SYNCORA HOLDINGS LTD.
YEAR-END 2017 CONSOLIDATED GAAP EARNINGS CALL

Moderator: Scott Beinhacker
March 28, 2018
8:30 a.m. ET

Operator: This is conference #737-7329

Operator: Good morning. My name is Marianna and I will be your conference operator today. At this time, I would like to welcome everyone to the Syncora Holdings Ltd. Year-End 2017 consolidated GAAP Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. 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. If you would like to withdraw your question, press the pound key. Thank you. I would now like to turn the call over to Mr. Scott Beinhacker, Head of Investor Relations.

Scott Beinhacker: Good morning, and thank you for joining us today for Syncora Holdings Ltd. Year-End 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, syncora.com specifically, on the investor events page.

These documents include: the Syncora Holdings Ltd. consolidated GAAP financial statements as of December 31, 2017 and for the year ended December 31, 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 and Syncora Guarantee 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 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.

I would now like to turn the call over to our CEO, Fred Hnat.

Fred Hnat: Thank you, Scott and good morning everyone.

As you have seen from the press releases we have issued since our last earnings call, we have had a very busy and productive last few months. We have made major advances on our previously-mentioned strategic initiatives around risk reduction and asset monetization in furtherance of our goal to return value to stakeholders. On this call, we would like to provide details on positive events that have occurred since our last call in November, as well as update you on developments in some of our ongoing initiatives and projects. Although some of the events I will mention have already been described in press releases, they bear mentioning again on this call.

First, and perhaps foremost in people's minds, I want to mention the reinsurance deal we recently announced. On February 2nd, we entered into a reinsurance framework agreement with Assured Guaranty Corp. that provides the terms of a reinsurance arrangement between us, the closing of which is subject to several conditions precedent, including regulatory approvals and consents from certain third parties. Pursuant to the agreement, Assured Guaranty agreed to provide reinsurance to SGI, generally on a 100% quota share basis, on approximately 13.5 billion dollars of net par outstanding of SGI-insured financial guaranty insurance policies, which represent approximately 91% of SGI's outstanding insured exposure as of December

31, 2017. As consideration for the transaction, SGI would pay approximately 360 million dollars (which amount includes material ceded reserves) and assign over future installment premium for the reinsured policies. From a value point of view, once these reserves are excluded from the premium paid, the rate on-line is very beneficial to Syncora. There are, notably, some credits not included in the reinsurance transaction that, pursuant to our mutual agreement with Assured Guaranty, will remain on Syncora's books. In connection with the reinsurance arrangement, SGI would also enter into an administrative services agreement with Assured Guaranty pursuant to which Assured Guaranty would provide certain administrative services with respect to the reinsured policies, for a fee. We continue to believe value is provided by: capping a substantial portion of our future liabilities and reducing our overall risk profile; the potential for future distributions on our outstanding securities; and the continued reduction to operating expenses. I believe it is important to note that we are confident the agreement reached with Assured Guaranty will deliver in all respects.

Next, I would like to mention the settlement of one of our larger litigation matters. In late December, US Bank, Syncora and GreenPoint Mortgage Funding, Inc. reached a settlement over a long-standing dispute relating to a 2006 GreenPoint transaction. As a result of the settlement, Syncora received approximately 335 million dollars in January, with an additional present value of 15 million dollars expected to be received over the remainder of the transaction, based on the performance of the assets remaining in the related trust. As the amount received by SGI is in excess of the amounts carried primarily as salvage and subrogation recoverable on SHL's consolidated GAAP financial statements, this settlement increased SHL's 2017 GAAP net income by approximately 283 million dollars. The financial effects of this settlement and other related disclosures are described in SHL's year-end 2017 consolidated GAAP financial statements posted to our website last night and SGI's statutory-basis financial statements included in its Annual Statement filed with the NYDFS in February. This large influx of capital further stabilizes the Company's financial position and provides another step forward on our strategic initiatives. As you can imagine, we are very pleased to have concluded this litigation on such favorable terms.

Another litigation matter I would like to briefly mention is our suit against Macquarie. Although we cannot speculate on the ultimate timing or outcome of the case, a court date was set for July of this year to begin proceedings in a jury trial.

The next favorable event to discuss is the successful refinancing of Reliance Rail--another very positive development for the company. As we announced last year, with the completion of the refinancing, a significant credit risk in our portfolio was eliminated along with the majority of our liquidity mismatch risk that we have discussed on prior calls. The refinancing was also an important step in facilitating the previously mentioned reinsurance transaction.

As we announced in early January, on December 31st, we successfully completed the merger of SCAI with and into SGI. The merger helped address potential liquidity issues at SCAI, with no additional risk to SGI, while providing a more efficient organizational structure at Syncora as a whole. We believe the merger was a logical next step and will help drive greater value for our stakeholders through the increased stabilization of the platform, as well as an associated decrease in operating expenses.

