SYNCORA HOLDINGS LTD.
2Q 2017 GAAP EARNINGS CALL

Moderator: Scott Beinhacker
August 15, 2017
8:30 a.m. ET

Operator: This is conference #65417011

Operator: Good morning. My name is (Crystal) and I will be your conference operator today. At this time, I would like to welcome everyone to the Syncora Holdings Ltd. Q2 2017 GAAP Financial Results Conference Call. All lines have been placed on mute to prevent any background noise and, after the speakers remarks, there will be a question and answer session.

If you would like to ask a question during this time simply press star then the number 1 on your telephone keypad. Thank you. I will now turn the conference over to Mr. Scott Beinhacker. Please go ahead.

Scott Beinhacker: Good morning, and thank you for joining us today for our second quarter 2017 consolidated GAAP financial results investor call. I'm Scott Beinhacker, the Head of Investor Relations at Syncora. As a reminder, please feel free to reach me by phone at 212-478-3400 or by email at investorrelations@scafg.com.

Participating with me on the call today are Fred Hnat, our chief executive officer, and David Grande, our chief financial officer.

Before I turn the call over to my colleagues, I will remind everyone that during our call and the Q&A session, management will reference certain documents that we posted after the market closed yesterday to the investor relations section of our website, www.syncora.com specifically, on the investor events page.

These documents, which I hope you have had an opportunity to review, include: the Syncora Holdings Ltd. GAAP consolidated financial statements for the six months ended June 30, 2017, and the associated earnings release, together with a financial highlights deck.

Please note that, as in the past, while we will not be reviewing the presentation slide-by-slide during the call, we will make reference to a number of the slides as we discuss our financial results.

I would also like to remind everyone that during the call and the Q&A session, we may make projections or other forward-looking statements about future results, plans and events. We caution that these forward-looking statements are not a guarantee of future events, and that actual events may differ materially from those in these statements.

These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond the company's control, including, but not limited to, the factors described in our historical filings with the New York State Department of Financial Services and in Syncora Holdings Ltd.'s, Syncora Guarantee Inc.'s, and Syncora Capital Assurance Inc.'s consolidated GAAP and statutory financial statements, as applicable, which are posted on our website.

Forward-looking statements generally can be identified by the use of forward-looking terminology such as, "may, plan, seek, comfortable with, will, expect, intend, estimate, anticipate, believe or continue," or the negatives thereof, or variations thereon, or similar terminology.

You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. The company assumes no obligation to update forward-looking statements, information in the press release, the financial highlights deck or as presented on the call to reflect the impact of circumstances or events that arise after the date that the forward-looking statements are made.

References throughout the call to SHL, SGI, and SCAI refer to Syncora Holdings Ltd., Syncora Guarantee Inc., and Syncora Capital Assurance Inc., respectively, and the NYDFS refers to the New York State Department of Financial Services. Finally, references to numbers on the call are generally stated as approximations.

Lastly, to the extent possible, we have tried to address many of your questions and topics we received since our last earnings call in our prepared remarks. I look forward to receiving your feedback after the call.

And with that introduction, I would now like to turn the call over to our CEO, Fred Hnat.

Fred Hnat: Thank you, Scott and welcome to our second quarter earnings investor call.

We had our investor call on our first quarter 2017 financial results less than two months ago and our annual shareholder meeting two weeks ago, so there is a bit less information to discuss on this call. We are pleased to note the high level of voter turnout for the annual shareholder meeting and thank our shareholders for the strong support for the proposals voted on at the meeting. There are, however, several developments that we want to relay to you today as a means of conveying both the progress we have made on certain fronts and the challenges we continue to face on our key risk remediation efforts.

The **first** of these developments is an update on the progress we have made on our efforts around reinsurance. We have had productive discussions with certain entities that have submitted pricing indications so far and continue to focus on the impact of the proposed transactions on remaining assets and remaining risks, policyholder protections, the ability to make payments on the surplus notes and the increased value to shareholders by virtue of the proposed transaction. No definitive agreement has been reached at this time and, it should be noted, that we can provide no assurance whether one will be reached. It should also be noted that the Company's ability to consummate a transaction, as well as make any payments on surplus notes, would remain subject to the approval of the NYDFS.

