CAPITAL MANAGEMENT

Assured Guaranty

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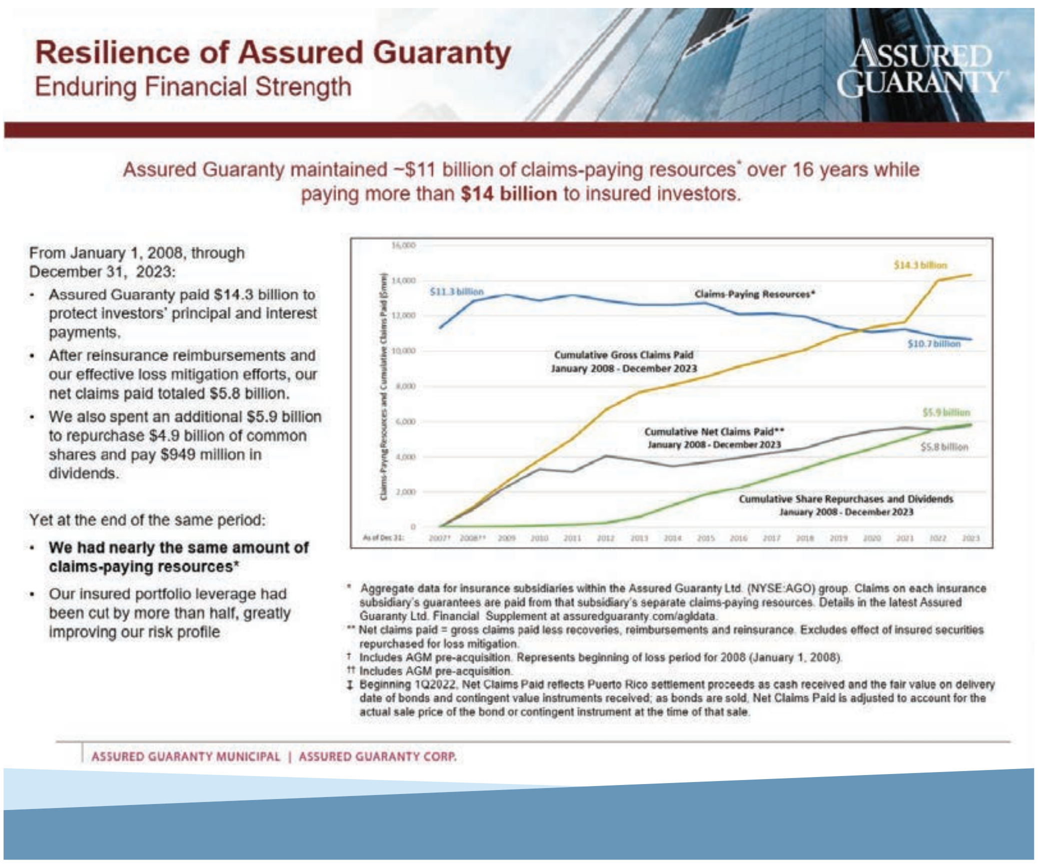
Assured Guaranty is the leading bond insurance company in the United States, and despite a robust rally in stock price, the stock still trades at a material discount to intrinsic value. The company has painstakingly worked through the Puerto Rico debt restructuring for nearly a decade, and despite paying heavy claims, the company remains in arguably its best financial position in its history. Higher interest rates have created more opportunity for bond insurance, while also providing a boost to earnings via higher investment income. While I think it is likely the economy will continue to weaken, I'm confident AGO's management team will still be able to build more value for shareholders from current prices.

As you can see from the image below, from January 1st, 2008, through December 31, 2024, AGO paid $14.3B to protect investors' principal and interest payments. After reinsurance and loss mitigation, net claims paid totaled $5.8B. Despite all this pressure on cash flow, the company was still able to repurchase $4.9B of common shares and pay $949MM in dividends, while maintaining a relatively stable amount of claims-paying resources.

Because the stock price has traded at a deep discount to most book value metrics, as well as my estimate of intrinsic value, these buybacks have created an enormous amount of shareholder value over the years.

