Operator

Greetings, and welcome to the Ambac Financial Group, Inc. Third Quarter 2021 Earnings Call. (Operator Instructions) As a reminder, this conference call is being recorded.

It is now my pleasure to introduce your host, Ms. Lisa Kampf, Head of Investor Relations; Claude LeBlanc, Chief Executive Officer; and David Trick, Chief Financial Officer. I will now turn the call over to Lisa.

Lisa Kampf – Managing Director, Head of Investor Relations

Thank you. Good morning and thank you all for joining today's conference call to discuss Ambac Financial Group's third quarter 2021 financial results.

We'd like to remind you that today's presentation may contain forward-looking statements about our business, including, but not limited to, new business, credit outlooks, market conditions, credit spreads, financial ratings, loss reserves, loss mitigation, loss recoveries, investment returns or other items that may affect our future results. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance of events. Actual performance and events may differ, possibly materially, from such forward-looking statements.

Factors that could cause this include the factors described in our most recent SEC-filed quarterly or annual reports under Management's Discussion and Analysis of Financial Condition and Results of Operation and under Risk Factors. Ambac is not under any obligation and expressly disclaims any obligation to update any forward-looking statement whether as a result of new information, future events or otherwise.

Today's presentation contains non-GAAP financial measures. The reconciliations of such measures to the most comparable GAAP figures are included in our earnings press release, which is available on our website at ambac.com.

Please note that presentations have been posted to the Events and Presentations section of our IR website which support our comments today.

I would now like to turn the call over to Mr. Claude LeBlanc.

Claude LeBlanc – Chief Executive Officer

Thank you, Lisa, and welcome to everyone joining us on today's call.

I am very pleased with our third quarter results, which were primarily driven by positive credit development in our structured finance and public finance insured portfolios. Net income for the third quarter was $17 million, or $0.35 per diluted share, and adjusted income was $25 million, or $0.53 per diluted share. David will discuss our financial results in more detail in a moment.

As we approach the end of 2021, we have demonstrated significant progress in the active de-risking of our legacy financial guarantee portfolios, the further rationalization of our capital structure via the refinancing of

our senior notes and the continued growth and expansion of our new specialty property and casualty program insurance business.

Taking a closer look at our new specialty P&C business. Starting with Everspan Group, our specialty P&C insurance platform, which anchors Pillar 1 of our strategy. Since its launch in February, Everspan has continued to make material progress on all key growth and value metrics.

Everspan Indemnity, our surplus lines carrier, is currently authorized for excess & surplus lines in all 50 states and is whitelisted in 45 states that either maintain or have a de-facto registry. Everspan Insurance Company, our admitted carrier, now has full P&C authority in 45 jurisdictions, including California. We are working to secure authority in the few remaining states in the near term.

Since its launch, Everspan Group has built a robust program pipeline across various classes of business through multiple distribution sources and has signed up and is currently writing for 3 program partners, the most recent being Cover Whale, an insurtech focused on the commercial auto space. Everspan is poised to launch a number of additional programs in the fourth quarter.

Everspan Group has also expanded its carrier base this quarter with the purchase of an admitted shell, Providence Washington Insurance Company, or PWIC, the second oldest insurance company in the United States. PWIC will provide Everspan with additional capabilities to launch new admitted programs, develop innovative products and provide enhanced flexibility to foster strategic relationships with prospective program partners.

Everspan Group has also filed Form A's, to acquire additional admitted carriers, which will further expand its admitted carrier offerings. We hope to close on these acquisitions in the fourth quarter. The acquisition of additional carriers furthers our goal to build a leading specialty P&C program insurance business where we can provide multiple options for our distribution partners, minimizing the risk of channel conflicts.

Turning to the second pillar of our new business strategy, MGA and MGU businesses. The acquisition of Xchange Benefits, our A&H MGU, at the end of 2020 was the first of what we expect will be several distribution businesses for our Pillar 2 strategy.

Xchange continues to perform well in the current environment and our outlook remains favorable. Since our acquisition, Xchange has broadened its carrier base, expanded its product offerings and, has made $6 million in distributions to AFG. The Xchange team continues to actively explore opportunities to grow the business by further expanding their carrier network and distribution channels.

We continue to seek opportunities to grow Pillar II through further acquisitions and de novo start-ups and we are seeing a growing pipeline of quality opportunities. As a public company with permanent capital, we are a differentiated strategic partner for prospective MGAs and MGUs. As part of our value-add, Ambac also offers our partners a full suite of business services, including advanced P&C technology solutions which we believe will enhance the competitive position of our Pillar II businesses.

