SYNCORA HOLDINGS LTD.
Q3 2018 CONSOLIDATED GAAP EARNINGS CALL

Moderator: Scott Beinhacker
November 15, 2018
8:30 a.m. ET

Operator: Good morning, my name is Jamie and I will be your conference operator today. At this time, I would like to welcome everyone to the Syncora Holdings Ltd. Q3 2018 GAAP Financial 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 one on your telephone keypad. If you would like to withdraw your question press the pound key. Thank you.

Thank you. Scott Beinhacker, you may begin your conference.

Scott Beinhacker: Good morning and thank you for joining us today for the SHL Q3 2018 consolidated GAAP financial results investor call. I'm Scott Beinhacker, the Head of Investor Relations at Syncora.

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 September 30, 2018 and for the nine months ended September 30, 2018, the associated earnings release, together with the 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.

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 and SGI refer to Syncora Holdings Ltd. and Syncora Guarantee 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.

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, everyone, to our third quarter 2018 earnings investor call.

I would like to provide an update on our activities year-to-date and to also provide some details on our efforts towards achieving our ongoing strategic objectives before turning the call over to our CFO, David Grande, who will update you on our financial position.

As you will recall, when talking about the priorities for Syncora, we have discussed: de-levering Syncora's overall capital structure, de-risking SGI's insured portfolio, asset monetization, reducing operating expenses and planning for our next phase.

De-levering of the Company by reducing the amount of debt outstanding remains a major priority for the Company. Under the terms of our surplus notes, we are required to request a surplus note payment of at least approximately one hundred and forty million dollars, which is the entire past due amount along with what is currently owed on the long term and short term surplus notes for the payment due in December 2018. I am very pleased to report that the New York Department of Financial Services has just approved a payment of two-hundred and seventy-five million dollars, to be paid pursuant to the terms of the surplus notes in December 2018. This second sizable payment on the surplus notes this year greatly furthers our goal of de-levering and simplifying Syncora's overall capital structure. On a pro forma September 30, 2018 basis, after the payment in December, there will be approximately one-hundred and sixty million dollars of principal and accrued interest outstanding on Syncora's surplus notes.

On last quarter's earnings call in August, we described to you the successful completion of our efforts to reinsure approximately 90% of our insured exposure to Assured Guaranty Corp. Notwithstanding that success, we continue to look for opportunities to further de-risk the Company's insured portfolio. To that end, we are continuing to work on possible ways to reduce our exposure with respect to those credits not reinsured to Assured – including commutations, reinsurance and other hedging strategies. Among the retained portfolio, we have had recent success in commuting a 100 million dollar international power and gas exposure after the end of the third quarter. We also view the recent proposed settlement reached by Puerto Rico with respect to the COFINA bonds and the recent increase in bond prices for Puerto Rico general obligation bonds as an indication of overall improvement for our Puerto Rico exposures.

To improve our financial position, we continue our successful efforts to work opportunistically to convert to cash more non-core and illiquid assets on our balance sheet. In July, we announced the closing of the sale of American Roads LLC for a cash consideration of approximately 220 million dollars, which you will see reflected on this quarter's financial statements. As was disclosed in court filings, we sold reimbursement claims related to prior payments on Puerto Rico general obligation bonds on terms that were undisclosed due to confidentiality provisions in the related documentation, thereby reducing our overall exposure to Puerto Rico obligations. I am also pleased to announce that we have settled our litigation with Macquarie Capital (USA) Inc. The terms of this settlement are confidential. We will continue our asset monetization strategy to further strengthen our balance sheet which, we believe, puts the Company in a better position to return value to our stakeholders.

We continue to focus on ways to reduce our operating expenses on a run rate basis. We are making steady progress in transitioning certain administrative responsibilities of the reinsured policies that Assured Guaranty will now administer as part of our reinsurance transaction that closed in the second quarter. This work is a part of our continued efforts to drive operational efficiencies throughout our Company and realize the expense reductions, related to staff, office space, compensation and benefits.

