S&P Capital IQ

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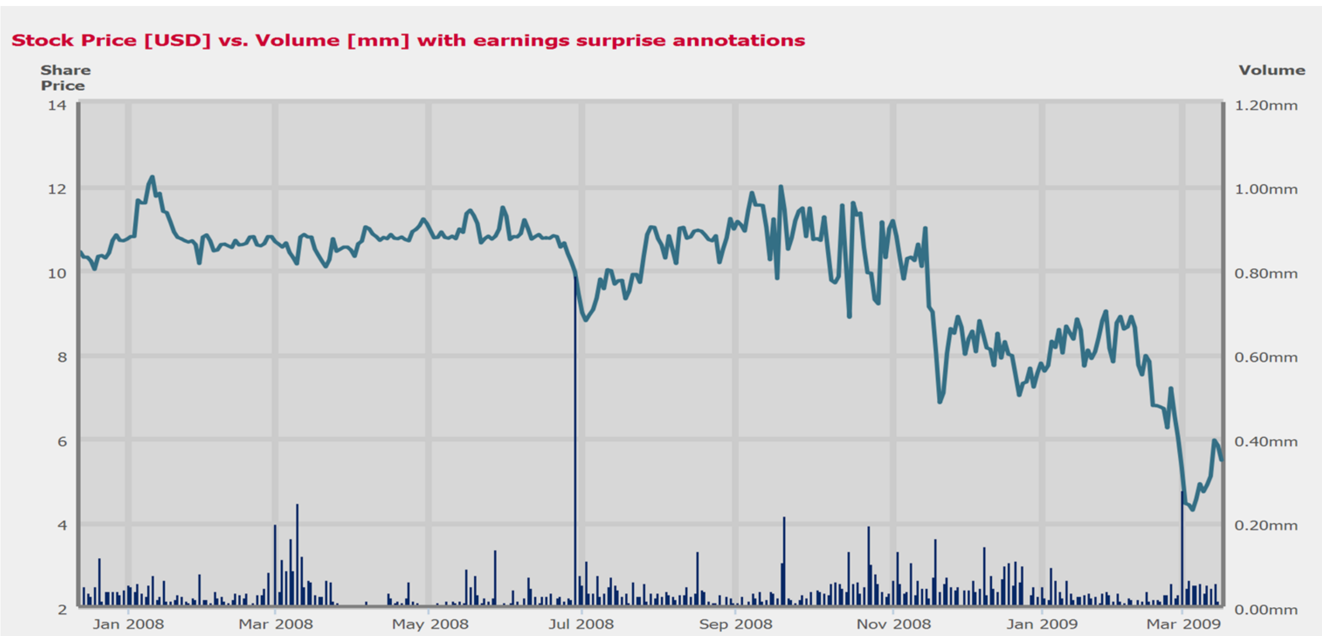

Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman

Sandra E. Bell
Chief Financial Officer

Presentation

Operator

Greetings, and welcome to the Tiptree Inc. Second Quarter 2017 Financial Results Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to turn the conference to your host, Sandra Bell, Chief Financial Officer. Thank you, you may begin.

Sandra E. Bell
Chief Financial Officer

Good morning, and welcome to our second quarter 2017 earnings call. We are joined today by our Executive Chairman, Michael Barnes; and CEO, Jonathan Ilany.

We have posted the earnings release and presentation on our website at tiptreeinc.com. Our remarks today are qualified in their entirety by the disclaimers on Page 1 of the presentation. Prior to turning the call over to Michael, we want to highlight a few of the key disclosures.

This presentation supplements our SEC filings and is provided solely for information purposes. Throughout the presentation, there are forward-looking statements. Our businesses are subject to risks and uncertainties, which are outlined in our SEC filings and which could impact our expectations of future results. Except as required by securities law, we undertake no obligation to update any forward-looking statements. We also use non-GAAP measures, which we believe provide supplemental information about our businesses and are useful to investors. As these measures are not GAAP, they should not be used as a substitute for GAAP disclosures. The appendix provides a reconciliation of each of these measures to their GAAP equivalents. With that, we will turn the call over to Michael, who will begin on Page 3 of the presentation.