And finally, I am pleased to report that we have reached an agreement with Dan Gilbert's real estate firm, Bedrock, to partner in redeveloping the police headquarters asset in Detroit. As you may recall, Syncora's wholly owned subsidiary Pike Pointe acquired the option, along with several other assets, as part of the bankruptcy settlement with the city of Detroit. With this partnership, we are excited to play a positive role in the revitalization of Detroit while, at the same time, bringing further value to our stakeholders. We expect to include the effects of this agreement in the Q1 2018 financial statements. We also continue to finalize partnerships to develop the other assets received in connection with the bankruptcy settlement with the city of Detroit.

I would now like to update you on the progress we are making on some of our other strategic initiatives.

In addition to those positive agreements reached in the last few months, we continue to progress the sale of our American Roads asset. From our first round of bids, we reduced the number of potential bidders to a smaller group to whom we provided additional diligence information. We are currently entertaining bids from members of that smaller group and will review them internally and with our external advisors to determine which bid is the most attractive. We expect to conclude the bidding process in the second quarter of this year and hope to finalize the sale before the end of the third quarter. In addition, in November 2017, the Mayor of Orange Beach announced an initiative that would include a potential new non-tolled bridge approximately one mile to the west, which we expect may impact the ultimate price paid by a bidder for American Roads.

Puerto Rico remains a large focus for Syncora. Although our overall assessment that the situation on the island will be developing over an extended period of time remains unchanged, there is one recent development I would like to mention. On February 2nd, the Financial Oversight and Management Board petitioned the Court to gain permission to seek financing from the Commonwealth through a priming DIP loan. In response, Syncora joined with an ad hoc group of bondholders to offer competing financing that prevented the Commonwealth from making a priming lien. This attempt to supersede Syncora's position in the payment hierarchy is an example of the continued need for vigilance in protecting the interests of our stakeholders. That being said, we remain cognizant of striking the proper balance between protecting our rights and the basic humanitarian concerns in Puerto Rico. Syncora remains fully prepared to work hand-in-hand with the Commonwealth, PREPA, and other creditors to resolve the numerous issues facing the island.

Another area where we have made a great deal of progress and where we think we can continue to make progress is the reduction in the level of our operating expenses. We are very conscious of the need for ongoing and regular assessment to find the proper balance between costs and the expenses necessary to advance on the company's objectives. To that end, in 2017 we reduced consolidated operating expenses by 37%, as compared to 2016. As we continue to deliver on our strategic initiatives, we will continue to focus on reducing operating expenses by evaluating them to ensure that our operations remain as cost-effective while still maintaining a high level of performance.

Lastly, Syncora continues to hold a significant amount of net operating losses (or NOLs) and we continue to review the merits of different businesses to potentially utilize this asset. As we are still in the exploratory phase, we are not in a position to provide specific details but are considering a number of different areas – including asset management – that would enable us to use existing resources in a cost efficient manner. Any new venture would be evaluated on its own merits and the opportunity to offset any related income against NOLs would be considered an added advantage. In connection with any new business effort, it is expected that we would look to work with our current stakeholders and others both for feedback and to provide or raise capital that could be deployed in such an effort.

A year ago, we set forth specific strategic initiatives. Our record of success over the past 12 months is evidence of our commitment to delivering on those initiatives and, thereby, our dedication to creating value for our stakeholders. The recently signed reinsurance framework agreement, the GreenPoint settlement, and the refinancing of Reliance Rail, as well as other positive developments in our strategic initiatives have all done this while further stabilizing our financial position. While the 4th quarter of 2017 was a very busy time, including another 27.5 million dollar payment to our surplus noteholders, we still have significant goals to accomplish. We will continue working diligently to maintain our positive momentum as we move to deliver on our other strategic initiatives, including the sale of American Roads and, potentially, the use of our NOLs.

With that, I would like to turn the call over to David Grande to discuss our year-end 2017 financial performance and provide insured portfolio highlights.

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

As Fred just finished discussing, the many successes with respect to our strategic initiatives have resulted in improvements to our financial performance for the year. For the year ended December 31, 2017 we had GAAP net income attributable to SHL of 133.5 million dollars or one dollar and 54 cents per common share, as compared to 32.7 million dollars or two dollars and 18 cents per common share for the same period last year. For purposes of our earnings per share calculation for the 2016 period, we included 115.2 million dollars which related to the extinguishment of the Series A perpetual non-cumulative preference shares at that time.