The **second** development I want to discuss is our current position with respect to Puerto Rico. In May, the Oversight Board filed a Title III bankruptcy petition for the Commonwealth. Then, in June, the Oversight Board declined to approve the RSA that we and other creditors had negotiated previously despite the benefits the RSA provided to PREPA and the path to a speedy restructuring. As a result, the RSA terminated and the Oversight Board subsequently filed a Title III bankruptcy petition for PREPA.

We are aggressively pursuing enforcement of all of our rights as special revenue bond holders in the PREPA proceeding. We have joined with other creditors in legal actions to enforce our special revenue rights, including a motion to lift the stay to allow bond holders to request the appointment of a receiver and a complaint seeking to compel the turnover of PREPA revenues to bond holders.

We will also be participating in mediation in an attempt to resolve issues related to PREPA and GO bonds without prolonged litigation.

In July, we made large claim payments on our Puerto Rico exposure in the amount of 164.5 million dollars (gross). That payment broke down to approximately 122 million dollars on the GO bonds and 42.4 million dollars on PREPA bonds. However, most of these claims payments were made out of SCAI and are expected to leave SCAI with a large proportion of illiquid salvage assets (for statutory accounting purposes). Given the Title III filings of the Commonwealth, and PREPA, as well as the termination of the PREPA RSA, we do not expect to be in a position to monetize this salvage position in the short-term. This may create a protracted period of time where SCAI has large salvage assets.

The **third** development to discuss is that, this month, we started a process for the sale of American Roads, which, as you know, we obtained coming out of a bankruptcy involving bonds we insured. For GAAP purposes, we consolidated American Roads on SHL's balance sheet. However, for STAT purposes, we currently hold the asset as salvage for our policy claims. As we previously disclosed, we have made changes at American Roads to stabilize the asset and enhance its value and, given the success of our efforts to stabilize the asset and enhance its value, together with the current favorable market for infrastructure assets, we believe that this is a good time to monetize our salvage asset of American Roads.

Finally, in June we spoke about Reliance Rail, one of several credits that constitute our liquidity mismatch, which all face refinancing risks due to a variety of factors including the underlying credit, market conditions or the transaction structure. We reported that there had been activity on the part of the New South Wales Government and Reliance Rail for a refinancing. We also noted this is a complicated credit with potential execution risk and uncertainty remains as to timing for completion of a refinancing.

Later in June, the complexity of this credit manifested in litigation related to the refinancing. Reliance Rail brought suit in the Supreme Court of New South Wales against the trustees for the bondholders seeking a declaration from the court that Reliance Rail is entitled to redeem the bonds prior to their stated maturity dates at the outstanding par amounts without payment of any premium amounts. In late July, Syncora was added as a defendant on matters involving the control rights of the insurers, Syncora and FGIC UK.

This is a well-performing, strong credit, but the complexity of the transaction and divergent interests of the many stakeholders will make the ultimate remediation of this credit difficult. We are working with our advisors in Australia to proactively remediate the exposure.

We are pleased with the progress we have made on American Roads and reinsurance. We believe that the progress on reinsurance and the launch of a sale process for the American Roads asset, together with our ongoing efforts on other fronts, further stabilize the insured portfolio and will have a positive impact on our financial condition, to the benefit of our stakeholders. At the same time, we continue to make every effort to preserve and improve our position on more challenging credits, as evidenced by our stance with respect to PREPA. We will continue to work to unlocking meaningful value for our stakeholders.

Now, I would like to turn the call over to David Grande, our CFO, to discuss our second quarter 2017 financial performance and provide insured portfolio highlights.

David Grande: Thank you Fred. As Scott mentioned, last night we posted to our website our second quarter 2017 GAAP earnings release and consolidated financial statements. In addition, we have posted our financial supplement titled "Second Quarter 2017 Highlights," which we refer to as our financial highlights deck.

I'd like to first start out by describing one change to our second quarter financial statements whereby we've included pro forma information, on a comparative basis, within our consolidated SHL balance sheets, consolidated statements of operations and comprehensive loss and consolidated statements of cash flows.

As Fred just discussed, management, with Board of Director approval, has now committed to a formal plan to sell American Roads. Under the applicable accounting rules the assets and liabilities related to a business classified as held-for-sale are separately reported only in the period in which the business meets the criteria for the held-for-sale classification. Because we met these conditions after June 30, 2017, we have not reflected this classification in the current period as it represents a non-recognized subsequent event. However, because of the significance to our financial statements, we have provided pro forma information which give effect to this presentation as if we met the accounting criteria as of June 30th, 2017.

