Operator

Greetings, and welcome to Ambac Financial Group, Inc. Second Quarter 2022 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Charles Sebaski, 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 second quarter 2022 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 recently filed SEC 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.

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

Claude LeBlanc, President and Chief Executive Officer

Thank you, Chuck, and welcome to everyone joining today's call.

For the quarter ending June 30, 2022, Ambac reported net income of $5 million, or $0.11 per diluted share, and adjusted earnings of $13 million, or

$0.28 per diluted share. Book value at quarter end was $784 million and adjusted book value was $773 million. During the quarter we repurchased 1.6 million shares of our common stock, under our share repurchase program, at an average price of $8.86 per share.

David will discuss our financial results in more detail shortly.

There are several performance and strategic highlights I would like to touch on this morning. This quarter we continued to advance our goals of building a leading Specialty P&C Platform while simultaneously reducing volatility and exposure in our Legacy Financial Guarantee business.

Our specialty P&C business had gross insurance production of $65 million, representing a 168% increase from the second quarter of last year.

We believe gross insurance production, which is the combined gross premiums written for Everspan and the premiums placed by our Insurance Distribution segment, to be one key metric for how the business is growing and performing.

Turning to Everspan…during the quarter Everspan Group led our insurance production with another strong quarter of growth, with gross premium written up over 70% from the first quarter of this year. This quarter's results represent an annualized, gross premiums written run rate of over $160 million, compared to our first quarter run rate of $100 million. Everspan

currently has 11 MGA program partners, up from 10 last quarter, and has signed 3 new programs this quarter. The operating environment for specialty insurance continues to be robust and supportive of the strong pipeline of new MGA partners Everspan continues to see. In addition, commercial P&C pricing, while moderating from 14% at year-end 2021, is still increasing (up 10% in Q2 of this year) and remains above loss cost trends. In the E&S market, conditions remain favorable, with hard markets expected to continue through year-end, with strong, although decelerating, premium growth.

We expect these factors, along with the strength of our existing programs, to provide Everspan with robust growth opportunities. The Everspan team is also focused on underwriting discipline, which is key to the company's profitability and supports the growth and expansion of our strong reinsurance panel.

Turning now to our Insurance Distribution business…during the quarter, Cirrata, our Insurance Distribution segment anchored by Xchange, our first MGU partner, continued its expansion and growth. Xchange placed over $24 million in premiums, an increase of 7% over the prior year.

Xchange also saw strong growth in both its Affinity business, which grew by 4%, and its ESL business, which grew by 6%, bolstered in part by the EBU

renewal rights acquisition announced last quarter. During the quarter, Xchange also announced its continued market expansion with the addition of Markel as a new partner and the related launch of a new ESL program.

This quarter we were also very pleased to announce our first de novo MGA, with Penny Parisoff, in the Health and Human Services sector. Penny has extensive experience and is considered a market leader in this sector, which is an area of the economy we see poised for growth. Penny has prior experience and success building out a book of business in this space from the ground up, and we are confident in her ability to do it again.

With the recent launch of our full business services infrastructure operation, led by our technology and data solutions offerings, we see Insurance Distribution to be an area of significant future growth potential for Ambac. Our business services operation was developed to support MGA teams in the rapid build-out and expansion of their distribution platforms and is expected to generate significant cost and operational synergies for our partners, whether de novo or acquired. Interest in the MGA market remains strong, as evidenced by the execution of several notable transactions, including the recent acquisition of NSM Insurance by Carlyle for $1.8 billion. Conning reports that the total market size for this sector is estimated to be $70 billion, with the industry seeing growth of 15.5% last year, outpacing the overall P&C market premium growth.

Turning to our Legacy Financial Guarantee business…during the quarter we achieved material success in our active de-risking initiatives, as evidenced by the reduction in our Watch List and Adversely Classified Credits, which were reduced by $1.6 billion, or 16% from the prior year end.

One key component of our de-risking was the material reduction of our Puerto Rico exposure. During the second quarter we paid off our last remaining PRIFA and CCDA exposures, reducing net par by a total of $317 million, which leaves HTA as our only unresolved exposure. The HTA Plan of Adjustment is currently scheduled for a confirmation hearing beginning on August 17th, and we expect the Plan to become effective later in the third quarter or early in the fourth quarter. I am pleased with the outcome of our meaningful de-risking activities related to our Puerto Rico exposure this year and I look forward to the final resolution of this last, but significant, piece related to HTA, which totals $398 million of net par exposure.

Our continued de-risking initiatives are focused on reducing the overall volatility of our Legacy Financial Guarantee business, which accomplishes several things for Ambac. Near term, we believe it will stabilize AFG's consolidated financial performance relative to the last several years. Longer term, we believe our de-risking and stabilization activities will increase the attractiveness of our Legacy Financial Guarantee business as

we consider potential strategic alternatives to support our growing Specialty P&C Platform.