As I discussed on last quarter's earnings call, we classify the American Roads entity as held for sale on the Consolidated Balance Sheets, and as discontinued operations within the Consolidated Statements of Operations. The income from discontinued operations of 12 and a half million dollars is included in the net income attributable to SHL of 133.5 million dollars.

Non-GAAP operating income was 148.3 million dollars or one dollar and 71 cents per common share for the year ended December 31, 2017, as compared to income of 150.9 million dollars or 2 dollars and 22 cents per common share for the same period last year.

The excellent results for the year also significantly improved our non-GAAP adjusted book value per share. As of December 31, 2017, adjusted book value per common share increased by 1 dollar and 43 cents from 5 dollars and 59 cents as of December 31, 2016 to 7 dollars and 2 cents as of December 31, 2017.

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 year-ended December 31, 2017, the main positive development, as Fred just discussed, was the settlement of the GreenPoint litigation. Overall, this settlement resulted in a benefit of approximately 283 million dollars for the year. I should also note that although we reflected the benefit of this settlement through our 2017 insurance accounts, since the 335 million dollars of related cash was received in January of this year, the cash will be reflected in our first quarter 2018 balance sheet.

Other significant drivers for the year included:

First, 51.1 million dollars of net premiums earned, which was lower than last year as a result of lower premium accelerations and from the continued run-off of our book of business. Total premium accelerations were 24.8 million dollars for the year ended December 31, 2017, as compared to 43.2 million dollars for the same period in 2016.

Second, 59.7 million dollars of mark-to-market gains on our CDS contracts, as compared to 56.4 million dollars of mark-to-market losses for the same period last year. These gains were primarily due to higher non-performance risk spreads primarily as a result of Puerto Rico adverse developments.

Third, interest expense, which includes both non-cash accretion on SGI's surplus note balance and the accrual of interest increased by 16.7 million dollars to 88.5 million dollars for the year ended December 31, 2017 from 71.8 million dollars for the same period last year. In addition, on December 28th we made a net 27 and a half million dollar surplus note payment which reduced accrued interest by 23.3 million dollars and principal by 4.2 million dollars. As of December 31, 2017, total surplus note obligations, including principal and accrued interest was 805.5 million dollars.

And Fourth, lower operating expenses mainly as a result of headcount reductions since last year, as well as the 2016 restructuring-related costs that did not recur in the current year.

As I just discussed, Income from discontinued operations represents the results of American Roads which was 12 and a half million dollars for the year ended December 31, 2017 as compared to 13.0 million dollars for the same period last year.

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 year ended December 31, 2017, SHL reduced its total net par exposure by 5.6 billion dollars or 27 percent, to 14.8 billion dollars. The reduction in total net par exposure was driven mainly by 3.6 billion dollars in public finance refundings, 811 million dollars in amortization, and 1.8 billion dollars in terminations and commutations, which includes Reliance Rail. This reduction in net par outstanding was also partially offset by a 560 million dollar increase as a result of the weakening U.S. dollar and 148 million dollars of accretion. The average internal rating of our portfolio was bbb+, unchanged from year end 2016, and total credit count decreased 40 percent from 819 credits as of December 31, 2016 to 495 credits as of December 31, 2017.

Our below investment grade credits, or BIG exposures, were 1.2 billion dollars, or 8 percent of Syncora's total insured portfolio as of December 31, 2017. 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 51.0 percent in total.

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, I'd like to remind everyone in order to ask a question please press star and then the number one on your telephone keypad. Your first question is from Rob Halder with NatAlliance. Your line is open.

Rob Halder: Good morning, guys. Couple of questions on your pro forma retained portfolio. In the additional information that you guys posted to your website, you have comments on reserves or your level of reserves for Puerto Rico, Detroit, CDOs, that kind of thing, I am wondering for the balance of that retained portfolio, what was the thought process behind what was left or what will be left behind: is it a difference in reserve estimates between you guys and Assured or is there some other is there something else?

Fred Hnat: Good morning, Rob, it's Fred Hnat. The retained portfolio that you are referring to was a negotiated list of credits, just one aspect of a much larger negotiation that we had in negotiating reinsurance. It is not unusual in a large treaty like this to have certain credits that do get held back. We can't speak to whether Assured would or would not have reserved on those credits where we don't have reserves on the list. We are all subject to the same accounting guidance, but we all have, we each have our own loss models. Assured has theirs, we are not privy to it, but this was part of a negotiated vetting of different credits and it ended up being, in my judgement, a very modest list of just over a billion dollars net par outstanding out of a ceded pool of about 13.5 billion.

