Operator

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

Good morning and thank you all for joining today's conference call to discuss Ambac Financial Group's fourth 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 annual report 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 today's call.

For the year ending December 31, 2021, Ambac reported a net loss of $17 million, or $0.61 per diluted share, and adjusted earnings of $43 million or $0.66 per diluted share. For the fourth quarter, Ambac reported a net loss of $22 million, or $0.42 per diluted share, and adjusted loss of $10 million, or $0.16 per diluted share.

David will discuss our results in more detail shortly.

2021 was a transitional year for Ambac. Against the backdrop of a rapidly growing programs market in the U.S. and healthy rate increases across the P&C industry in most classes of business we launched and materially advanced our specialty P&C insurance platform at AFG.

When we introduced this new business strategy to you last year, we classified each component into separate Pillars. Each Pillar has since evolved into three distinct operating units, under the following names

- Pillar 1, our participatory fronting insurance platform, is branded under Everspan Group
- Pillar 2, our product development and distribution partner division, will operate under Cirrata Group and
- Pillar 3, our strategic investment unit, will fall under Redgrove Capital Group

Everspan Group was launched in the first quarter of 2021 with an A- rating and Class VIII designation from AM Best. At launch, the platform consisted of Everspan Indemnity Insurance, our surplus lines insurer and Everspan Insurance Company, our admitted insurer.

Everspan Group expanded its platform during the latter half of 2021 with the purchase of Providence Washington Insurance Company and in early 2022 acquired three additional admitted carrier shells. With these acquisitions Everspan Group has multiple active certificates of authority in all fifty states and is well positioned as a differentiated platform with greater optionality for its program partners.

Since its launch, Everspan has seen a robust program pipeline across various classes of business from multiple distribution sources. To date, Everspan has signed 9 program partners and has a strong pipeline going into 2022.

Everspan's differentiated business plan provides for up to 30% retention of underwriting risk, distinguishing Everspan from its competitors and creating significant alignment of interest with Everspan's reinsurance partners.

The Company's leadership team consists of industry veterans in underwriting, programs and claims administration, as well as regulatory and compliance. We believe the platform is positioned well for strong growth in 2022.

Turning to our product development and distribution partner division, Cirrata Group.

Xchange, our first MGU partner was onboarded at the beginning of 2021. Xchange successfully expanded its distribution network, diversified its business model and had a strong finish to the year. Xchange distributed $7.4 million in 2021, 80% of which was paid to Ambac.

We are actively pursuing new M&A and de novo opportunities to grow Cirrata's partner platform, supported by centralized business service offering, including core P&C technology solutions that we believe will enhance our distribution partners' competitive positions.

The last pillar of our strategy, Redgrove Capital Group, was established as our strategic investment division to make investments that we believe will further enhance the value of Everspan and Cirrata. We made three investments in 2021, including investments in companies involved in data analytics and insurance technology, all with attractive target returns on capital.

Overall, we are very pleased with the progress we made in 2021 and we believe we are well positioned to expand and grow our specialty P&C insurance platform in 2022.

Turning now to an update on our legacy financial guaranty business and our accomplishments for the year: We continue to reduce risk in the insurance portfolio through active de-risking and natural portfolio run-off. Net par exposure was $28 billion at December 31, down approximately $6 billion or 17 percent from December 31, 2020.

Ambac's watchlist and adversely classified credits were reduced to $10 billion at December 31, down approximately $3 billion, or 23 percent from the prior year end. Proactive de-risking efforts accounted for decreases of approximately $3 billion in net par exposure and $2 billion in watch list and adversely classified credits during 2021.

As it relates to our largest at-risk exposure, Puerto Rico, Ambac continues to make substantial progress.

Significant milestones were recently reached in January with the bankruptcy court approval of a Plan of Reorganization related to our GO and PBA exposures and Qualifying Modifications for our PRIFA and CCDA exposures. Ambac and other relevant parties have been working on finalizing necessary documentation that we anticipate will lead to effective dates for those reorganizations in mid-March.

