Ambac

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Ambac Financial Group, Inc. Announces Second Quarter 2012 ResultsAmbac Financial Group, Inc. Announces Second Quarter 2012 Results

NEW YORK--(BUSINESS WIRE)--Aug. 9, 2012-- **Ambac Financial Group, Inc.** ("Ambac") today announced a second quarter 2012 net loss of $811.1 million, or a net loss of $2.68 per share. This compares to a second quarter 2011 net loss of $102.4 million, or a net loss of $0.34 per share. Relative to second quarter 2011, second quarter 2012 results were primarily driven by higher net loss and loss expenses, a net loss relating to the extinguishment of Ambac Assurance surplus notes, and higher derivative product losses, partially offset by higher net realized investment gains.

Second Quarter 2012 Summary

Relative to the second quarter of 2011,

- Net premiums earned increased $3.8 million to $103.0 million
- Net investment income declined $1.8 million to $93.8 million
- Net realized investment gains (losses) increased $69.6 million to a gain of $67.1 million
- Net realized gains (losses) on the extinguishment of debt declined $180.9 million to a loss of $177.7 million
- Derivative product losses increased $58.5 million to $124.1 million
- Financial guarantee net loss and loss expenses increased $545.0 million to $741.4 million

As of June 30, 2012, unrestricted cash, short-term securities and bonds at Ambac, the holding company, totaled $33.9 million, a decline of $0.1 million from March 31, 2012.

Financial Results

Net Premiums Earned

Net premiums earned for the second quarter of 2012 were $103.0 million, up 4% from $99.3 million earned in the second quarter of 2011. Net premiums earned include accelerated premiums, resulting from refundings, calls, and other policy accelerations recognized during the quarter. Accelerated premiums were $35.9 million in the second quarter of 2012, up 217% from $11.3 million in the second quarter of 2011. The increase in accelerated premiums was primarily driven by an increase in the overall volume of calls of Ambac insured debt within the public finance market due to low interest rates. Normal net premiums earned, which exclude accelerated premiums, were $67.1 million in the second quarter of 2012, down 24% from $88.0 million in the second quarter of 2011. The decline in normal net premiums earned was primarily due to the continued run-off of the insured portfolio as a result of transaction terminations, refundings, and scheduled maturities.

Net Investment Income

For the combined financial guarantee, financial services, and corporate investment portfolios, net investment income for the second quarter of 2012 was $93.8 million, a decrease of 2% from $95.6 million earned in the second quarter of 2011. Financial Guarantee net investment income rose 2% from $88.0 million to $90.0 million, benefitting from a higher average invested asset base and higher yielding assets in the portfolio for the three months ended June 30, 2012. Compared to the second quarter of 2011, the 2012 Financial Guarantee invested asset base has benefited from the reinvestment of interest and principal receipts, and premiums collected, as well as the impact of the moratorium on segregated account claims payments, partially offset by payments made to commute certain financial guarantee exposures and to repurchase surplus notes. Higher average yields on the portfolio resulted from the ongoing shift in the portfolio mix away from tax-exempt municipals toward taxable securities, including Ambac-insured securities. Financial Services investment income for the three months ended June 30, 2012 was $3.8 million, a decline of 50% from $7.6 million for the second quarter of 2011. The decline in Financial Services investment income was driven primarily by the effects of a smaller portfolio of investments as Ambac's investment agreement obligations continue to run off.

Net Realized Investment Gains (Losses)

Net realized investment gains for the second quarter of 2012 were $67.1 million, an increase of $69.6 million over net realized investment losses of $2.5 million during the second quarter of 2011. The realized investment gains in the second quarter of 2012 were largely the result of portfolio repositioning and relative value trades executed in response to market conditions.

Net Realized Gains (Losses) on Extinguishment of Debt

Net realized losses on the extinguishment of debt were $177.7 million for the second quarter of 2012 as compared to gains of $3.1 million during the second quarter of 2011. During June 2012, Ambac Assurance exercised options to repurchase surplus notes having an aggregate par value of $789.2 million for a cash payment of $188.4 million. Certain of these options were free-standing derivatives for accounting purposes and were carried at fair value as assets on the Company's balance sheet. The $177.7 million net realized loss on extinguishment of debt represents the difference between the consideration paid and the net carrying value of the stand-alone derivative assets and the repurchased surplus notes and accrued interest liabilities. The remaining options to acquire surplus notes have expired.