Michael Gene Barnes
Executive Chairman

Thanks, Sandra. Good morning, and thank you for joining our call today. For the second quarter, while total revenues grew 19.5% year-over-year, we reported a net loss of $5.3 million and adjusted EBITDA of $6.8 million. Tiptree's as exchanged book value per share ended at $9.87, up 2% from this point last year. The net loss for the quarter and the 6 months and the decline in adjusted EBITDA over the prior year were primarily driven by unrealized losses of $8.3 million and $10.1 million, respectively, on equity securities which are held within our insurance investment portfolio.

The unrealized losses masked the overall positive performance of our underlined businesses. Excluding the unrealized gains on our equities in 2016 and unrealized losses in the current 6-month period, adjusted EBITDA at our operating businesses improved. Our primary focus, as always, is on continuing to build a company that can generate a high portion of stable and repeatable earnings from operations. In addition, we actively manage our insurance investment portfolio. We evaluate the performance of the portfolio on a total return basis, focusing on investments that provide cash flow from interest in dividends and the potential for capital gains over a long-term horizon. As a result, we may experience volatility on these positions from quarter-to-quarter. We've invested approximately 10% of the insurance portfolio in a concentrated group of equity securities, which we believe to be undervalued and, which in most cases, carry dividend yields that are attractive relative to our purchase price. From inception to date, we have received $4.2 million of dividends on our equity investments, partially offset by cumulative $2.5 million of unrealized losses. Our investment portfolio has grown to $346 million, a 12.7% increase from this time a year ago. Looking forward, over the next 12 months, while we would anticipate the portfolio will continue to grow, it will likely be at a slower pace, as much of last year's growth came with our captive reinsurance assumption of third-party reinsurance contracts in the fourth quarter.

With regards to our insurance business, we are continuing to recalibrate the product mix to achieve a balance between growing near-term earned premiums and offering products that will increase investable assets over time. For the second quarter, gross written premiums were $186 million, up 5.5%, driven by growth in our warranty products. Year-to-date, warranty written premiums were $57.5 million, more than double the first half of 2016, as we are seeing the new programs take hold.

Net written premiums for the quarter were $97 million, nearly 2x the second quarter of 2016, as we retained a greater portion of our credit insurance book to our captive reinsurance starting in late 2016. For the quarter, our asset management operations contributed $4.5 million of pretax income, down $1 million from the prior year, as we continue to pair our risk to CLO subordinated notes at attractive prices. Our Senior Living business acquired 10 properties during the quarter for $56 million, bringing our total gross assets in this segment to $407.6 million.

For the quarter, NOI margins were down, as recent acquisitions and recently upgraded properties are gradually ramping up towards stabilized occupancy levels. Looking forward, the senior living industry is experiencing softness in overall margins in near term, primarily driven by recent industry-wide capacity additions, increasing competition for occupants and pressure on payroll costs impacting minimum wage jobs. We believe supply and demand will ultimately realign, leading to the potential for stable and attractive returns in this business, as long-term demographics favor senior housing.

Book value per share, as exchanged, grew 2% year-over-year. Growth was driven by a combination of trailing 12-month earnings per share and share buybacks, partially offset by the impact of dividends and the issuance of shares in connection with the exercise of the Tricadia option. Lastly, during the recent quarter, we returned $9.5 million to shareholders through dividends and share buybacks.

With that, I'll hand the call back to Sandra, who will discuss the financials in more detail.