Over the past several months, we met with or spoke to holders of a majority of our common stock, Twin Reefs preferred and surplus notes as part of our ongoing shareholder engagement process. We have heard a range of views on

Syncora's strategic direction, including about the potential effect on stakeholder value from a business focused on investments in CLO equity.

We are sharing the feedback we have received with the Board as it determines the optimal path forward. Over the next several months, the Board will meet to consider the feedback we have received as well as our strategic options and we expect to provide an update on our strategic direction no later than our next earnings announcement which is in March 2019. No final decisions have been made at this time. As we have said in the past, we are in an exploratory phase, the Board is considering all options and all options are still on the table as we evaluate the possibilities. We will continue to proactively communicate with our stakeholders throughout this process.

As I have just described, we continue to make large strides in our various efforts to create value for our stakeholders and believe that we have been successful at doing so in the last year. In looking at our stock price over the last year, it has nearly doubled in that time period. As with monoline insurers generally, the share price of our common equity trades at a discount to our adjusted book value, but it is worth noting that today our discount is less than that of all the other public monolines. Those two facts, together with the six-hundred seventy-five million dollars of payments we will have made to third party surplus noteholders in 2018, show that our strategic efforts have created significant value for stakeholders.

I am very pleased to report all the progress we have made, and especially the just-approved surplus note payment for December 2018. I will continue to work with our outstanding team at Syncora on the initiatives I just described and update you on further developments.

With that, I would like to turn the call over to David Grande to discuss our third quarter 2018 financial performance and provide insured portfolio highlights.

David Grande: Thank you Fred. As Scott mentioned, yesterday after the market closed we posted to our website four documents: our third quarter 2018 GAAP earnings release, SHL's consolidated GAAP financial statements, our financial highlights deck and SGI's statutory-basis Quarterly Statements as of September 30, 2018.

Jumping right into our results, for the nine months ended September 30, 2018 we closed the period with a GAAP net loss attributable to SHL of 19.3 million dollars or a loss of 22 cents per common share, as compared to a net loss of 125.7 million dollars or 1 dollar and 45 cents per common share for the same period last year.

Non-GAAP operating loss was 11.7 million dollars or a loss of 13 cents per common share, as compared to a loss of 123.5 million dollars or a loss of 1 dollar and 42 cents per common share for the same period last year.

Non-GAAP adjusted book value per common share was 6 dollars and 3 cents as of September 30, 2018 as compared 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 loss and Adjusted Book Value, is included in the earnings release.

Two of the more significant drivers of our results this period include:

First, the closing of the sale of American Roads on July 16th. The gain on the sale was 64.4 million dollars and is consistent with the amount I disclosed on last quarters' earnings call. This gain is included in the caption "income from discontinued operations" on the Income Statement.

And second, net recoveries, including loss adjustment expenses, are reflective of public finance positive developments in the third quarter, including the effect of the sale of reimbursement claims related to prior payments on Puerto Rico General Obligation bonds as Fred already mentioned.

Other highlights worth mentioning include:

First, net premiums earned of 26.1 million dollars for the nine months ended September 30, 2018, which was lower than the 38.6 million dollars of net premiums earned for the same period last year primarily as a result of higher premiums ceded of 5.1 million dollars and lower earned premiums from the continued run-off of our book of business. Total premium accelerations decreased by 4.2 million dollars to 15.7 million dollars for the nine months ended September 30, 2018.

Second, net investment income decreased by 2.9 million dollars from 34.0 million dollars for the nine months ended September 30, 2017 to 31.1 million dollars for the nine months ended September 30, 2018. The decrease was primarily due to lower income on remediation bonds as compared to the prior period.

Third, 25.5 million dollars of mark-to-market losses on our CDS contracts, as compared to 45.6 million dollars of mark-to-market gains for the same period last year. The decrease was primarily due to the accounting effects of entering into the reinsurance agreement with Assured Guaranty Corp. and lower non-performance risk spreads.

