SYNCORA HOLDINGS LTD.
Q1 2018 CONSOLIDATED GAAP EARNINGS CALL

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

Operator: Good morning, my name is Melissa and I will be your conference operator today. At this time, I would like to welcome everyone to the Syncora Holdings Ltd. Q1 2018 GAAP Financial Results.

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.

Mr. Beinhacker, you may begin your conference.

Scott Beinhacker: Good morning and thank you for joining us today for the SHL Q1 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 March 31, 2018 and for the three months ended

March 31, 2018, the associated earnings release, together with the financial highlights deck and a form of a fifth waiver and amendment to the master transaction agreement with certain stakeholders.

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 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 first quarter 2018 earnings investor call.

Before David shares details of our performance over the first quarter, I wanted to take a few minutes to provide some quick updates on the positive accomplishments in the six weeks since our last earnings call.

We have made significant progress in satisfying the conditions precedent to the reinsurance transaction and have also executed an agreement for the sale of American Roads, both of which demonstrate our success in executing on our strategy of capping risk and monetizing non-core assets to help us continue to deliver value to our stakeholders.

With respect to reinsurance, we are pleased to have received an approval from the NYDFS for the reinsurance transaction, including a payment of $400 million to our surplus noteholders, which amount will be paid consistent with the term of the notes and prior payments. We expect the record date for the payment to be June 12, 2018, and the related payment date to be June 27, 2018. Payment of this large amount of surplus notes materially reduces the negative carry associated with the interest expense on our surplus notes, resulting in a significant benefit to all our stakeholders. In addition to the NYDFS approval of the $400 million payment to the surplus noteholders, we have obtained the required level of third-party consents for a waiver of certain provisions of our master transaction agreement, or MTA, to permit the reinsurance transaction. With payment approval and the consents, we have satisfied all of the major conditions precedent to the closing of the reinsurance and will now work with Assured Guaranty to close the transaction. Subject to satisfying the remaining additional conditions precedent, we expect to close the reinsurance transaction on June 1, 2018, but can provide no assurance that the closing will occur on such date. As we focus on closing the reinsurance transaction, we are also working with Assured Guaranty to begin transitioning certain administrative services to Assured upon closing of the reinsurance, which we expect will continue to decrease our operating expenses.

Last week, we issued a press release detailing the sale of American Roads, a non-core asset we acquired in a bankruptcy proceeding in 2013. Following an analysis of the final round of bids with our advisors, Evercore and Kirkland & Ellis, we chose to move forward with a wholly-owned subsidiary of DIF Infra 5 U.S. LLC, a subsidiary of a Dutch asset manager. Given the complexity of the asset, which includes varied and geographically dispersed infrastructure entities, we are very pleased with the final terms of the sale. The cash consideration expected to be received for American Roads is approximately $220 million before payment of related expenses with provisions that provide for the payment of additional amounts if specified conditions are met within 12 months of the date of the agreement. In addition, Syncora will be entitled to take a distribution of approximately $31 million of cash in American Roads and related entities prior to the closing of the transaction. Taken together with the approximately $24 million in cash held by Pike Pointe that is outside the scope of the American Roads transaction, Syncora will retain approximately $55 million of cash from Pike Pointe and its subsidiaries, all of which was previously included on Syncora's consolidated balance sheet. The closing of the sale of American Roads is subject to customary conditions, including a filing under the Hart-Scott-Rodino Antitrust Improvements Act, and is expected to take place in the third quarter of 2018. We expect to report a gain of $61 million on the sale for GAAP purposes in the related reporting period.

In connection with the solicitation of consents from third parties for the reinsurance, we also obtained modifications to restrictions placed on SGI in the MTA. As you can see in the form of fifth waiver and amendment to the MTA posted to our website last night, we will now be able to utilize up to $65 million to conduct a onetime purchase or tender offer for outstanding SGI preferred equity shares, which are known as Twin Reefs securities. We would conduct these purchases only if we are able to obtain a substantial discount, which we believe would enable us to deliver additional value to our common holders.

As mentioned on our last earnings call, the trial on our Macquarie litigation was scheduled to begin in July 2018, but on Macquarie's motion, the trial court adjourned the trial date. SGI has opposed the adjournment and anticipates that the issue of the trial date will be heard further at a June 4th summary judgment argument. Moving forward, we will continue to vigorously prosecute our case as we prepare for the jury trial.

With regard to Puerto Rico, yesterday, the GO and COFINA bondholders issued a press release and disclosure materials regarding a proposed settlement between the GO and COFINA bondholders regarding, among other things, whether the sales and use taxes purportedly pledged by COFINA to secure its debt are property of the Commonwealth or COFINA. This dispute has been the subject of extensive litigation and mediation. Syncora supported the proposed settlement. However, we are disappointed that the Commonwealth agent, the PROMESA Oversight Board and the Puerto Rico Fiscal Agency and Financial Advisory Authority each rejected the proposed settlement. Syncora will continue working with the other GO bond holders and monolines and, where appropriate, COFINA bondholders to maximize the recoveries of the GO bonds.