So, there were certain reasons specific to Syncora where it didn't make sense for us to reinsure. I can speak to those. There are certain credits that are in salvage mode, which means we paid claims on those and now have rights to reimbursement so we obviously wouldn't want to trade away those rights to reimbursement. There are also a few credits where we expect a refunding in the near term, so it didn't make sense not to pay for reinsurance on those credits. At the end of the day, we are very comfortable with the credits we have retained, the level of reserves we have on those that is referenced. I should also mention a very strong leverage ratio once we come out on the other side of having actually closed the reinsurance transaction.

Rob Halder: Thanks, Fred. Just to follow up on that. The largest remaining exposure looks like that large PFI PPP exposure…could you give us any info on that line item...is it one credit is it multiple credits?

Fred Hnat That's one credit. It's a UK PFI transaction, a hospital deal called Newcastle Hospital which is in Northern England. It's a private finance initiative deal that closed back in 2004, 2005. It's an availability based credit, so there's a government funded trust that makes payments on the debt so long as some operating company makes the project available for public use.

There was some noise around Newcastle hospital three or four years ago there was some litigation involving the construction of something called the clinical office block. That got settled. Construction is complete now. We've gotten through, I guess, the most difficult phase of the transaction from credit standpoint. It's a performing credit. It's an essential infrastructure project in the U.K., and we're comfortable that, that will continue to perform.

Rob Halder Got you. Thanks for the clarity on that. And then just timing of that reinsurance transaction. What's timing if I missed it in your prepared remarks or what's the update on timing of the arrangement of the transaction?

Fred Hnat Say 2 to 4 months, Rob. The documents are fully negotiated. All the hard work and labor has been done there. We are in the process of nailing down conditions precedent.

We submitted an approval request to the NYDFS in back in February. And we have been advised to expect for something of this magnitude, this large portfolio transfer, anywhere from 2 to 4 months to get an approval from the Department. But we also have some consents that we need to get from third-party stakeholders, which we think is achievable in the same time frame.

So once we get the NYDFS approval and the various consents that we need to get, we should be ready to go live with Assured on the reinsurance and begin transitioning administrative functions under an administration services agreement that we have -- that we will have with them.

Rob Holder Got you. And then the last question from me is your Puerto Rico exposure. Obviously, Puerto Rico bonds over the last little bit have rallied with the new fiscal plan. Does that have any impact on your remediation strategy on the way you are reserving for it -- how are you thinking about that given where the market has gone to?

Fred Hnat: Certainly, good news from a credit standpoint. And we follow the market very closely. We always look for opportunities in the market to purchase Syncora-insured bonds at attractive discounts. But I wouldn't say that the rally that we've seen this week affects our remediation strategy in any respect.

We tend to think of remediation that's involving things like litigation, working with other creditors to come up with creative restructuring and refinancing solutions like we did on the DIP loan that I referenced earlier. The DIP loan wasn't accepted, but it helped strike down the priming loan that the Commonwealth had proposed.

As far as reserves are concerned, we model out a number of different scenarios, including a stress case, and we look at a number of factors and bond prices are one of the factors that we refer to, and, as a result, feel very well and very appropriately reserved on Puerto Rico, the various credits that we insured there.

Rob Holder: Thank you, guys. Thanks, Fred. And I will hop back.

Operator: Your next question comes from Andrew Gadlin from Odeon Capital.

Andrew Gadlin: Hi, guys, good morning. Along those lines, in terms of the reinsurance agreement, one of the key provisions is your ability to pay down $400 million of surplus notes, any word on timing when you will hear back from the department on that?

Fred Hnat: Hi, Andrew. The $400 million is a condition precedent to the agreement. So it's sort of baked into the same approval process that we’ve got with the department. So the same -- sort of 2 to 4 months is our best estimate of timing.

Andrew Gadlin OK. Great. Thanks. On the Detroit deal that you announced, Fred, I know you have a couple of other assets. So the first question would be a little more color on the magnitude of this deal, dollars amount, what the plans are for the property and could this become meaningful, how meaningful, I guess, is the question. And then the second question is what else do you have that you're working on in Detroit?

Fred Hnat We are under confidentiality on the purchase price of that recent transaction at police headquarters, Andrew can discuss that detail. There are other properties up there that we have development rights with respect to and we're working on them now.

Those properties have termination dates related to timing for when we -- when we're able to exercise those rights. And we're -- all I can say is we're working on them now. I think in terms of materiality, these things are not material to our financial condition.

They're helpful and we're happy to be sort of closing the chapter on our Detroit exposure, but these are not things that are going to move the needle significantly on our financial position.

Andrew Gadlin Got it. Thank you very much.

Fred Hnat Thank you, Andrew.

Operator: There are no further questions at this time. I'll now turn the call back over to Scott Beinhacker.

Scott Beinhacker: Thank you operator, and thanks everyone for joining us on the call. We look forward to talking to you again after the release of our Q1 2018 financial statements. In the meantime, if you have any questions at all, 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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