out of the operating subs to support that $500 million annual target? Not necessarily needed for this year but for the coming year.

Dominic Frederico
We've always said, Geoff, when we think it's the proper time, we will seek special dividend approval. We think you're correct in assuming that we get the first Puerto Rico deal done as of year-end and then funded through January. Obviously, we didn't deal with the new bonds that we get within that settlement period. I think that puts us in very good shape to be able to go to the states and ask for special dividends. So I think we're just following the course of our strategy that we think we espoused long ago. But as you clear up these conditions of what are uncertainties and make them certain, I think it allows us that opportunity and we're obviously if we want to keep our current pace of share repurchase, we would need a special dividend, as you well know. So our thinking is, let's get the PSA done for the general obligations and then let's move forward from there.

Robert Bailenson
In addition, Geoff, remember, with these debt offerings, we increased our flexibility with the cash that we have available, in addition to which, as we stated last quarter, the reorganization of MAC and the unwind of MAC provided us a benefit, which will increase our dividend capacity next year, so that will give us more flexibility as well and reducing the need to ask for significant special dividend.

Geoffrey Dunn
Okay. And then last one, if and when we get to the full Puerto Rico resolution, what are your thoughts about targeting more than $500 million annually as a steady goal?

Dominic Frederico
Geoff, obviously, I think in our strategic vision, we want to be efficient managers of capital. So to the extent that we can use the capital, we don't see opportunities to put it to work in other areas then obviously the most accretive transaction we could do today and remains that way is share repurchase. So we would continue to look at share repurchases as a primary strategic objective, but we make those decisions basically at the time. When we look at availability, ratings, market opportunities, excess cash and obviously, the accretiveness of the share buyback.

Geoffrey Dunn
Okay. Thank you.

Operator
Next question comes from Jordan Hymowitz of Philadelphia Financial. Please go ahead.

Jordan Hymowitz, *Philadelphia Financial*
Hey, guys. Great quarter. Question is now that you're no longer a melting ice cube and now that no longer Puerto Rico is blowing you up, it seems like a lot of the marginal business is not only you gaining more share and not only is the market growing, but you're growing a more profitable business, specifically the structure, the European. Can you discuss the marginal profitability of some of those businesses? And could they work to expand your overall profitability as a company as a result?

Dominic Frederico
I think you're right. As we look at our business opportunities and the fact that we're the only company that stayed diversified across all three aspects of financial guarantee, and you're correct in making your assumption in today's marketplace where spreads and rates are, the structured finance and the international infrastructure business has a lot higher capital return than the U.S. public finance, although we set minimum targets for all of them, right? And at the end of the day, I can't give you the exact numbers, but I will tell you that the structured finance and international make about a 60% higher return than U.S. public finance, and we calculate return on a deal-by-deal basis.

Our biggest challenge to true profitability, however, is really the excess capital. And the drag that that creates on ROEs is significant. And obviously, we've got to continue to manage that to really make profitability a key result of our organization, even though the deals per se are profitable on their own. And as I said, we set minimums, and we track that religiously. We've got to deal with excess capital. And I think we're finally turning the curve here in terms of where the business now starts to grow. We think we've hit the bottom in terms of production and growth in our premium reserve.

We're now starting to see the benefits of the hard work that all of our business people have done relative to go out and generate investor acceptance, recognizing the value of the product and it's getting now more acceptance worldwide. Plus, we also have goals of expanding internationally. Right now, we're still too much of a U.K. dominant international player and there's got to be market opportunities significantly throughout the rest of the Continental Europe as well as in certain markets and say, Asia and the Far East.

Jordan Hymowitz
And you said just repeat that the other business of 60% higher profit margins and your core business, I believe, is targeting at least a double-digit return on equity, correct?

Dominic Frederico
Correct.

Jordan Hymowitz
Perfect. Now if we could just keep the Eagles to win, everything would be great in the world.

Dominic Frederico
Exactly right. Thank you.

Operator
The next question comes from Tommy McJoynt with KBW. Please go ahead.

Tommy McJoynt, *Keefe, Bruyette, & Woods (KBW)*
Hey, guys. Good morning. Thanks for taking my question. Just want to go back real quick to the math for the buybacks and especially thinking of next year, so if you could just elaborate a bit on the puts and takes between the reorganization of MAC, some of the new debt you've taken on dividend capacity. Just where buybacks could shape out and let you without a special dividend? If you could just kind of walk through that now?

Dominic Frederico
Rob, do you want to do that?

Robert Bailenson
Yes. Well, we generally, I always say that we have about, Tommy, we have about $250 million to $300 million without a special dividend. The MAC benefit, if I recall correctly, is roughly going give us another $100 million. So we'll be at about $400 million without even a special dividend depending on, and that would be depending if we don't have any other cash-enhancing transactions. So that's where we're at for next year.

Tommy McJoynt
Okay. That's helpful. And then switching over real quick. The RMBS benefit in the quarter, was that lower just driven by home price appreciation?

Robert Bailenson
Yes. The RMBS, yes, it was driven by home price appreciation, so better performance on transactions that had previously charged off loans. So if you have previously charged off loans and your home price is increasing, you have equity in your home, you're able to actually generate a benefit when either the home is sold or the borrower realizes, I've got equity, and we're going to actively to be able to reach out to these borrowers with our special servicing contract we have with our surveillance group and telling these borrowers to remind them that they have equity in this home and that we still have a lien on this. And so as they sell, as home prices increase, and as also people start prepaying. If they start prepaying on this, they would pay off their loans, and they, and then we would get the benefit of those previously charged-off loans. So yes, that's primarily increased. And continued increase in home price appreciation will continue to see benefits going forward.

Tommy McJoynt
Thanks. You answered the second part of my question as well. And then just lastly, when do you expect the Asset Management segment to report its first full year of operating profitability?

Dominic Frederico
Well, as we said, we continue to make substantial progress. And honestly, the growth fee turn is going to be when we finally get rid of the legacy funds and the administrative

expenses regarding how we have to administer those funds, and we hope that that will be done by the end of this year, I'm sorry, the end of 2022.

Tommy McJoynt
Right. Yes, thank you.

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

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
This concludes today’s conference call. Thank you all for attending. You may now disconnect your lines. Have a great day.