Turning to an update on litigation…in our main case against Countrywide/Bank of America, we are actively preparing for our trial beginning on September 7th, which was affirmed by Justice Reed at our May 18th hearing and conference. We are pleased that this case is finally headed to trial and remain confident in the strength of our claims.

We are also looking forward to our summary judgement hearing later this month in our fraud-only case against Countrywide, which we refer to as our Harborview case. While we recognize no credit for the Harborview case in our financial statements, prevailing on summary judgment will provide us a path to a trial in front of a jury, potentially as early as the first half of 2023, although timing and scheduling remain out of our control. We are also actively working to advance our First Franklin case, our third material litigation against Bank of America.

As I mentioned last quarter, the size and scope of all of our active cases against RMBS sponsors are very material to Ambac's balance sheet, relative to our recorded litigation recovery credit of about $1.5 billion.

In Countrywide, we are seeking damages of well over $2 billion. And in First Franklin, Harborview, and our Nomura case, we are seeking aggregate damages of more than $1 billion.

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.

Before I discuss our second quarter results, I'd like to remind everyone that as of last quarter we began disclosing our results through three segments: Legacy Financial Guarantee insurance, Specialty Property and Casualty insurance, and Insurance Distribution.

For the second quarter of 2022, Ambac reported net Income of $5 million, or $0.11 per diluted share, compared to a net loss of $29 million, or $0.63 per diluted share, in the second quarter of 2021.

Adjusted earnings for the second quarter of 2022 were $13 million, or $0.28 per diluted share, compared to an adjusted loss of $13 million, or $0.30 per diluted share in the second quarter of 2021. The difference between adjusted earnings and GAAP net income for the second quarter of 2022

and 2021 related mostly to the exclusion of $13 million of insurance intangible amortization from adjusted income.

The $34 million increase in net income for the second quarter of 2022, as compared to the second quarter of 2021, related mostly to a $57 million gain on extinguishment of debt and a $29 million gain on derivatives, which includes our macro interest rate hedge. These gains were somewhat offset by a $21 million net investment loss in the quarter, compared to a $42 million net investment gain in the second quarter of 2021. Other notable variances relative to the prior period include a lower loss and loss expense benefit and lower tax expense.

Premiums earned were $14 million in the second quarter compared to $11 million in the second quarter of 2021. As it continues to build momentum, growth in Everspan's earned premium more than offset the contraction in the Legacy Financial Guarantee portfolio. Active de-risking and organic run-off of the Legacy Financial Guarantee insured portfolio will continue to result in earned premium for this segment trending lower. This trend may also be impacted by positive or negative accelerated earned premiums resulting mostly from our proactive de-risking strategy. In the second quarter of 2022 such accelerated earned premiums totaled $2.3 million.

Everspan earned premium of nearly $3 million for the quarter, compared to nearly zero in the prior year period, as it wrote its first program in May of 2021. Sequentially, Everspan's net earned premiums were up 141% in the second quarter.

In addition, we would highlight that of the $41 million of gross written premiums in the quarter, Everspan retained $8 million, or about 20%, which will earn in over the next year. Everspan's strategy as a hybrid fronting carrier is to retain up to 30% of the gross premium it writes.

Everspan also collected $1.7 million and earned approximately $600,000 of program fees in the quarter. As a reminder, program fees earn in over the course of a policy similar to how premium is earned. Therefore, as Everspan continues to add programs and grow gross premiums written, both earned premium and program fees will grow significantly.

Cirrata, our distribution segment, also continues to grow both organically and strategically. As Claude noted, $24 million of premiums were placed in the quarter, a 7% increase from the $22 million placed last year. Insurance Distribution business revenues comes from commissions earned as a percentage of the premiums placed. For the second quarter gross commissions were $6.2 million, up 4% from the prior year period, and total revenues were $6.5 million, up 7.3% from the prior year period.

The Insurance Distribution segment produced nearly $1 million of EBITDA for the second quarter, down slightly from the second quarter of 2021. Gross commissions and EBITDA were impacted by a catch-up adjustment to profit commissions, which occurred in second quarter of 2021. In addition, expenses were impacted by the renewal rights transaction and certain timing differences.

Investment loss for the second quarter was $21 million, down from a gain of $42 million in the second quarter of 2021, largely on account of broad macro changes across markets.