Fourth, as discussed last quarter, we recorded a 91.4 million dollar loss on debt prepayment as a result of the payment made on SGI's long-term surplus notes in the second quarter which have not yet been fully accreted to par. The total payment made last quarter was 400 million dollars. As a result of the recent approval by the NYDFS of a two-hundred seventy-five million dollar payment for December as Fred mentioned, we would expect another loss on debt prepayment in the fourth quarter.

And **lastly**, even though we've implemented significant cost reduction initiatives, operating expenses were slightly higher as compared to the same period last year primarily as a result of expenses incurred in connection with the reinsurance agreement.

Also, it is worth noting that subsequent to quarter close, the company entered into a transaction for the sale of the majority of its private equity investment program for approximately 33 million dollars which is the carrying value at September 30, 2018. The private equity program began in 2015 and was established primarily to enhance our asset and liability management for longer dated liabilities. The sale is expected to close during the fourth quarter.

Moving on to our retained insured portfolio, and as outlined on slides 11 and 12 of the financial highlights deck, as of September 30, 2018, SHL reduced its total net par exposure by 13.8 billion dollars, to 1.0 billion dollars primarily as a result of the reinsurance cessions to Assured. Post-reinsurance, the average internal rating of our retained portfolio was bb, which is lower than the bbb+ from year end 2017, and total credit count decreased from 495 credits as of December 31, 2017 to 20 credits as of September 30, 2018. I should note that these amounts do include a 100 million dollar international power and gas exposure that was commuted after September 30th, so the effects of that transaction will be reflected in our fourth quarter reporting.

Our below investment grade credits, or BIG exposures, were 0.5 billion dollars as of September 30, 2018, a reduction of 0.7 billion dollars from year end also primarily as a result of the reinsurance agreement. 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 significantly by 39 percent in total to 0.43 as of September 30, 2018. In addition, 5 percent and 0.09 of this decrease to our BIG flag list leverage ratio has taken place post-reinsurance.

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 press star then the number one on your telephone keypad.

Your first question comes from Andrew Gadlin with Odeon Capital. Your line is open. Andrew Gadlin, your line is open. Andrew Gadlin, please unmute your line.

And your next question comes from Rob Halder with NatAlliance Securities.

Robert Halder: Good morning, guys. Hopefully I am not stealing Andrew's question. Congrats on the surplus note approval to start, but I did have a couple questions. On the noncore and illiquid asset sales, you mentioned that you were able to sell and I see in the court filings the Puerto Rican GO claims salvage. It looks like that's about half of the net claims paid already in Puerto Rico. Do you think there are other opportunities to either sell this or other assets held in salvage?

Frederick Hnat: Good morning, Rob. We're happy to come back to Andrew, if he's able to join the question with a question. But we are always looking for opportunities to sell less liquid assets at the right price and enhance the company's credit profile. And there are different types of assets held in salvage bankruptcy claims, repurchased bonds, PREPA had a concept of bridge bonds or relending bonds. They were purchased to fund past debt service. The GO claim that we were able to monetize earlier this year was a volatile asset, and the timing and price made sense for us. We have a strategy to monetize assets to facilitate payments on the surplus notes. And we think that enhances our ability to obtain approvals from the NYDFS to pay surplus notes. Clearly, it didn't monetizing that GO claim didn't hurt us in our last approval cycle with them. So yes, this is something we'll continue to be focused on. There may be opportunities on Puerto Rico or other illiquid assets that we have in our balance sheet.

Robert Halder: OK. And then the follow up on the private equity sale. Can you guys provide any more information? It sounds like it's going to boost cash when it closes, but kind of a de minimis impact on surplus. Am I thinking about that correctly?

