S&P Capital IQ

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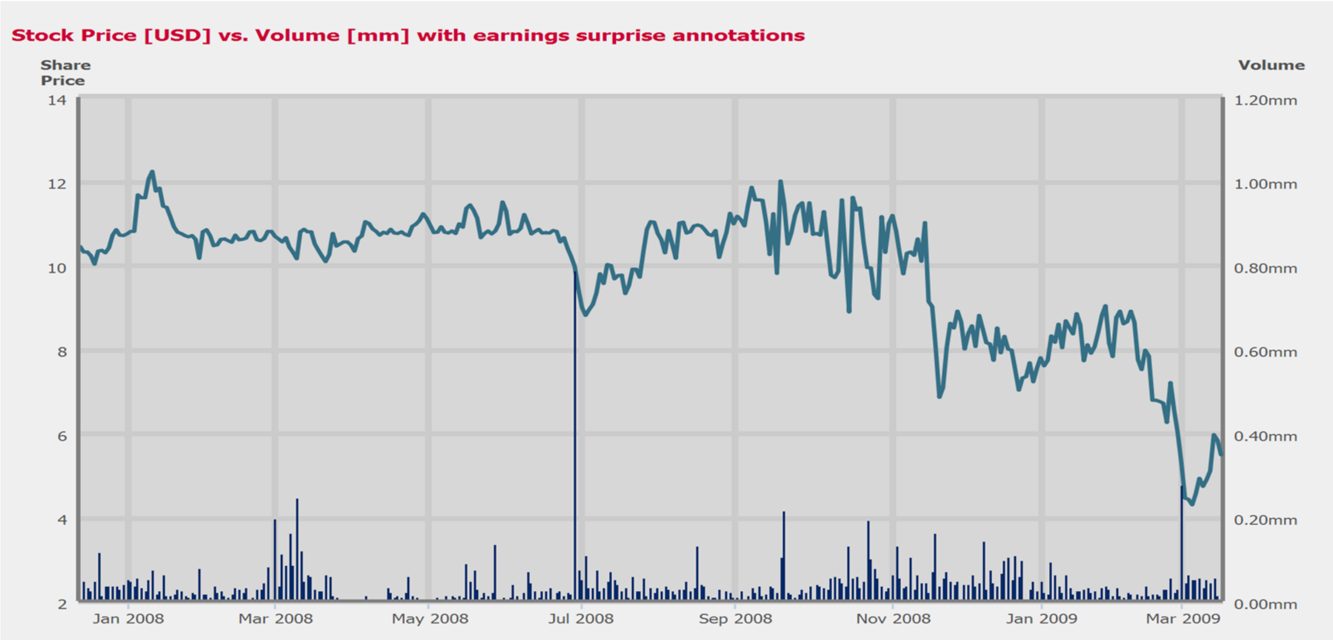

Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman

Sandra E. Bell
Chief Financial Officer

Presentation

Operator

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

It is now my pleasure to introduce your host, Sandra Bell, Chief Financial Officer. You may begin.

Sandra E. Bell
Chief Financial Officer

Good morning, and welcome to our First Quarter 2017 Earnings Call.

I am 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, I 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 use non-GAAP measures, which we believe provide additional information about our business 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.

As discussed in our recent SEC filings, after we filed the 10-K, certain immaterial errors were identified in the financial statements and related disclosures. The common characteristic among these errors, in addition to their immateriality, was the fact that they were onetime or unique in nature. As a result of their immateriality, the company expects no changes to the year-end or first quarter financials. Although these items are not material to the financial statements, the company is also required to evaluate the impact of the immaterial errors on the company's internal controls.

With that, let me 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 earnings call today.

For the first quarter, total revenues grew 25.4% year-over-year while generating $1.3 million of net income and $11.8 million of adjusted EBITDA. Tiptree's as exchanged book value per share ended the quarter at $10.15, up 11.5% from this point last year.