Other Income

Other income for the three months ended June 30, 2012 was $36.1 million, as compared to $9.2 million for the three months ending June 30, 2011. The increase was primarily driven by mark-to-market gains of $39.0 million relating to Ambac's option to call certain bank surplus notes that were free-standing derivatives for accounting purposes, as discussed above. As these options were exercised in June 2012, only changes in fair value of these options through the date of exercise are included in other income.

Derivative Products

For the second quarter of 2012, the derivatives product business produced a net loss of $124.1 million compared to net loss of $65.6 million for the second quarter of 2011. The derivative products portfolio has been positioned to record gains in a rising interest rate environment in order to provide a hedge against the impact of rising rates on certain exposures within the financial guarantee insurance portfolio. As a result of declining interest rates, mark-to-market movements on these hedges contributed losses of $96.8 million during the second quarter of 2012, compared to losses of $63.2 million during the second quarter of 2011. Additionally, customer related swaps contributed $27.3 million of losses in the second quarter of 2012 versus $2.4 million of losses for the second quarter of 2011. These losses primarily resulted from adverse changes in interest rates, projected inflation rates and foreign exchange rates, which influence the fair value of certain customer swaps, net of the impact of changes to Ambac's own credit risk. The results include positive valuation adjustments pertaining to Ambac's own credit risk of $28.9 million for the second quarter of 2012 and $4.6 million for the second quarter of 2011.

Financial Guarantee Loss Reserves

Loss and loss expenses for the second quarter of 2012 was $741.4 million as compared to $196.4 million for the second quarter of 2011. The net loss for the three months ended June 30, 2012, was driven by higher estimated losses in the first-lien and second-lien RMBS portfolio, as well as on certain structured insurance, asset backed and municipal credits.

Loss and loss expenses paid, including commutations, net of recoveries from all policies, amounted to a net recovery of $18.4 million during the second quarter of 2012 versus a $23.4 million net recovery for the same period in 2011. The amount of actual claims paid during each period was impacted by the payment moratorium imposed on March 24, 2010, by the court overseeing the rehabilitation of the Segregated Account. Claims presented to Ambac Assurance and unpaid during the second quarter of 2012 amounted to $491.2 million versus $345.0 million during the same period in 2011. Since the establishment of the Segregated Account in March 2010, a total of $3,653.6 million of claims have been presented and remain unpaid.

Loss reserves (gross of reinsurance and net of subrogation recoveries) for all RMBS insurance exposures as of June 30, 2012, were $4,769.8 million, including claims on RMBS exposures that have been presented since March 24, 2010, and unpaid as a result of the claims moratorium. RMBS reserves as of June 30, 2012, are net of $2,770.2 million of estimated representation and warranty breach remediation recoveries. The estimate of remediation recoveries related to material representation and warranty breaches is up 4% from $2,655.4 million reported as of March 31, 2012. Ambac has initiated and will continue to initiate lawsuits and other methods to achieve compliance with the repurchase obligations in the securitization documents with respect to sponsors who disregard their obligations to repurchase loans.

Expenses

Underwriting and operating expenses rose in the second quarter of 2012 to $33.6 million from $15.5 million during the second quarter of 2011. The increase in underwriting and operating expenses is primarily related to higher compensation, premises, premium taxes and legal fees. The increase in premises related expense is attributable to the benefit realized in the second quarter of 2011 from the termination and settlement of the Company's lease on its headquarters. The increase in compensation expense is due to stock compensation forfeitures in the second quarter of 2011. Interest expense for the combined Financial Guarantee and Financial Services sectors was largely unchanged during the period.

Reorganization Items, Net

For purposes of presenting an entity's financial evolution during a Chapter 11 reorganization, the financial statements for periods including and after filing the Chapter 11 petition distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Reorganization items in three months ended June 30, 2012 were $0.8 million, down from $6.5 million for the three months ended June 30, 2011, primarily due to lower professional fees incurred following the confirmation of the bankruptcy plan of reorganization.

Balance Sheet and Liquidity

Total assets declined during the second quarter of 2012 to $26.6 billion from $27.4 billion at March 31, 2012. The decrease in total assets was primarily due to declines in (i) the consolidated non-VIE investment portfolio to $6.7 billion from $6.9 billion, (ii) VIE assets to $16.6 billion from $16.9 billion, (iii) insurance premium receivables to $1.8 billion from $1.9 billion, and (iv) derivative assets to $133 million from $273 million.