Under the relevant accounting guidance, we have reclassified, as pro forma, all of the assets and liabilities related to American Roads as "Assets held for sale" and "Liabilities held for sale". In addition, since the disposal of American Roads represents a strategic shift and is expected to have a major effect on SHL's operations and financial results, American Roads is being reported as a discontinued operation within the pro forma consolidated Statements of Operations.

As it relates to our financial results, for the six months ended June 30th, 2017, we had a GAAP net loss attributable to SHL of 69.5 million dollars or a loss of 80 cents per common share, as compared to net income attributable to SHL of 8.5 million dollars or 15 cents per common share for the same period last year. On a pro forma basis, we had a net loss attributable to SHL of 62.6 million dollars or a loss of 72 cents per common share for the six months ended June 30th, 2017, as compared to net income of 8.5 million dollars or 15 cents per common share for the same period last year.

Pro forma net loss was 6.9 million dollars lower than Actual net loss as a result of the reversal of certain deferred tax liabilities on a pro forma basis relating to American Roads. Now that we've committed to a formal plan to sell American Roads, we can better determine the expected timing and manner of recovery of this liability and use it as a source of taxable income.

Non-GAAP operating loss was 33.0 million dollars or a loss of 38 cents per common share for the six months ended June 30, 2017, as compared to income of 81.2 million dollars or 1 dollar and 44 cents per common share for the same period last year. On a pro forma basis, non-GAAP operating loss was 26.1 million dollars or a loss of 30 cents per common share for the six months ended June 30, 2017, as compared to income of 81.2 million dollars or 1 dollar and 44 cents per common share for the same period last year.

A full description of the limitations in using non-GAAP financial measures and the adjustments made to derive our non-GAAP operating income and Adjusted Book Value, is included in the earnings release.

Turning to the drivers of our results, for the second quarter of 2017, our performance was affected by adverse loss developments in Puerto Rico. Between incurred losses of 62.4 million dollars and other temporary impairments on remediation bonds of 7.7 million dollars, Puerto Rico accounted for 70.1 million dollars of losses for the first six months of 2017. Offsetting this adverse loss development on Puerto Rico is 24 million dollars of continued positive reserve developments on our RMBS exposures. For the same period last year, we had net incurred gains of 91.4 million dollars.

Other major drivers for the period included:

First, 27.4 million dollars of net premiums earned, which was slightly higher than last year due to premium accelerations from refundings, partially offset by lower earned premiums as a result of the continued run-off of our book of business. Total premium accelerations were 13.9 million dollars for the six months ended June 30, 2017, as compared to 7.8 million dollars for the same period in 2016.

Second, 3.1 million dollars of mark-to-market gains on our CDS contracts, as compared to 28.4 million dollars of mark-to-market losses for the same period last year. These gains were primarily due to the tightening of collateral spreads, partially offset by lower non-performance risk spreads.

Third, lower operating expenses mainly as a result of headcount reductions since last year. For the six months ended June 30, 2017, operating expenses were 31.3 million dollars, as compared to 44.2 million dollars for the same period last year. This represents a 29 percent reduction.

And **Fourth**, interest expense, which includes both non-cash accretion on SGI’s surplus note balance and the accrual of interest increased by 2.5 million dollars to 42.6 million for the six months ended June 30, 2017 from 40.1 million dollars for the same period last year. In addition, as we discussed on our last call, on June 14th, the New York Department of Financial Services approved a net payment of 27.5 million dollars on SGI’s surplus notes which wasn’t paid until July 24th and therefore not reflected in our second quarter financial results. Had this payment been made prior to June 30th, 4.3 million dollars of this payment would have been allocated to the Note Payable balance and the accrued interest liability would have been reduced by 23.2 million dollars.

As shown on slide 9 of the financial highlights deck, SHL's common shareholders' equity decreased from year end 2016 by 48.0 million dollars to 476.7 million dollars, or 4 dollars and 10 cents of GAAP book value per common share as of June 30, 2017. On a pro forma basis, SHL's common shareholders' equity decreased by 41.1 million dollars to 483.6 million dollars, or 4 dollars and 18 cents of GAAP book value per common share. This was primarily driven by the items I just discussed on the consolidated statements of operations. Similarly, SHL's adjusted book value decreased by 48.1 million dollars to 436.0 million dollars, or 5 dollars and 2 cents per common share and, on a pro forma basis, the decrease to adjusted book value was 41.2 million dollars to 442.9 million dollars, or 5 dollars and 10 cents per common share.