Ambac-insured bondholder elections have been received and tabulated which, once effective, will significantly reduce our insured GO, PBA, PRIFA and CCDA liabilities through commutations and acceleration options consistent with the court-approved Plan and Qualifying Modifications.

Once these plans are effective, Ambac will reduce its insured principal and interest exposure to Puerto Rico by approximately $450 million, and when combined with the 2019 COFINA restructuring will reflect the elimination of approximately 85% of our total Puerto Rico exposure.

Later this year, Ambac expects that HTA will complete its Title III bankruptcy process on terms consistent with the Plan Support Agreement that we joined in the summer of 2021. We anticipate that a Plan of Adjustment for HTA should be available for consideration in the coming weeks.

The range of uncertainty around our Puerto Rico exposure continues to reduce, and loss reserve levels have been reduced commensurately in line with current proceedings.

Ultimate loss experience on Puerto Rico remains dependent on the conclusion of the bankruptcy process and the realized market value of plan consideration. Additionally, the economic performance of Puerto Rico over the long term will impact final Ambac losses for those exposures not otherwise settled through commutation and acceleration.

Turning now to our loss recovery efforts.

In regards to our Bank of America/Countrywide litigation presided over by Justice Reed, all parties have agreed to an in-person trial date of September 7, 2022.

We are pleased to have established a trial date and look forward to resolving our claims as favorably and expeditiously as possible. We are also making material progress on our fraud-only case against Countrywide, where we expect to conclude the summary judgment phase of the case in the coming months and proceed to trial next year. Similarly, we are working to get through the summary judgment phases for our cases against First Franklin and Nomura and hope to get to trial on one or both of those cases next year.

Turning to our efforts to rationalize our capital and liability structure.

During 2021, we executed two key transactions leading to material benefits across our capital and liability structures. This included: the junior surplus note exchange transactions, resulting in the extinguishment of $76 million in debt and accrued interest.

Second, the issuance of new senior secured notes by AAC, through a newly formed VIE, proceeds of which, along with other sources of liquidity, were used to fully redeem the outstanding Ambac LSNI notes. The benefits of this refinancing are lower net interest carry costs and an extended debt maturity date to 2026. We believe the extended maturity period will provide increased financial flexibility during the pendency of our RMBS litigations.

We are pleased with the market receptivity that allowed us to execute on these transactions and continue to evaluate additional means to further simplify and streamline our capital and liability structure.

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 fourth quarter of 2021, Ambac reported a net loss of $22 million, or $0.42 per diluted share, compared to net income of $17 million, or $0.35 per diluted share, in the third quarter of 2021.

The adjusted loss for the fourth quarter was $10 million, or $0.16 per diluted share, compared to adjusted earnings of $25 million, or $0.53 per diluted share in the third quarter. The difference between the adjusted loss and GAAP net loss relates mostly to the exclusion of $11 million of insurance intangible amortization from adjusted income. The net loss for the fourth quarter, as compared to the third quarter, was primarily driven by a lower loss and loss expense benefit.

Brief highlights include:

Premiums earned of $11 million in both the fourth and third quarters. Financial guarantee earned premiums continue to trend downward as a result of our active de-risking efforts and continued organic run-off of the insured portfolio.

Everspan's contribution to net earned premium, although modest, was nearly 3 times what it was in 3Q21 off of gross written premiums that were up 1.6 times from the third quarter. As Everspan continues to add programs and as each program grows, its earned premium will contribute more materially. This is in addition to program fee growth which has a similar earnings pattern to premiums. As Claude referenced, Everspan

added four programs in the fourth quarter and seven for the full year 2021. In addition, Everspan has already added 2 programs in 2022.