In the 1st quarter, AGO's adjusted operating income was $1.96 per share, up from $1.12 in the first quarter of last year. Adjusted operating shareholders' equity ended the quarter at $107.69, compared with $94.58 a year ago, while adjusted book value per share of $157.31, was $14 higher than a year ago. Shareholders' equity per share was $102.19, also $14 higher for a new record. I truly believe these book value metrics are the most appropriate proxy for intrinsic value, although due to the company's relatively low returns on equity, the stock should trade at a discount, although I think that discount is too pronounced most of the time.

AGO's new business production has been solid, with Q1 PVP of $63MM, with U.S. Public Finance accounting for $43MM of PVP, approximately double its PVP at the same time last year. Total first-quarter primary market volume sold utilizing bond insurance was up 24% YoY, with primary market insurance penetration continuing to exceed 7% of par sold, as it mostly has since 2020. Crises such as Puerto Rico and the Lockdown-driven recession of 2020 have really reiterated the value of bond insurance in uncertain times. In AGO's target rating category of transactions with single-A underlying ratings from S&P and/or Moody's, insurance penetration was 27% of par sold and 63% of the number of transactions sold.



Global structured finance contributed $19MM of PVP from 11 transactions across primarily the insurance securitization and subscription finance sectors. AGO maintained its status as the market leader in Public Finance, insuring roughly 53% of all primary market insured par sold during Q1 of 2024, insuring $3.8B of new issue par sold, which was up 12% YoY. AGO insured 7 transactions with $100MM or more of insured par, totaling approximately $1.4B.

Often AGO's willingness to take a big insurance position helps the rest of it get sold to institutions. The company also insured $605MM of par on 23 transactions on double-A credits, where investors are showing the value in both AGO's financial strength and other aspects of value proposition such as risk mitigation. Q2 is also looking very strong as AGO insured a whopping $1.134B of bonds for the Brightline Florida Passenger Rail Project in May, which was part of a $2.219B debt-refinancing package.

From a credit perspective, the company has resolved all of its non-paying Puerto Rico exposures with the exception of the electric power authority, PREPA, which represents only $624MM of net par exposure. Almost certainly, this exposure is conservatively reserved for. Beyond that, AGO's below investment grade insured exposures include some hospitals both in the United States and in the UK, along with some universities etc. I view these risk exposures as quite manageable, especially given the mission critical nature of the assets. AGO's biggest credit issues historically have arisen from Puerto Rico, where the Commonwealth just decided to stop paying the vast majority of its debt, instead of attempting to address its corruption and other financial issues internally. The other big one was of course the Financial Crisis where RMBS led to billions of losses, but many of these losses were ultimately covered by reps and warranty agreements, which protected the insurer from the fraudulently written mortgages that were so pervasive during that era.

AGO's management is confident that it can get back to the $500MM a year buyback level it was hitting a few years back, starting with 2024, which is great news given the stock's large discount to intrinsic value. In Q1, AGO repurchased $129MM or common shares, which equals 2.7% of the shares outstanding when the year began. AGO has greatly simplified its investments in the asset management space, as it now owns a 30% interest in Sound Point, where it benefits from much more economies of scale, while also obtaining attractive investment returns.

I see this as very beneficial as Sound Point is more profitable than Assured's asset management business was on its own, and it also allows AGO's management to focus its efforts on bond insurance, where it makes its bread and butter.

At a recent price of $78.01, AGO trades at just 72.4% adjusted operating shareholders' equity, and 49.5% of adjusted operating shareholders' equity. These metrics are right in line with recent historical averages when the insured portfolio had larger below investment grade exposure. I don't expect there to be radical changes in the business, but I believe PVP can continue to grow steadily, particularly as the company expands internationally. Management already knows the value creation playbook, which entails sound underwriting and using excess cash to buy back its undervalued stock. These moves should lead to solid book value per share and intrinsic value growth. I believe AGO should trade around $95 per share to account for the recent book value growth, while also accounting for the relatively low ROE of the business. I think there is potential for the valuation multiple to be pushed higher as those returns ultimately increase. Long-term investors should take advantage of any weakness in the stock to acquire AGO.

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