During the second quarter of 2012, the fair value of the financial guarantee non-VIE investment portfolio fell by $80.6 million to $6.1 billion (amortized cost of $5.6 billion) as of June 30, 2012. The portfolio consists primarily of high quality municipal and corporate bonds, asset backed securities, U.S. Treasuries, Agency RMBS, as well as non-agency RMBS, including Ambac Assurance guaranteed RMBS. The fair value of the financial services investment portfolio declined $176.6 million to $587.1 million during the second quarter.

Liabilities subject to compromise totaled approximately $1.7 billion at June 30, 2012. The amount of liabilities subject to compromise represents Ambac's estimate at June 30, 2012, of known or potential pre-petition claims to be addressed in connection with the Chapter 11 reorganization. As of June 30, 2012, liabilities subject to compromise consist of the following *(in thousands):*

Debt obligations and accrued interest payable	$1,690,312
Other	17,099
Consolidated liabilities subject to compromise	$1,707.411

Overview of Ambac Assurance Statutory Results

As of June 30, 2012, Ambac Assurance reported policyholder surplus of $100.0 million, down from $232.9 million as of March 31, 2012. The Segregated Account reported statutory policyholder surplus of $(333.2) million as of June 30, 2012, down from $105.1 million as of March 31, 2012. The decline in Ambac Assurance's policyholder surplus was due to (i) contributions to contingency reserves of $233.2 million as a result of adverse development of non-defaulted policies that remain in the general account of Ambac Assurance; (ii) insurance losses of $222.2 million; (iii) net intercompany loan impairments of $131.0 million, primarily from the interest rate swap business; and (iv) the extinguishment of $789.2 million of surplus notes for a cash payment of $188.4 million. These declines were partially offset by (a) net investment income, (b) earned premiums, and © a $463.3 million reduction in the liabilities assumed by Ambac Assurance from the Segregated Account for losses on policies allocated to the Segregated Account. The reduction of these liabilities is pursuant to a prescribed accounting practice issued by the Wisconsin Office of the Commissioner of Insurance, which maintains Ambac Assurance's policyholder surplus at a minimum level of $100 million.

Ambac Assurance's claims-paying resources amounted to approximately $6.2 billion as of June 30, 2012, down $215.5 million from $6.4 billion at March 31, 2012. This excludes Ambac Assurance UK Limited's claims-paying resources of approximately $1.1 billion. The decrease in claims paying resources was primarily attributable to the repurchase of surplus notes and a lower present value of future installment premiums as of June 30, 2012.

About Ambac

Ambac filed for a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court") on November 8, 2010. The Bankruptcy Court entered an order confirming Ambac's plan of reorganization on March 14, 2012. However, Ambac is not currently able to estimate when it will be able to consummate such plan. Until the plan of reorganization is consummated and Ambac emerges from bankruptcy, Ambac will continue to operate in the ordinary course of business as "debtor-in-possession" in accordance with the applicable provisions of the Bankruptcy Code and the orders of the Bankruptcy Court. Currently, Ambac's common stock trades in the over-the-counter market under ticker symbol ABKFQ. Upon consummation of the plan of reorganization, Ambac's existing common stock will be cancelled and extinguished and the holders thereof will not be entitled to receive, and will not retain, any property or interest on account of such common stock.

Additional information regarding Ambac's second quarter 2012 financial results, including its quarterly report on Form 10-Q for the quarter ended June 30, 2012, can be found on Ambac's website at www.ambac.com under the Investor Relations tab.