As we continue to achieve our strategic goals of reducing overall risk on our portfolio and delivering value to our stakeholders, we are exploring potential new business opportunities within our core competencies that could have the added benefit of generating income that could be offset against our NOLs.

The activity in the last six weeks shows our continued success at effectively executing on our strategic initiatives. The approval of the reinsurance transaction and related surplus note payment and the sale of American Roads are significant events, and I am pleased to be able to share some of those details with you.

It has been a busy start of the year for us, and we look forward to continuing our efforts to unlock further value for all of our stakeholders.

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

David Grande: Thank you Fred. As Scott mentioned, last night we posted our first quarter 2018 GAAP earnings release, consolidated financial statements and financial highlights deck to our website.

Jumping right into our earnings for the quarter, overall we had GAAP net loss attributable to SHL of 8.8 million dollars or 10 cents per common share, as compared to a net loss of 30.8 million dollars or 36 cents per common share for the same period last year.

As I've discussed on previous earnings calls, 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 6.9 million dollars is included in the net loss attributable to SHL of 8.8 million dollars.

Non-GAAP operating income was 16.7 million dollars or 19 cents per common share, as compared to a loss of 21.9 million dollars or 25 cents per common share for the same period last year.

Non-GAAP adjusted book value per share increased from year-end as well. As of March 31, 2018, adjusted book value per common share was 7 dollars and 14 cents 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.

Turning to the highlights for the quarter, in January, the Company received $335 million of cash related to the settlement of the GreenPoint litigation. The effect of receiving this cash, which flows through several financial statement accounts, was net neutral from a statement of operations perspective.

Other key drivers for the quarter include:

First, 14.3 million dollars of net premiums earned, which was lower than the same period last year as a result of the continued run-off of our book of business despite having slightly higher premium accelerations in the current period. Total premium accelerations were 9.6 million dollars for the first quarter of 2018, as compared to 8.1 million dollars for the same period in 2017.

Second, fees and other income increased by 15.0 million dollars to 16.2 million dollars for the first quarter primarily as a result of the sale of the Detroit real estate development option as described in last quarter's earnings conference call.

Third, 21.1 million dollars of mark-to-market losses on our CDS contracts, as compared to 13.5 million dollars of mark-to-market gains for the same period last year. These losses were primarily due to lower non-performance risk spreads.

Fourth, interest expense, which includes both non-cash accretion on SGI's surplus note balance and the accrual of interest, increased by 2.7 million dollars to 24.5 million dollars for the first quarter from 21.8 million dollars for the same period last year.

And lastly, lower operating expenses of 1.7 million dollars, mainly as a result of headcount reductions as compared to the same period last year.

As I just discussed, income from discontinued operations, which represents the results of American Roads, was 6.9 million dollars for the first quarter of 2018 as compared to 2.8 million dollars for the same period last year.

As it relates to our insured portfolio, and as outlined on slides 11 and 12 of the financial highlights deck, for the first quarter of 2018, SHL reduced its total net par exposure by 0.3 billion dollars or 2 percent, to 14.5 billion dollars.

The reduction in total net par exposure was driven mainly by 195 million dollars in refundings, 130 million dollars in amortizations, and 234 million dollars in terminations and commutations. This reduction in net par outstanding was also partially offset by a 168 million dollar increase as a result of the weakening U.S. dollar and 45 million dollars of accretion. The average internal rating of our portfolio was bbb+, unchanged from year end 2017, and total credit count decreased 9 percent from 495 credits as of December 31, 2017 to 452 credits as of March 31, 2018.

Our below investment grade credits, or BIG exposures, were 1.1 billion dollars, or 8 percent of Syncora's total insured portfolio as of March 31, 2018. 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 17 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 would like to remind everyone in order to ask a question press star then the number one on your telephone keypad. Again, press star then the number one on your telephone keypad to ask a question.

Your first question is from Rob Halder with Nat Alliance Securities.

Robert Halder: Good morning, guys. Couple of quick questions for you. First one is really just housekeeping. Given the amortizations and prepayments and refundings that you've seen in the book, are there any material changes to the about $1.3 billion in pro forma insurance in force after that AGO transaction? Or is that number going to be about the same?

Fred Hnat: Good morning, Rob. I think that number is about the same. There haven't really been any material changes in the retained portfolio. You're referring to the credits that aren't reinsured through to Assured Guaranty under our

Reinsurance Framework Agreement. There is one development with respect to one credit, Arkansas River Power Authority, that you may be familiar with – ARPA – that was a story credit that had litigation involving the validity of the bond, so it was high on Syncora's flag list. But that litigation got settled and we understand the authority, ARPA, is planning to refinance their outstanding debt, including the bonds insured by Syncora. So that is in process now. For your reference, there's a rating agency report out there that assigned an investment grade rating to the refunding bond. So that's a significant credit in the retained portfolio that we expect to roll off soon. But other than that, I'm not aware of any other significant developments in the retained portfolio.