I'd like to now cover some highlights of our insured portfolio. As outlined on slides 11 and 12 of the financial highlights deck, for the six months ended June 30th, SHL reduced its total net par exposure by 3.4 billion dollars or 17 percent, to 17.0 billion dollars. The reduction in total net par exposure was driven mainly by 2.8 billion dollars in public finance refundings, 506 million dollars in amortizations, and 368 million dollars in terminations and commutations. This reduction in net par outstanding was also partially offset by a 279 million dollar increase as a result of the weakening U.S. dollar. The average internal rating of our portfolio was unchanged from year end 2016 at bbb+, and total credit count decreased 22 percent from 819 credits as of December 31, 2016 to 639 credits as of June 30, 2017.

Our below investment grade credits, or BIG exposures, were 2.4 billion dollars, or 14 percent of Syncora's total insured portfolio as of June 30. In addition, our BIG flag list leverage ratio, as shown on slide 15 of the deck and defined as our BIG exposure divided by our claims paying resources, decreased by 8.3 percent in total, which was driven by decreases in BIG exposures at SCAI.

With that, let me turn the call back over to Scott for a brief question and answer period.

Scott Beinhacker: Thank you, David. With that operator, let's open the call to questions. Operator, would you please provide instructions for those analysts on the call?

Operator: At this time, if you would like to ask a question, please press Star followed by 1 on your telephone keypad. You're the first question comes from Andrew Gatlin of Odeon Capital.

Andrew Gadlin: Hey, good morning and thank you for taking my question. I wanted to drill down into the American Roads sale. If you could talk a little bit about the considerations of the Board in leading up to this decision, whether the DFS needs to approve it, and how you're going to run the process, who the advisor is, etcetera?

Fred Hnat: Thank you, Andrew. Appreciate the question. As we noted, we've been working to stabilize American Roads as an asset, enhance its value and position it for sale. The NYDFS's consent is not required for us to sell American Roads. Our board took into account a variety of considerations in making the decision to move forward.

One being the work that we had done to position the asset and get it to this point where we feel comfortable launching a sale process. I would note that we hired an advisor, Evercore, a firm with extensive experience in this space to review strategic options and present those to management and to our Board.

And, also the market conditions that exist currently for assets of this type are very favorable. So, a combination of factors that we feel made this a compelling move for Syncora.

Operator: Your next question comes from the line of Rob Halder with Nat Alliance Securities.

Robert Halder: Good morning, guys. Thanks for taking the question. I actually have two. First is more of a scheduling thing. I noticed that there really was an accelerated filing process this quarter. I'm curious is that a onetime thing, do you guys plan to report this way going forward? And then I have a follow up to that.

David Grande: Sure, I can take that first question. Rob, I can just talk a little bit about that process. As you picked up on, over the last year or so the Company has been working extremely hard to accelerate our closing process especially as it relates to our GAAP books and records.

As you're aware on a statutory basis we continue to be required to file our quarterly statements 45 days after a period ends and then 60 days after year-end on an annual basis -- so, for our annual statements. But on a GAAP basis, this quarter really represents the earliest that we've completed and posted our financial statements in quite some time.

We continue to be focused on improving our transparency, including within our financial statement disclosures. And I would put the timing of the issuance of our financial statements under that bucket as well. But really, it hasn't been an easy process to be honest, especially in light of the headcount reductions over the last year. This required us basically to reengineer most aspects of our GAAP closing process, including our control environments.

But our intention is to maintain this same timing for the quarters going forward, and then to improve our timing for this year end, as well. So hopefully that answers your question.

Robert Halder: It does, thank you. I guess the second question I have -- I noticed during the quarter the cash at SCAI had risen to above $200 million, and I'm assuming that is for the July 1 Puerto Rico payments. And I'm wondering, first of all, if you can confirm that and second of all, if you had any thoughts given the fall away of the PREPA RSA and the receiver hearing after the end of the quarter.

David Grande: Yes, I'll take the first part of that.

Robert Halder: Sure.

David Grande: That's accurate. We were repositioning the portfolio in preparation for the July 1 claims payment. As Fred mentioned, most of those payments are coming out of SCAI and that's what you're seeing on the balance sheet.