David Grande: Yes, that's right, Rob. As I mentioned on the – during my prepared remarks, the PE program was established primarily to better match our assets and liabilities. And it primarily involved small dollar purchases of minority positions in relatively young companies. From the outset, the program has been extremely successful, and it has yielded an IRR on the sales of an excess of 20 percent, I think maybe 23 percent to be more accurate on that.

But from an accounting perspective, the gain on the sale in the fourth quarter is not expected to be material, but that's – and that's because we've – from the beginning, we elected the fair value option on those investments. And so we've been marking them to market through the P&L against – since the beginning.

But again, the monetization of the liquid assets is consistent with our stated strategy, and we believe that it was and will be helpful in getting surplus notes paid quicker.

Robert Halder: Got you. And then just following up on that. After the approval in the surplus notes, I know that about 6 months ago you guys have gotten approval from some of the surplus noteholders for a transaction, a single transaction—Twin Reefs. I didn't know where stood. Is there any progress that you guys can report on that? Is that something that you're thinking about? And how are you thinking about that?

Frederick Hnat: Well, we have until May of 2019 to do a onetime tender, as you mentioned, Rob. And we can make a purchase for up to $65 million in cash. We don't plan to move forward on that this year, as it will require NYDFS approval. We felt the best use for our cash at the station was just maximizing our surplus note pay down, and we're, obviously, pleased with the outcome of that process.

But as we get into next year, we'll again be looking for ways to repurchase Twin Reef Securities at a meaningful discount to par. In the meantime, they are a cheap financing vehicle. They are perpetual and noncumulative. So clearly, the economics have to be beneficial, and we'll continue to review it together with other strategic initiatives and capital allocation.

Robert Halder: And just as you guys are talking about to you talking about it, it sounds like, obviously, the focus for now is on redeeming the surplus notes. Should we continue to expect that into next year where the surplus notes remain kind of the #1 priority? And then the auction rates, the Twin Reefs, come after that? That's of kind of what it sounded like.

Frederick Hnat: Yes, I think, for this year, it's a priority. I think it continues to be a priority. We want to reduce the interest costs, and we've talked about the negative carry between the interest paid on the surplus notes and the earnings on our investment portfolio.

The sooner we pay off the surplus notes, the sooner we can make distributions to equity not subject to surplus note holder consent. So those are the objectives. And we'll continue to evaluate it periodically with our board, and – it will continue to be a priority, and we'll have to balance how our dealings work with the regulator and our available capital to make distribution.

Robert Halder: Ok, great, thank you, guys.

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

Andrew Gadlin: Hey, guys, sorry about that earlier. I just wanted to ask a follow-up question about the existing portfolio. And you mentioned some of the stats and derisking the company for that portfolio. Can you give any more color on the remaining credits? And what additional work you can do to derisk further?

Frederick Hnat: Hey, Andrew, the remaining portfolio, obviously, there's some Puerto Rico. That picture I think is improving somewhat. The other credits, even the below investment grade credits, are fairly stable on our view.

We've reinsured 90 percent of our book to Assured and now we're exploring multiple ways to derisk that stub-piece, that remaining portfolio, looking at things like reinsurance, commutations, there are other hedging strategies that we can use or the risk can run off on their own, and we explore ways to work with the issuers to do that like we did with Reliance Rail in 2017.

So yes, we think pursuing these kinds of opportunities make sense, it adds further value to our stakeholders by, David alluded to it, increasing the speed of distributions that are approved by the New York Department of Financial Services. We noted the one recent success we had, which was to commute an international power and gas credit.

One way to approach this is to focus on lower hanging fruit policies that are held by a single policy holders, single policy holder, because it simplifies negotiation and execution and some of our larger European infrastructure credits are ones that are held by single policy holders to we can approach and hopefully make more progress on. So we're going to continue to look for those types of opportunities not at any price obviously, but opportunistically and at the right price.

Operator: There are no further questions. I will 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 year-end 2018 financial statements.

In the meantime, if you have any questions, please feel free to reach out to me at (212) 478-3400 or through our dedicated Investor Relations e-mail, 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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