Forward-Looking Statements

This release contains statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any or all of management's forward-looking statements here or in other publications may turn out to be incorrect and are based on Ambac management's current belief or opinions. Ambac's actual results may vary materially, and there are no guarantees about the performance of Ambac's securities. Among events, risks, uncertainties or factors that could cause actual results to differ materially are: (1) failure to consummate a plan of reorganization under Chapter 11, which may lead to the commencement of liquidation proceedings pursuant to Chapter 7; (2) the impact of the bankruptcy proceeding on the holders of Ambac securities; (3) failure to satisfactorily resolve our dispute with the United States Internal Revenue Service; (4) the unlikelihood that Ambac Assurance Corporation ("Ambac Assurance") will pay dividends to Ambac in the foreseeable future; (5) adverse events arising from the Segregated Account Rehabilitation Proceedings, including the failure of the injunctions issued by the Wisconsin Rehabilitation Court to protect the Segregated Account and Ambac Assurance from certain adverse actions; (6) litigation arising from the Segregated Account Rehabilitation Proceedings; (7) decisions made by the Rehabilitator for the benefit of policyholders may result in material adverse consequences for Ambac's securityholders; (8) potential of a full rehabilitation proceeding against Ambac Assurance or material changes to the Segregated Account Rehabilitation Plan, with resulting adverse impacts; (9) inadequacy of reserves established for losses and loss expenses, including our inability to realize the remediation recoveries or future commutations included in our reserves; (10) adverse developments in our portfolio of insured public finance credits; (11) market risks impacting assets in our investment portfolio or the value of our assets posted as collateral in respect of investment agreements and interest rate swap and currency swap transactions; (12) risks relating to determination of amount of impairments taken on investments; (13) credit and liquidity risks due to unscheduled and unanticipated withdrawals on investment agreements; (14) market spreads and pricing on insured collateralized loan obligations ("CLOs") and other derivative products insured or issued by Ambac or its subsidiaries; (15) Ambac's financial position and the Segregated Account Rehabilitation Proceedings may prompt departures of key employees and may impact our ability to attract qualified executives and employees; (16) the risk of litigation and regulatory inquiries or investigations, and the risk of adverse outcomes in connection therewith, which could have a material adverse effect on our business, operations, financial position, profitability or cash flows; (17) credit risk throughout our business, including but not limited to credit risk related to residential mortgage-backed securities, student loan and other asset securitizations, CLOs, public finance obligations and exposures to reinsurers; (18) default by one or more of Ambac Assurance's portfolio investments, insured issuers, counterparties or reinsurers; (19) the risk that our risk management policies and practices do not anticipate certain risks and/or the magnitude of potential for loss as a result of unforeseen risks; (20) factors that may influence the amount of installment premiums paid to Ambac, including Segregated Account Rehabilitation Proceedings; (21) changes in prevailing interest rates; (22) the risk of volatility in income and earnings, including volatility due to the application of fair value accounting, required under the relevant derivative accounting guidance, to the portion of our credit enhancement business which is executed in credit derivative form; (23) changes in accounting principles or practices that may impact Ambac's reported financial results; (24) legislative and regulatory developments; (25) operational risks, including with respect to internal processes, risk models, systems and employees; (26) changes in tax laws, tax disputes and other tax-related risks; (27) other risks and uncertainties that have not been identified at this time, and (28) the risks described in the Risk Factors section in Part I, Item 1A of Ambac's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, and also disclosed from time to time by Ambac in its subsequent reports on Form 10-Q and Form 8-K, which are available on the Ambac website at www.ambac.com and at the SEC's website, www.sec.gov. Readers are cautioned that forward-looking statements speak only as of the date they are made and that Ambac does not undertake to update forward-looking statements to reflect circumstances or events that arise after the date the statements are made. You are therefore advised to consult any further disclosures we make on related subjects in Ambac's reports to the SEC.

Ambac Financial Group, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 2012 and December 31, 2011
(Dollars in Thousands Except Share Data)

	June 30, 2012 (unaudited)	December 31, 2011
Assets		
Investments:		
Fixed income securities, at fair value (amortized cost of $4,945,921 2012 and $5,346,897 in 2011)	**$5,390,290**	**$5,830,289**
Fixed income securities pledged as collateral, at fair value (amortized cost of $286,115 in 2012 and $261,958 in 2011)	**286,660**	**263,530**
Short-term investments (amortized of $1,009,868 in 2012 and $783,015 in 2011)	**1,010,059**	**783,071**
Other (approximates fair value)	**100**	**100**
Total investments	**6,687,109**	**6,876,990**