Investment income for the fourth quarter was $27 million up from $21 million in the third quarter. The increase in investment income during the fourth quarter was from pooled funds which generated $13 million of gains compared to $6 million of gains in the third quarter. Higher gains were recognized in equities, real estate and private credit, partially offset by lower, but still attractive, returns on hedge funds. The total return on pooled funds was approximately 2.0% in the fourth quarter vs. 1.0% in the third quarter. The yield on the available for sale portfolio was relatively unchanged.

Other income for the fourth quarter was relatively unchanged compared to the third quarter at $8 million. Other income included gross commissions from Xchange of $6 million, program fronting fees earned at Everspan, as well as other fees. Xchange gained momentum in the fourth quarter with $26 million in gross written premiums, 17% higher than in the fourth quarter of 2020.

Loss and loss expenses were a benefit of $15 million in the fourth quarter compared to a benefit of $55 million in the third quarter.

Public Finance experienced $41 million of positive development in the fourth quarter driven by lower reserves related to Puerto Rico and an enhanced recovery profile related to the further restructuring of a long-standing adversely classified credit. The reduction to Puerto Rico reserves resulted from further clarity on expected outcomes related to the Commonwealth Plan of Adjustment and the PRIFA and CCDA qualifying modifications. While further adverse development in our Puerto Rico reserves may occur due to outcomes that are less favorable than currently expected, we may also incur additional 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 the consummation of the Commonwealth POA and qualifying modifications, the confirmation and consummation of an HTA plan, 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.

The structured finance portfolio generated a loss and loss expense of $24 million compared to a benefit of $21 million in the third quarter as a result of incremental litigation costs and a lower estimated subrogation recoverable related to a single RMBS transaction.

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 $3 million for the fourth quarter, compared to gains of $5 million for the third quarter.

Counterparty credit adjustment losses on uncollateralized derivative assets offset gains from higher rates by $2 million in the quarter while supplementing gains by $2 million in the third quarter.

Operating expenses were $33 million, up from $32 million in the third quarter. The increase in operating expenses for the fourth quarter was primarily due to higher performance-based compensation, including as a result of higher headcount related to our new businesses, partially offset by lower strategic advisor fees.

Xchange Benefits and Everspan Group collectively accounted for approximately 26% and 22% of fourth and third quarter consolidated operating expenses, respectively.

Turning to the balance sheet:

Shareholder's equity decreased $0.49 per share to $22.42 per share, or $1.0 billion at December 31, 2021. The decrease was due to a net loss of $22 million and a reduction to net unrealized gains on investments of $10 million partially offset by $9 million of impact related to stock compensation, foreign exchange, and changes in the redemption value of Xchange's noncontrolling interest.

Adjusted book value decreased to $874 million or $18.88 per share at December 31, 2021, from $882 million or $19.05 per share at September 30, 2021.

This $0.17 per share decrease was primarily due to the adjusted loss (net of premiums earned), partially offset by the impact of inflation adjustments on certain future installment premiums and an adjustment to the carrying value of the redeemable noncontrolling interest in Xchange.

At December 31, 2021, AFG, on a stand-alone basis, excluding investments in subsidiaries, Everspan, Xchange and AAC, had cash, investments and net receivables of approximately $269 million, or $5.81 per share, including approximately $142 million of liquid assets.

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

Claude LeBlanc – Chief Executive Officer

In conclusion, our accomplishments position Ambac well for the coming year and the Board and management team are steadfastly focused on maximizing shareholder value through the execution of key strategies for both the specialty P&C insurance platform and the legacy financial guarantee business.

As we look to execute on our strategic priorities, we have further expanded the Board’s diverse skillset with the addition last August of Lisa Iglesias to our Board of Directors. Lisa brings with her a wealth of insurance and other business expertise that will be beneficial to us as we expand our specialty P&C insurance business.