Sandra E. Bell
Chief Financial Officer

Thank you, Michael. On Page 4, we highlight the company's 6 months performance relative to last year. For the 6 months ended June 30, 2017, we had a pretax loss of $4.7 million and adjusted EBITDA of $18.6 million. On the right-hand side of the page, we have provided a bridge for both pretax income and adjusted EBITDA. While we reported a loss overall year-over-year, as indicated in the bridge, pretax income from operations was up $2.9 million over 2016, and adjusted EBITDA from operations was up $5.9 million. The primary drivers of the improvements included growth in warranty products in our insurance segment, the impact of acquisitions in our senior living operations, incentive management fees in asset management, improved operating metrics in specialty finance and reductions in corporate cost. We will go into these operating drivers in a bit more detail when we cover our segment operations later in the presentation.

As you can see in the bridge, our insurance portfolio investment income, excluding unrealized losses on our equity securities, added $1.6 million to both pretax income and adjusted EBITDA, driven by increases in portfolio assets. Offsetting the positive contributions from operations and insurance portfolio and net investment income were $2.2 million of stock-based compensation, granted based on improvements in underlying performance in prior years. Performance and time vested stock compensation is accounted for over the vesting period, which under our compensation plan is generally a minimum of 3 years. Also impacting 6 months pretax income was an increase in the earn-out reliability of Reliance of $3.5 million. This item is added back to adjusted EBITDA, so it does not impact that metric's relative performance. As part of the acquisition consideration to the selling shareholders when we bought Reliance, we tied a portion of the purchase price to Reliance's performance over 3 years. The second payment will be paid in the current quarter for the annual performance period ended June 30, 2017.

The better Reliance is underlying operating performance the higher the additional purchase price consideration. Reliance's strong performance over the last 12 months drove the increase in the earn-outs, which is paid in Tiptree shares calculated based on our book value per share.

In 2016, we recorded realized gains on the sales of certain equity positions previously held as principal investment, which were primarily related to our liquidation of noncore assets and was not repeated in 2017. Lastly, as Mike -- Michael has already mentioned, we had unrealized gains in equities held on our insurance portfolio in 2016 and unrealized losses in 2017 for a combined year-over-year change for the 6 months of $15.1 million. This volatility was by far the largest contributor to the reduction in both pretax income and adjusted EBITDA.

Moving to Page 6. We provide further details regarding our specialty insurance performance. We have divided the discussion into 2 components. On this page, we will focus on insurance operations and on the next page pretax income and adjusted EBITDA from the insurance portfolio. Pretax income and adjusted EBITDA from insurance operations were down year-over-year. The chart on the bottom left-hand corner shows insurance operations adjusted EBITDA was down $4.6 million, of that amount, $1.3 million was attributable to as adjusted underwriting margins, primarily driven by the mobile protection product. We have begun to see a leveling off in the decline in this product and have seen offsetting growth in other warranty products, such as auto, furniture and appliances. As a reminder, the mobile protection contract is shorter duration than the auto, furniture and appliance warranty products. That's why $1 of earned premium will impact earnings faster in the mobile protection product. The other warranty products come with additional investable assets for a longer period. The credit business is up year-over-year, primarily driven by the associative contracts from third parties by our captive reinsurance subsidiary. In addition, the softness we saw earlier in the year from foot traffic at our partners has begun to rebound. On the expense side, stock-based compensation was up $1.7 million, a portion of which was related to the carryover adjustment from 2016. In addition other expenses grew $1.5 million, primarily related to premium tax increases as gross written premiums grow. Our gross written premiums grew by what -- 5.5% year-over-year, contributing to higher unearned premiums and deferred revenues, which were up a combined 7% from last year. The increase in these 2 balance sheet items show the impact of growth in the longer-term contracts and the opportunity to enhance net investment income overtime with additional portfolio assets.