First quarter operating results continued to trend positively, excluding unrealized mark-to-market activity on our equity investments, and similarly, excluding gains on legacy corporate investments in 2016. It is important to note, we will experience occasional short-term volatility from quarter-to-quarter with these type of mark-to-market investments, but continue to believe, over the long-term, our investments will provide attractive risk-adjusted returns. Sandra will go through those drivers in further detail later in the call. Our primary focus, as always, is on continuing to build a company that can generate a higher portion of stable and repeatable earnings from operations.

With regard to our insurance business, we are constantly working 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. While these are sometimes competing objectives, we target a combined ratio in the mid-90s or better while growing our investable assets and longer-term investment income.

For the first quarter, gross written premiums were $165 million, down 9%, driven by reductions in nonstandard auto programs, which is partially offset by increases in our warranty products. Nonstandard auto is a good example of how we enter new product markets. We start small, ceding much of the business until we have a track record of underwriting performance. We then recalibrate to focus on the most successful programs to build the business and increase retention if desired. In the short-term, like nonstandard auto, we may write less premium as a result.

Net written premiums for the quarter were $86.3 million, up 82% from last year as we retained a greater portion of our credit insurance book starting in late 2016.

Our investment portfolio grew to $347 million, an 18.3% increase from this time a year ago. Looking forward, we expect the portfolio to continue to grow, yet it will likely be at a slower pace than the last 12 months.

Our asset management operations contributed $5.6 million of pretax income for the quarter, up from $2.7 million in the prior year as unrealized gains were up significantly from last year. In January 2017, we took active steps to reduce our volatility and capital exposure to CLO equity by selling our position in Telos 5 for a gain over year-end values.

Our senior living business continues to grow through additional property acquisition and expanding margins. In the first quarter, we added 2 properties for $24.7 million, bringing our total gross assets to $352 million. Looking forward, we believe the demographics of an aging nation and favorable financing rates will continue to create the potential for stable and attractive returns.

Lastly, we increased the dividend by 20% to $0.03 per share for the quarter. It is our objective to maintain a stable dividend policy going forward.

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

Sandra E. Bell
Chief Financial Officer

Thank you, Michael.

On Page 4, we've presented our first quarter operating performance by segment. In the upper left-hand portion of the page, we highlight pretax income and adjusted EBITDA by segment contribution. Overall, pretax income was $2.5 million and adjusted EBITDA was $11.8 million, down $2.5 million and $3.5 million, respectively, from the prior year. On the bottom left-hand portion of the page, we highlight the impact on earnings from our investments for the quarter, which include unrealized marks on our equities and gains and losses on CLO sub notes and legacy corporate investments. The combination of these factors was the primary driver of the decline year-over-year. Excluding these impacts, pretax income and adjusted EBITDA from operations would have been up slightly.

At a high level, I would like to take a minute to review the key drivers of our performance this quarter. As always, I will delve into each segment in more detail shortly.

Our specialty insurance segment contributed $9.4 million of adjusted EBITDA, down from the prior year. The decline was driven primarily by unrealized losses in our equity portfolio in 2017 versus unrealized gains in 2016 that are highlighted in the box I just mentioned. Additionally, we experienced softness in credit and mobile protection products as well as increases in stock-based compensation expense over the prior year. Approximately $900,000 of the increase in stock compensation was a onetime catch-up expense related to performance awards.

The softness in underwriting margins is largely due to the change in product mix where our growth in written premiums is coming from longer duration warranty and other specialty products that earn out over a longer time horizon. Because premiums are paid upfront, we keep the float over a longer duration, which allows us to match assets and liabilities and invest in higher-yielding assets.

Our asset management segment was up significantly, driven primarily by additional unrealized gains in fair market values on the remaining CLO subordinated notes. As Michael mentioned, the sale of our interest in Telos 5 resulted in a gain over year-end 2016 values.