As we look ahead for 2022, our strategic priorities for the specialty P&C insurance business include:

1) Growing and diversifying Everspan Group’s participatory fronting platform with existing and new program partners;
2) Building Cirrata Group into a leading federation of specialty MGA and MGU insurance partners through additional acquisitions and de novo builds, supported by a centralized business services unit with core technology solutions;
3) Making opportunistic investments through Redgrove Capital Group that are strategic to the overall Specialty P&C insurance platform;

Our priorities for the legacy financial guarantee insurance companies include:

1) Actively managing, de-risking and mitigating insured portfolio risks;
2) Pursuing loss recovery through active litigation and other means, particularly RMBS Rep & Warranty litigation;

3) Improving operating efficiency and optimizing our asset and liability profile and;
4) Exploring, at the appropriate time, strategic options to further maximize value for AFG

We remain excited about the opportunities that lie ahead for Ambac, and I look forward to updating you on our progress.

Operator, please open the call for questions.

Operator

Thank you. At this time, I will be conducting a question-and-answer session. (Operator Instructions)

Thank you. Our first question comes from the line of Greg Nihon with Leodium Capital. Please proceed with your question.

Greg Nihon – Leodium Capital

Good morning Claude, David and Lisa, thank you so much for those informative remarks and congratulations on all the progress you've made on the specialty platform and on Puerto Rico. I just had a couple of questions for you this morning. The first one was with regard to Countrywide. And in the event that we were to reach a settlement, is that something that would typically happen only on the eve of trial? Or could we see something like that happen months ahead of a trial date?

And the second question is with regard to our warrants. I know that they're fairly thinly traded, but does the company ever consider repurchasing and retiring the warrants? Thank you.

Claude LeBlanc – Chief Executive Officer

Thanks, Greg. Thanks for your questions and good morning. I'll take the first question and pass the second to Mr. Trick. As it relates to settlements, we typically don't comment on settlement discussions as a matter of our policies. But I think in the past, we've seen litigation settle at various times. But certainly, there's been a track record of settling at or near trial dates, but that's probably as much as I can say about that. We are certainly looking forward to our trial date in September. And that's as much as we can comment this morning. David?

Greg Nihon – Leodium Capital

Thanks Claude.

David Trick – Chief Financial Officer

Sure. Thank you. We have looked at repurchasing the warrants. A few years ago, actually, we did repurchase a number of the warrants and then reissued them in connection with a recapitalization transaction that we did back in 2018, if I recall correctly. So we continue to monitor opportunities there and weigh the opportunity to repurchase those against some of the other opportunities we have for redeploying capital. And to date, since the initial repurchase we made in reissuance in 2018, we have not made any additional repurchases of the warrants, but something we continue to monitor again versus other opportunities we have to deploy capital.

Greg Nihon – Leodium Capital

Thank you so much.

Operator

Our next question comes from the line of Charles Post with Sterling Grace. Please proceed with your question.

Charles Post – Sterling Grace

Good morning. I'm trying to get a better sense for the returns we're achieving on Everspan and Xchange. We got a roughly $200 million tied up with the two entities and I've heard they're growing. But I'm trying to get a better idea of the returns we're getting on that money.

David Trick – Chief Financial Officer

Sure, Charles, it's David. I think it's not only about the returns that we're getting today, but what our expectations are for the future. So Everspan, as you probably know, only got off the ground with its ratings in February of last year. So it's still very much in startup mode, but we are starting to experience, as Claude's comments and my comments indicated, starting to experience real growth and market acceptance of the platform. And so for a platform like that, our expectations would be mid-teen type returns that would be available to capital deployed there. And I would say for Xchange, we bought Xchange at the end of 2020. I think during 2021, it's fair to say that COVID continued to have a little bit of an overhang onto the growth of the platform. But as my remarks indicated in the fourth quarter, they had really substantial growth in business volume in the fourth quarter. And for that business, similarly, we expect to see over the medium term, mid-teen type returns. And it is today profitable in generating cash back to the holding company, which in 2021 was about $6 million just in distributions in 2021, which we expect to grow in 2022 as well. The first quarter of 2022, distribution to AFG from Xchange is about $1.6 million. So it's a nice cash-generating business and its growth as demonstrated in the fourth quarter is expected to continue to improve as the overhang of COVID continues to lift.