Robert Halder: OK, great. And then, second question is, it looks like you guys marked down slightly your salvage recoveries for PREPA during the quarter on your presentation. Which kind of brings me to the question, how do you guys think of loss reserves for Puerto Rico in light of, kind of, higher Puerto Rican bond prices? I know a number of other monolines have addressed this in their calls, wondering how you guys think about it.

Fred Hnat: David, do you want to take that?

David Grande: Yeah, I'll cover that. So you know, really, I can say that, even though you did see a slight downtick in the salvage recoverable, it really didn't change materially for the quarter. And in regards to any reserve adjustments in response to the bond prices going up, you have to remember that bond prices are really just one component of several that we look at when we analyze and when we establish reserves. So, you know, we use a scenario approach. And in fact, under GAAP, under generally accepted accounting principles, we're actually required to use a scenario approach. And so even though the Puerto Rico bond prices have been improving, we did not feel that there was enough information at this time to justify making a positive adjustment to our reserves. And as we've noted in the past, Syncora's overall Puerto Rico exposure, including both insured exposure and salvage, as well as the bonds that we've purchased back, is relatively small – I think it's at about $300 million, as of first quarter. And our reserving has been careful and we believe that it's been appropriate from the very outset of the Puerto Rico financial crisis.

Robert Halder: Got you. Thank you. And then I guess one last one question is – congrats on the AGO approval, but at this point, where do you go from here, right? What's go forward? I think, at this point you have the Macquarie litigation, you have NOLs, Detroit properties. What’s your view for growth or for the path forward for Syncora, at this point?

Fred Hnat: Thanks, Rob. You know, those things that you mentioned, obviously, we're very, very pleased to be executing on our strategic plan, as you summarized. I want to emphasize that we are very committed to maximizing value for shareholders. All options are on the table, including new business. We're not in the position to share details of any new business opportunities but we continue to work internally to explore various options and our ability, obviously, to use the $2.5 billion NOL. We do still have significant work to do on a number of things. Obvious priority, currently, is getting the money in on American Roads – getting the money in the door. We project the third quarter for that. We need to implement the reinsurance and also continue to deal with the retained portfolio of credits that are not ceded through to Assured. And we'll continue to take action to de-risk and de-lever the company, where possible. And the $400 million approval we got from the NYDFS was clearly a major step.

Also to your question, I would note that a key area that should enhance shareholder value is managing our operational expenses. As I mentioned in our prepared remarks, as we begin transitioning administrative services to Assured under the reinsurance agreement, there will be opportunities for more substantial OpEx reductions. And as you know, we’ve brought operating expenses down over the past year and a half but shareholders should begin to see more of that.

Robert Halder: Got you. Thank you guys very much. Appreciate it.

Operator: Your final question is from Andrew Gadlin with Odeon Capital Group.

Andrew Gadlin: Hi, good morning. In terms of the American Roads sale, how much have you already briefed the DFS on the ramifications to book value, surplus, et cetera, liquidity? And how much are you kind of saving that as dry powder for conversations next year about pay down on surplus notes?

David Grande: Obviously, the NYDFS is aware of the sale. At this point, it's too early to have actually gone through and detailed the analysis of what that means from a liquidity and surplus perspective with them. But they can gather a lot of that information just from the sale price alone. So we're really in the early stages of briefing the NYDFS from that perspective.

Fred Hnat: I would look at the $400 million approval as a payment connected to the reinsurance and any positive development subsequent to that – getting the purchase price of American Roads – is additive to where we are with the NYDFS.

Andrew Gadlin: Has the DFS given you any color on what negotiations – because every year you've agreed to request payment in full of the surplus notes – so have they given you any color on how they're thinking about future distributions and pay downs going forward?

Fred Hnat: No. We have to go to them semiannually and request the full amount and based on the facts and circumstances at that time, they make their own judgment.

Andrew Gadlin: OK. And then on the American Roads valuation, we know the numbers on a GAAP basis. But David, can you give us that on a STAT basis as well?

David Grande: So on a statutory basis, the book value, the carrying value was higher. I think maybe by – I don't have the numbers in front of me, but approximately $40 million higher. So I think we're looking at an $18 to $20 million gain on a statutory basis. That would be a gain that would be a direct benefit to surplus.

Andrew Gadlin: Got it. Okay, thank you very much.

Fred Hnat: Thank you.

David Grande: Thank you.

Operator: There are no further questions. I will now turn the call back over to Mr. Beinhacker for closing remarks.

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 Q2 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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