We have also progressed our Pillar III segment where we have identified and executed on three opportunities. To date, these investments have included data analytics and insurance related technology companies, the most recent being our investment in Cover Whale.

We expect these strategic investments will generate attractive returns on capital and allow for broad synergies across our Pillar 1 and Pillar 2 businesses.

In summary, we continue to see attractive growth opportunities across all three pillars of our specialty P&C insurance business, offering attractive risk adjusted returns and strong fundamentals. We are well positioned to take advantage of such opportunities as we advance our efforts to grow and further scale our platform.

Moving now to our Legacy Financial Guarantee business. Net par exposure was $29 billion at September 30, down 6 percent from June 30 and down 16 percent year to date. Ambac's watchlist and adversely classified credits were reduced to $11 billion at September 30, down 5 percent from last quarter and down 20 percent from year end.

Proactive de-risking efforts accounted for decreases of approximately $630 million in net par exposure and $340 million in watch list and adversely classified credits during the third quarter. Year-to-date, de-risking efforts accounted for $2.7 billion in the decrease of net par exposure and $1.7 billion in watch list and adversely classified credits.

Moving now to Puerto Rico. This past July, Ambac reached a settlement on our insured PRIFA Rum Tax exposure and became a party to agreements for our GO, PBA, HTA and CCDA exposures. During October and earlier last week, Puerto Rico bondholders submitted their settlement elections on all but our HTA bonds. Yesterday marked the start of the confirmation hearing to approve the Commonwealth's 8th amended Plan of Adjustment in bankruptcy court. The proposed plan has the broad support of creditors and the Commonwealth of Puerto Rico.

While there are objectors to the plan, we expect the plan to be approved by the court with an effective date sometime during the first quarter of 2022.

Confirmation of the Plan of Adjustment will eliminate considerable uncertainty as to the ultimate loss experience for our Puerto Rico exposures, with the exception of our HTA exposure which will be addressed by a separate Title III process.

We expect the HTA Title III process to move to conclusion as quickly as possible following the recently announced settlement between the Oversight Board and the DRA parties pursuant to which, among other things, the DRA parties will support the Commonwealth Plan and the forthcoming HTA Plan of Adjustment.

Our loss reserves on Puerto Rico include settlement options offered to Ambac guaranteed bondholders, including the potential for commutation payments from Ambac and contingent value instruments issued by the Commonwealth which remain subject to residual market and credit risk.

With the bankruptcy conclusion of Puerto Rico in sight, our exposure to adversely classified credits at AAC will be significantly reduced. Puerto Rico risks currently total $1.1 billion of net par and represent 16% of total adversely classified credits as at September 30.

We view this as a major step toward accomplishing our strategic de-risking objectives in our legacy financial guaranty business.

Turning now to our Rep & Warranty litigation. A conference has been scheduled for late November in our Bank of America/Countrywide litigation. We plan to ask the judge to set a trial date as soon as reasonably possible.

I will now turn the call over to David to discuss our financial results for the quarter. David?

David Trick – Chief Financial Officer

Thank you, Claude, and good morning, everyone.

For the third quarter of 2021, Ambac reported net income of $17 million, or $0.35 per diluted share, compared to a net loss of $29 million, or $0.63 per diluted share, in the second quarter of 2021.

Adjusted income for the third quarter was $25 million, or $0.53 per diluted share, compared to an adjusted loss of $13 million, or $0.30 per diluted share in the second quarter. The difference between adjusted earnings and GAAP net income relates mostly to the exclusion of $10 million of insurance intangible amortization from adjusted income.

Net income for the third quarter, as compared to the second quarter, was primarily driven by a greater loss and loss expense benefit, gains on interest rate derivatives and a lower provision for income taxes. These improvements were partially offset by lower net investment income from pooled funds.

Briefly turning to some highlights...

Premiums earned were $11 million in both the third and second quarters. Lower normal premiums earned were driven by the continued organic and proactive reduction of the financial guarantee insurance portfolio offset by an increase in accelerated premium related to proactive de-risking. Everspan contributed modestly to earned premiums, but at an exponential growth rate.

Investment income for the third quarter was $21 million down from $42 million in the second quarter.

Income from the available for sale portfolio declined to $15 million in the third quarter from $22 million in the second quarter, as a result of the July redemption of the Ambac LSNI secured notes held in the investment portfolio. Excluding the impact of the LSNI redemption, which was more than offset by a reduction to interest expense, income from the available-for-sale portfolio was relatively unchanged during the quarter.

Income from pooled funds totaled $6 million in the third quarter, a reduction of $14 million from the second quarter, reflecting lower, but still positive, returns in most funds alongside losses on global equity and emerging market debt funds held in Ambac UK's portfolio.