Charles Post – Sterling Grace

Okay. So but then we've had a massive jump up and you guys overhead, the operating expenses went from $92 million in 2020 to $126 million, a 37% year-over-year. So is that the big increase? I know we have a lot of attorneys getting paid quite a bit of money, but is a lot of that increase also from these two entities?

David Trick – Chief Financial Officer

Yeah. Again, comments, a bigger percentage of our total expenses are related to Everspan and Xchange. And in particular, when you look at something like Xchange, which is a MGA/MGU, included in those expenses are the commissions that they pay to their agents that are on the front end of their business from a distribution standpoint. So, you have 3 different businesses included in operating expenses, all which have very somewhat different types of expenses, distribution expenses, commissions, ceding commissions. So it

gets a bit complex, but the growth in expenses is due to picking up a volume and the addition of these new businesses, while at the same time, the expenses related to legacy business, the financial guarantee business continue to decline.

Charles Post – Sterling Grace

Okay. Switching topics. On the RMBS, the structured finance, you excluding the recoveries, you got, you guys are showing about $850 million of expected payments to be made. How much, any payments did you make in dollar amount in 2021?

David Trick – Chief Financial Officer

On the structured finance business?

Charles Post – Sterling Grace

Yes. Correct.

David Trick – Chief Financial Officer

Well, the main source of client payments on the structured finance business is the RMBS book, which have been relatively light. We actually have been in a net recovery position on the structured finance book. We're paying nominally on structured finance, about $5 to$6 million a quarter on claims, and we're recovering $20 to $25 million a quarter. So our net recovery position is $15 to $20 million a quarter on the structured finance book.

Charles Post – Sterling Grace

Okay. So if I look at Page 53 of the 10-K, we have about $2 billion in recoveries. We got $850 million of expected expenses. So $1.7 billion of the recoveries from R&W. So we got $300 million of, I guess, excess spread against $850 million. So if we only have, if we're outgaining the payments then, am I wrong to think that $850 million could prove to be very high?

David Trick – Chief Financial Officer

$850 million of, talking about gross payments on the RMBS?

Charles Post – Sterling Grace

Yep, that's on your structured finance.

David Trick – Chief Financial Officer

That's probably a little high. You also have student loan claims in there as well. Specific to the RMBS book, that's high. But we have significant future student loan claim payments to come in the future, which are very,

sort of, back-ended and we wouldn't expect to see claims on the student loan book until at least five years from now.

Charles Post – Sterling Grace

Okay. All right. You know guys, Claude you've been here over five years now, and we've seen book value drop 41% and our stock was down 46%. S&P is up 90%, AGO is up 48%, excluding dividends, MBI is up 27%. Like to see us get going on some of the stuff that's a little more shareholder-friendly because the G&A is getting up there. Board's getting paid, management's getting paid, your army of attorneys are getting paid, so I'd like to see a little more tie in with the shareholders' place. Thank you.

Operator

Thank you. Our next question comes from the line of Arthur Kavalis with Three Court. Please proceed with your question.

Arthur Kavalis – Three Court

Thank you for taking my question. I have three questions. First is First Franklin and Nomura litigation. Is that fraud only? Or does that also include breach of contract?

My second question is, Harborview and Lehman transactions that are part of the Countrywide. You mentioned that the trials for these cases might be starting in a year from now. Why are they fraud only cases? Why is there no reps and warranty breaches as part of that process?

And lastly, with the Countrywide litigation, the trial date that's set for September 7, what's the expected next step assuming there is a favorable outcome in the trial and you get the favorable ruling, what would be the next steps in the process from a timing and process standpoint to get the final resolution to actually receive the payment? Is there some issue with the primary liability versus the contingent liability? Would there need to be another trial for the contingent liability? Can you just walk me through the next steps, assuming that you have a good outcome in the September '22 trial? Thank you.