As we replace some of our shorter duration products, we would expect to see these balance sheet items continue to grow and earn premiums recorded over extended periods of time. The jump in net written premiums was driven primarily by the increased reinsurance retained by our captive subsidiary. The adjusted combined ratio for the quarter was 92.8%, up 5.1 percentage points from the prior year but down from the first quarter, the latter of which was primarily impacted by the carryover stock compensation expense from 2016. This metric is within our parameters of expected underwriting performance from quarter-to-quarter. The increase from our historical combined ratio of approximately 90% is primarily driven by mobile protection and the softness is credit -- in credit written volumes in the first quarter.

Looking forward, we plan to continue to expand our warranty product offerings and program products to drive written premium growth.

Turning to the insurance investment portfolio on Page 7. You can see the growth in net investments over the past year. This growth was driven by a combination of several factors, including the assumption of third-party credit protection reinsurance contracts and organic growth in written premiums. Our investment portfolio earnings in the first half of 2017 were down primarily due to the unrealized equity losses. That was partially offset by increases in dividends, interest income and improvement in realized gains from sales of nonperforming mortgage loans. Trailing 12 months earnings of $11.1 million are down from $17.1 million at this point last year but would be up slightly if the unrealized gains and losses were excluded. As we go forward, volatility will continue from quarter-to-quarter, but our objectives remain the same. To balance our portfolio between cash and liquid short-term investments to cover claims and select alternative investments with a focus on enhanced risk-adjusted total returns.

On Page 8, asset management pretax income year-to-date was $10.1 million, up $1.9 million over 2016. The earning assets under management declined to $1.6 billion, as our older vintage CLOs continue to run off. Our financial results for the 6 months were positively impacted by the fair value adjustments of $3.4 million on our investments in CLO sub notes versus losses of $2.5 million in 2016 and increased incentive fees in the older CLOs. Partially offsetting those increases were declines in distributions as a result of smaller sub notes holdings and lower base management fees as our assets under management declined. The fair value gains similar to the first quarter, were driven by the strengths in the loan market and the refinancing of one of our CLOs.

On Page 10, we continue to see improvements in our senior living segment adjusted EBITDA, primarily as a result of additional investments in new properties. Adjusted EBITDA for the half was $5.4 million, up $1.1 million from last year, driven by increases in net operating income of 28%. During the first 6 months of 2017, we added 2 managed properties and 10 triple net leases. And over the latest 12 months, we have acquired $119.4 million in new properties. On the bottom left-hand portion of the page, you will see the decline in NOI margins year-over-year, primarily due to the impact of industry-wide competition for occupancy, which Michael mentioned earlier. More specifically, increased competition has slowed the recovery in occupancy at 2 of our properties that underwent renovations in 2016. Pretax income for the first half increased by $1.2 million versus the prior year, as losses incurred on interest rate swaps in 2016 did not repeat.

Now we will turn the call back to Michael to conclude our prepared remarks.

Michael Gene Barnes
Executive Chairman
Thanks, Sandra. We believe Tiptree is well positioned for the remainder of 2017 and beyond. Our insurance business is focused on growing premiums, while maintaining profitable underwriting standards. As our mix of business trends towards longer duration products, we expect our invested assets to grow. Our strategic objective is to leverage Tiptree's investment expertise to increase the total return of the insurance portfolio over the long term as the insurance business grows, while maintaining an attractive combined ratio. Our asset management business is stable. We are looking to further leverage our investment expertise to expand AUM as market conditions continue to improve, potentially into other asset classes. Our senior living pipeline remains strong. Our focus over the near term will be to drive occupancy rates to increases NOI and NOI margins. We believe our efforts to better position the company for growth and providing greater transparency into our investment and operating performance should allow investors to better understand Tiptree's intrinsic value. With that, we can open the line for questions.

Question and Answer

Operator

[Operator Instructions] There are no questions. At this time, I'd like to turn the call back to Sandra Bell for closing comments.

Sandra E. Bell
Chief Financial Officer

Thank you, Rob. And thanks everyone for joining us today. If you have any questions, please feel free to reach out to me directly. We will look forward to speaking with you again shortly after the third quarter results are in. This concludes our conference call.

Operator
This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.