The total return on pooled funds was approximately 1.0% in the third quarter vs. 3.1% in the second quarter. Pooled fund returns exceeded 2.0% at AAC and were close to nil at AUK. The yield on the remainder of the portfolio was relatively unchanged, excluding the impact of the Ambac LSNI notes, on a slightly smaller asset base.

Other income, which includes gross commission revenue earned from Xchange and fronting fees earned at Everspan, was $8 million for the third quarter compared to $7 million in the second quarter.
Loss and loss expenses were a benefit of $55 million in the third quarter compared to a benefit of $26 million in the second quarter.

The RMBS insured portfolio generated a $23 million benefit in the third quarter as a result of improved credit factors and higher forecasted recoveries, partially offset by a resulting lower estimated representation and warranty subrogation receivable and incremental litigation costs.

Public Finance also experienced positive development in the third quarter that translated to a $(30) million benefit, which was mostly driven by improvements to AAC's Puerto Rico reserves and a few other exposures, the impact of which was moderated by approximately $11MM of incremental loss expenses. The reduction to Puerto Rico reserves resulted from greater clarity on expected outcomes for the plan support agreements as we move closer to final resolution. While future adverse development in our Puerto Rico reserves may occur due to outcomes that are less favorable than currently expected, we may also incur favorable development in our Puerto Rico reserves in future quarters. Future development of our Puerto Rico loss reserves will be influenced by many factors, including final confirmation of the plans, our ability to execute risk mitigation opportunities, timing, the value and liquidity of new bond and CVI subrogation, as well as a number of other factors.

Net gains on derivative contracts, which are positioned as a partial economic hedge against interest rate exposure in the financial guarantee and investment portfolios, were $5 million for the third quarter, as a result of higher interest rates, compared to losses of $11 million for the second quarter.

Counterparty credit adjustments on uncollateralized derivative assets contributed $2 million of gains in the quarter, compared to $3 million of losses in the second quarter.

Operating expenses were $32 million, up from $28 million in the second quarter. The increase in operating expenses for the third quarter was primarily due to higher compensation costs and strategic advisor fees. Higher compensation costs were driven by higher performance base compensation, growing headcount at Everspan and severance costs at the legacy financial guarantee business.

Xchange Benefits and Everspan Group collectively accounted for approximately 22% of consolidated third quarter operating expenses.

The provision for income taxes was $2 million in the third quarter compared to $11 million in the second quarter. The decrease was a result of a deferred tax expense in the second quarter resulting from the UK enactment of a tax increase.

Turning to the balance sheet.

As discussed on our call in July, AAC, through a newly formed VIE, issued one billion, one hundred seventy-five million par amount of LIBOR plus 4.5% senior secured notes due 2026, proceeds of which, along with other sources of liquidity, were used to fully redeem the outstanding Ambac LSNI notes. The impact of this refinancing during the third quarter, compared to the second quarter, was a reduction to both assets and outstanding debt of over $460 million and net interest savings of $1 million.

Shareholder's equity was effectively flat compared to the end of the second quarter at $22.91 per share, or $1.1 billion at September 30, 2021; with net income of $17 million more than offset by foreign exchange translation losses of $19 million and unrealized losses on investments of $4 million.

Adjusted book value decreased to $882 million or $19.05 per share at September 30, from $889 million or $19.25 per share at June 30. This $0.20 per share decrease was primarily due to foreign exchange translation losses and premiums ceded under a reinsurance transaction, partially offset by adjusted earnings. Unlike book value, ABV is not impacted by changes in unrealized gains and losses.

At September 30, 2021, AFG, on a stand-alone basis, excluding investments in subsidiaries, Everspan, Xchange and AAC, had cash, investments and net receivables of approximately $282 million, or $6.09 per share, including approximately $161 million of liquid assets.

I will now turn the call back to Claude for some brief closing remarks.

Claude LeBlanc – Chief Executive Officer

Thank you, David.

In closing, we believe Ambac is well-positioned to further progress our goal to scale a sustainable diversified specialty P&C program insurance platform while we continue to progress the active run-off of our legacy financial guarantee businesses.

Our key value drivers include:

1. Material capital at the holding company, which remains unlevered;
2. Our differentiated P&C Platform encompassing capital light, fee based, growth-oriented businesses that can leverage Ambac's business services infrastructure, and our substantial NOLs, and lastly;
3. The resolution of near to mid-term catalysts with the goal of further stabilizing our legacy financial guarantee business and providing us with greater optionality and clarity surrounding capital movement to our holding company.

I am excited about the progress we have made and the future ahead as we look to further expand and grow our platform.

Operator

This concludes today's teleconference. We thank you for participating. You may disconnect your lines at this time.