The decrease in investment income during the second quarter was related to several items. First, fund investments generated a net loss of about $23 million in the quarter, compared to a $20 million gain in the second quarter of 2021. Secondly, we incurred an $11 million loss on Puerto Rico Plan consideration classified as trading, which represented a small component of our large overall gain from the Puerto Rico restructuring in the prior quarter. As of early July we monetized all of the new bonds and CVI received in the first quarter in connection with the restructuring of Puerto Rico and therefore are no longer on risk to these assets. That said, in July 2022 we received approximately $295 million notional amount of HTA CVI. Thirdly, fixed maturity securities income was down $6 million compared to the prior period due to the refinancing of the LSNI secured notes that were

held in second quarter of 2021. Since the refinancing occurred in early July of 2021, it will not represent a significant variance for our 3rd quarter results.

Regarding fund performance, while we would have certainly preferred the alternative portfolio to produce positive returns for the quarter, we are satisfied with its performance on a relative basis. During the second quarter our alternative portfolio was down 3.7%, which compares favorably to broad equity markets (which were down over 16%), high yield (which was down about 9%) and BBB Corporates (which were down 4.5%).

Loss and loss expenses were a $12 million benefit in the second quarter of 2022, compared to a $26 million benefit in the second quarter of 2021.

Public Finance experienced $3 million of positive development in the second quarter, compared to $11 million of positive development in the prior year quarter. The benefit this quarter was spread over numerous credits and was bolstered by higher discount rates compared to last year, which was driven by an improved outlook on certain COVID-exposed credits and a military housing project, partially offset by incremental loss expense costs and lower discount rates.

The structured finance portfolio generated a benefit of $11 million this quarter, compared to a benefit of $16 million in the second quarter of last

year. This quarter's benefit resulted primarily from higher discount rates and stronger recoveries which generated a $39 million gain that was somewhat offset by an $18 million reduction to our rep & warranty credit resulting from higher discount rates and $7 million in loss expenses. The benefit in the second quarter of last year was driven by improved credit factors, partially offset by incremental loss expenses.

Losses for the Specialty Property and Casualty Insurance segment were $2 million in the second quarter—equating to a loss ratio of 66.5%.

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 $29 million for the second quarter, compared to loss of $11 million for the second quarter of 2021.

Operating expenses were $34 million for the second quarter, up from $28 million in the second quarter of 2021. The increase in operating expenses was due to higher compensation expenses resulting from increases in headcount for the Specialty P&C Platform, higher equity incentive plan costs, higher sub-producer commissions in the Insurance Distribution segment, related to growth, and greater legal expenses for defensive litigation.

Turning to the balance sheet…shareholder's equity decreased $(2.21) per share to $17.44 per share, or $784 million at June 30, 2022 from the end of the first quarter. The decrease was primarily due to unrealized losses on available-for-sale investments of $72 million and foreign exchange translation losses related to AUK of $55 million.

Adjusted book value decreased to $773 million or $17.20 per share at June 30, 2022, from $841 million or $18.07 per share at March 31, 2022.

This $(0.87) per share decrease is due to the adverse effect of foreign exchange losses and higher discount rates on the PV of financial guarantee installment premiums partially offset by adjusted net income and a $0.33 per share benefit from share repurchases which were made below adjusted book value.

During the quarter we repurchased 1.6 million common shares for $14.2 million at an average purchase price of $8.86 per share, bringing the total unused authorized amount remaining to almost $21 million. In addition, we made several purchases of AAC debt, including surplus notes amounting to $65 million of current par value or $115 million of principal and accrued interest outstanding, which generated the previously mentioned $57 million gain on the retirement of debt. We also purchased $76 million of Sitka notes, at a discount, which are held as an asset on AAC's balance sheet.

At June 30, 2022, AFG, on a stand-alone basis, excluding investments in subsidiaries, had cash, investments and net receivables of approximately $218 million, or $4.85 per share.

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

Claude LeBlanc, President and Chief Executive Officer

In conclusion, we have made significant progress this quarter in advancing our key strategic priorities.

We continue to see very attractive opportunities to deploy capital in our Insurance Distribution business. We also see meaningful opportunities to capture growth and expense synergies across our growing businesses through our dedicated business service unit supporting the existing and future technology, distribution and infrastructure needs of our partners.

As we continue the transition and expansion of our P&C platform, we believe the company’s value will be increasingly defined by our two core strategic segments—the Specialty P&C Insurance business, Everspan Group, and the Insurance Distribution business, Cirrata. As a reminder, these new businesses are characterized by capital light models, EBITDA managed, and growth focused.

I look forward to continuing to update you on our progress in the coming quarters.

Operator, please open the call for questions.

Operator

Thank you. Ladies and gentleman, at this time we will be conducting a question and answer session. (Operator Instructions)

There are no questions in the queue at this time. This concludes today's teleconference. Thank you for your participation. You may disconnect your line at this time.