Fred Hnat: Yes, so Rob, hi, thanks for the question about Puerto Rico. Going back to the early part of the summer, after the Oversight Board's disappointing decision not to approve the PREPA RSAs, the Oversight Board filed a Title III petition on behalf of PREPA.

Then PREPA failed to make its July 1st debt service payment. For us, that meant a $42 million claim under our PREPA insurance policies. So, when the RSA was rejected, all the contractual rights that we and the other creditors had negotiated weren't implemented. Obviously, we weren't pleased with that development because without the RSA in place, there's uncertainty as to PREPA's operations and the effect on our interests.

So we've joined with other creditors now in legal actions that would permit bond holders to lift the automatic stay, to request appointment of receiver, and that motion was heard by the bankruptcy court last week and all parties are awaiting decision on that.

We've also joined with other creditors in filing a complaint to compel the turnover of PREPA revenues to bond holders during the Title III case. So all these lawsuits that we're a part of are necessary to preserve our interests with respect to the bonds we've insured.

And this is going to be a long process, we think. We're disappointed that the Oversight Board made the decision not to approve the RSA because that would have been a speedier process, one in which creditors had made significant concessions. But now we are forced into a position of having to enforce our rights under the original transaction.

So I hope that's helpful. Is that …

Robert Halder: Yes, that helps me. Thank you very much.

Operator: We have a follow up question from the line of Andrew Gadlin with Odeon Capital Group.

Andrew Gadlin: Hey, sorry, I think something went wrong with my phone. So I wanted to ask a follow up question on the American Roads sale. There is -- we can see that on a GAAP basis the carrying value for the asset is about $170 million on a net basis. Would you say that it's something similar on a statutory basis as well?

David Grande: The statutory carrying value is higher than the GAAP carrying value. Under GAAP, we consolidate the balance sheet of American Roads. Under STAT, we use a discounted cash flow methodology to come up with what we believe the salvage value to be. So that value is higher on a statutory basis.

Andrew Gadlin: Got it. And so presumably you're using the roughly 5 percent discount rate that you use for all cash flows under the STAT methodology?

David Grande: That's correct because we classify it as a salvage asset, which is part of the loss -- the loss accounts. All of the numbers that go through there are discounted at our statutory discount rate.

Andrew Gadlin: Got it. And then, in terms of the loss reserve taken this quarter was $42 million on a net basis, we saw about $17 million of losses on the uninsured cash flow certificates. Does that match up dollar for dollar in losses, meaning if there's $17 million loss on UCF then that means that there's basically 17 million of gain in loss reserves?

David Grande: Those don't match up dollar for dollar. The ICF represents the amount of exposure that we've remediated. So had we remediated 100 percent of all those exposures then it, in theory, would be very close to matching up. There's some discounting going on, difference is in the discounts but because it's not 100 percent remediated there is breakage between those two accounts.

Andrew Gadlin: So in other words, there was even more gain than that kind of $17 million number on the RMBS loss reserves?

David Grande: The loss reserves are higher, so that's correct, yes.

Andrew Gadlin: So the gain's higher there, which means that we know that the $42 million net was driven by Puerto Rico, does that mean that there's something on the order of magnitude of about $60 million of loss reserves taken for Puerto Rico taken this quarter?

David Grande: We can't confirm that. But as we said, there are higher losses for Puerto Rico offset by gains on -- for positive RMBS developments.

Andrew Gadlin: So I know there's a low probability you can answer this but in the past you've talked about what level loss reserves you've taken for, let's say, PREPAs and GOs. Is there any way you'd be willing to disclose that today?

David Grande: Yes, we can't comment on that at this moment.

Andrew Gadlin: I had to try. Thanks very much guys.

David Grande: All right, thank you, Andrew.

Fred Hnat: Thanks, Andrew.

Operator: At this time, there are no further questions. I will now turn the call back over to Mr. Scott Beinhacker for any additional or closing remarks.

Scott Beinhacker: Thank you operator, and thanks everyone for joining us on the call. I hope you found it helpful. We look forward to talking to you again next quarter. In the mean time, if you have any questions at all, and as a means of continuing our dialogue, please feel free to reach out to me 212-478-3400 or through our dedicated investor relations email, (investorrelations@scafg.com).

A transcript and replay of this call will be available on our website later today. Thank you all for listening.

Operator: This concludes today's conference call. You may now disconnect.

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