Cash	49,012	15,999
Restricted cash	2,500	2,500
Receivable for securities	112,013	38,164
Investment income due and accrued	42,651	45,328
Premium receivables	1,829,874	2,028,479
Reinsurance recoverable on paid and unpaid losses	169,961	159,902
Deferred ceded premium	197,437	221,303
Subrogation recoverable	442,097	659,810
Deferred acquisition costs	211,907	223,510
Loans	10,153	18,996
Derivative assets	132,914	175,207
Other assets	103,804	104,300
Variable interest entity assets:		
Fixed income securities, at fair value	2,162,062	2,199,338
Restricted cash	2,276	2,140
Investment income due and accrued	4,034	4,032
Loans	14,446,047	14,329,515
Other assets	5,940	8,182
Total assets	$26,611,791	$27,113,695
Liabilities and Stockholders' Deficit		
Liabilities:		
Liabilities subject to compromise	$1,707,411	$1,707,421
Unearned premiums	3,138,275	3,457,157
Losses and loss expense reserve	7,607,663	7,044,070
Ceded premiums payable	98,279	115,555
Obligations under investment agreements	424,840	523,046
Obligations under investment repurchase agreements	18,276	23,500
Current taxes	96,752	95,709
Long-term debt	144,036	223,601
Accrued interest payable	192,984	170,169
Derivative liabilities	394,040	414,508
Other liabilities	94,678	107,441
Payable for securities purchased	5,328	1,665
Variable interest entity liabilities:		
Accrued interest payable	3,645	3,490
Long-term debt	14,376,872	14,288,540
Derivative liabilities	2,063,809	2,087,052
Other liabilities	282	304
Total liabilities	30,367,170	30,263,228
Stockholders' deficit:		
Preferred stock	-	-
Common stock	3,080	3,080
Additional paid-in capital	2,172,027	2,172,027
Accumulated other comprehensive income	417,593	463,259
Accumulated deficit	(6,598,384)	(6,039,922)
Common stock held in treasury at cost	(410,755)	(411,419)
Total Ambac Financial Group, Inc. stockholders' deficit	(4,416,439)	(3,812,975)
Non-controlling interest	661,060	663,442
Total stockholders' deficit	(3,755,379)	(3,149,533)
Total liabilities and stockholders' deficit	$26,611,791	$27,113,695
Number of shares outstanding (net of treasury shares)	302,436,107	302,428,811

Ambac Financial Group, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)
For the Three and Six Months Ended June 30, 2012 and 2011
(Dollars in Thousands Except Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Net premiums earned	$103,042	$99,271	$197,992	$191,070
Net investment income	93,836	95,639	205,953	172,107
Other-than-temporary impairment losses:				
Total other-than-temporary impairments	(7,492)	(17,793)	(11,803)	(19,506)
Portion of loss recognized in other comprehensive income	5,164	215	6,404	215
Net other-than temporary impairment losses recognized in earnings	(2,328)	(17,578)	(5,399)	(19,291)
Net realized investment gains (losses)	67,067	(2,528)	67,459	(78)
Change in fair value of credit derivatives:				
Realized gains and other settlements	3,073	4,224	6,327	9,547
Unrealized (losses) gains	(10,488)	20,063	(20,964)	5,837
Net change in fair value of credit derivatives	(7,415)	24,287	(14,637)	15,384
Derivative products	(124,091)	(65,595)	(77,134)	(44,591)
Net realized (losses) gains on extinguishment of debt	(177,745)	3,119	(177,745)	3,119
Other income	36,137	9,227	100,930	37,530
Income (loss) on variable interest entities	5,536	2,353	20,756	(3,772)
Total revenues before expenses and reorganization items	(5,961)	148,195	318,175	351,478
Expenses:				
Losses and loss expenses	741,411	196,398	739,091	1,116,045
Underwriting and operating expenses	33,567	15,533	70,101	61,000
Interest expense	31,855	31,670	65,694	61,930
Total expenses before reorganization items	806,833	243,601	874,886	1,238,975
Pre-tax loss from continuing operations before reorganization items	(812,794)	(95,406)	(556,711)	(887,497)
Reorganization items	767	6,470	3,228	31,275
Pre-tax loss from continuing operations	(813,561)	(101,876)	(559,939)	(918,772)
(Benefit) provision for income taxes	(211)	542	89	2,892
Net loss	(813,350)	(102,418)	(560,028)	(921,664)
Less: net (loss) income attributable to noncontrolling interest	(2,232)	14	(2,230)	47
Net loss attributable to common shareholders	($811,118)	($102,432)	($557,798)	($921,711)
Net loss per share attributable to Ambac Financial Group, Inc. common shareholders	($2.68)	($0.34)	($1.84)	($3.05)

Net loss per diluted share attributable to Ambac Financial Group, Inc. common shareholders	**($2.68)**	**($0.34)**	**($1.84)**	**($3.05)**
Weighted average number of common shares outstanding:				
Basic	**302,469,196**	**302,467,255**	**302,467,762**	**302,410,881**
Diluted	**302,469,196**	**302,467,255**	**302,467,762**	**302,410,881**

Source: Ambac Financial Group, Inc.

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