Claude LeBlanc – Chief Executive Officer

Sure. Thanks for your questions. So I'm having a little bit of hard time hearing you. But on the first question was specific to First Franklin. Is that correct?

Arthur Kavalis – Three Court

That's correct, yes.

Claude LeBlanc – Chief Executive Officer

Yes. Yes. So that is a fraud and contract case that's proceeding. So it contains both elements at this time. And as it relates to the Harborview case, that is a fraud only case, and that is also proceeding. And we believe that we'll get to trial next year, barring any appeals or things that could potentially delay. But we hope

and expect that, that will be in front of our judge next year in a fraud trial. And in the case of the main Countrywide case that is set up a trial to start in September, the way, again, I don't think there's a one right way and I think judges take varying lengths of time to review cases and write decisions. So in the case of the MBIA case, it was six to twelve months, maybe closer to twelve months before a decision was reached on that. That may be a little bit on the long side of things. I think it would take a number of months, we would expect for a decision to be reached. But hopefully, likely certainly inside the year would be our expectation, but we really can't predict how long it would take. And for the question that was raised earlier, if it could settle earlier, obviously, to the extent that there was a settlement before a trial or even after the trial that would be a possibility that we would settle and get cash sooner. Once the decision is reached by the judge, then that's when the damages and awards would be determined, but there could be further delays potentially in that event from further appeals by either side. But that's to be determined, I think it will be evaluated in context of the trial, how it progressed and what the ultimate outcome is.

Arthur Kavalis – Three Court

May I ask a follow-up question? Does the bifurcation of the primary liability claims against Countrywide from the contingent secondary liability claims against Bank of America, is this September trial dealing with the primary liability claims against Countrywide and not the contingent secondary liability against the Bank of America? Or is it both together, both topics are being discussed? Because I understand that there is a bifurcation.

Claude LeBlanc – Chief Executive Officer

You're correct. You're correct. They were bifurcated. So this is directly against Countrywide and the successor liability would only proceed if needed. I think Bank of America has supported Countrywide and all its settlements for over a decade now. So to the extent that they would try to avoid liability that we would proceed to the successor liability case as a separate case, which would be a much shorter case, that was all. That's only if Countrywide is not satisfied in judgment. But again, Countrywide has paid out billions over the last decade, without regard to any successor case.

Arthur Kavalis – Three Court

So you would need to pursue a separate case to get paid if B of A decides not to pay?

Claude LeBlanc – Chief Executive Officer

No. Only if Countrywide did not pay. So if Countrywide did not satisfy the judgment, then we would pursue the successor liability against Bank of America directly.

Arthur Kavalis – Three Court

Understood. And one follow-up question on the First Franklin and the Nomura case. It's fraud only, what gives you the confidence that there is this fraud-only case has legs, given the December 2020 decision ruling against the AAC's fraud claim in the Countrywide case. How is this different, the First Franklin and Nomura, from a fraud standpoint than the Countrywide one?

Claude LeBlanc – Chief Executive Officer

So the First Franklin case is fraud and contract. And it's possible, we don't agree, but it's possible that a decision could be reached to limit our case to contract only or fraud only, that's a possibility. In the case of the, and contract has always been our primary path, our primary cases. So that remains true today also with our main Countrywide case. In the case of Harborview, that is not a contract case, so that is only fraud. And therefore, there's no basis for that case not to go through as a fraud-only case. And that one is preparing for oral arguments and summary judgment and assuming we get through that and no appeal, we expect that, that will go to trial as a fraud only case next year.

Arthur Kavalis – Three Court

Okay. Thank you.

Operator

Thank you. Ladies and gentlemen, that concludes our question-and-answer session, and thus concludes our call today. We thank you for your participation, you may now disconnect your lines.