Senior living improved as a result of expanding NOI margins at existing properties and the acquisition of new properties since last year increased overall revenue.

Specialty finance contributed positively as a result of improvements in volumes and margins in the mortgage business, along with steady performance in that segment's loan portfolio. We continue to make progress in reducing corporate expenses as professional fees declined year-over-year.

Moving to Page 5. We highlight the financial trends over the last 5 quarters. In the first quarter of 2017, diluted earnings per Class A share was $0.03, in line with the prior year when you remove the impact of a onetime $4 million tax restructuring benefit. Our first quarter is typically a seasonally low quarter for the year. In addition, the volatility in the current quarter of our equity investments was only partially offset by the gains in value of our sub notes, which may occur from quarter-to-quarter as Michael stated earlier.

Our as exchanged book value per share grew to $10.15. The total number of Class A and Class B shares outstanding now stands at $36.5 million, with $371 million of book value and $523 million of total enterprise value.

We have incurred $46.9 million of GAAP accumulated depreciation since acquiring Fortegra and $42.4 million on the Care real estate properties and intangibles. After tax and after third party noncontrolling interest, this translates to $1.48 of book value per share on a fully exchanged basis and assuming a 35% tax rate.

On Page 7, we provide further details regarding our specialty insurance performance. In addition to the highlights mentioned earlier, you can see unearned premiums and deferred revenue are trending positively, up 1.4% from $462.7 million to $469.4 million year-over-year. We view this as a leading indicator of future revenues and, when combined with net written premiums, give an indication as to the growth by product area.

The adjusted combined ratio for the quarter was 95.1%, up 6.6 percentage points from the prior year. Excluding the approximately $900,000 onetime catch-up in stock-based compensation expense, the ratio was closer to 94%, which 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 the softness in written volumes in credit and mobile protection impacting service and administration fees.

Additionally, when looking at underwriting profit, as we replaced some of our shorter contract duration products such as mobile protection with longer duration products such as auto and home appliance warranty products, we would expect to see earned premiums recorded over extended periods of time. As an example, $1 written premium with a 2-year contract would earn out in half the time as $1 written premium with a 4-year contract. However, longer duration contracts bring longer duration investable assets, which we expect would drive higher investment income over the long-term as we extend and match the maturity profile of our investments.

Looking forward, we plan to continue expanding our warranty product offerings and programs business to drive written premium growth, balancing between earned premiums and investment income contributions.

Turning to the insurance investment portfolio on Page 8. You can see the growth in net investments over the past 2 years going from $181 million to $347 million. This growth was driven by a combination of several factors: Assets contributed to Fortegra in mid-2016, the result of our captive reinsurance subsidiary replacing a third party as reinsurer of certain credit protection products in the fourth quarter of 2016 and organic growth in written premium.

Quarterly earnings were down year-over-year, primarily due to unrealized losses on equities of $1.7 million in the first quarter of 2017 as compared to $4.4 million of unrealized gains in the prior year. That was partially offset by increases in dividend, interest income and improvement in realized gains from the sales of nonperforming mortgage loans. The equities are concentrated in less than 10 positions, which may not always track broader market movements.

We view returns on this portfolio over a longer term, which have trended favorably with trailing 12-month earnings of $22.1 million, up from $11.2 million at this point last year. As we go forward, there will be volatility from quarter-to-quarter with gains and losses. Our objectives remain 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 returns.

On Page 9, asset management pretax income was $5.6 million, up $2.9 million over the first quarter of 2016. Fee-earning assets under management declined slightly to $1.8 billion as our older vintage CLOs are in runoff. Our financial results were positively impacted by the fair value adjustments on our investments in the CLO sub notes. This was driven by positive market movements and the refinancing of one of our CLOs. Historically, our earnings have been exposed to market volatility as a result of these investments. In January 2017, we elected to reduce our total investment to $40.6 million, which should decrease our exposure to market volatility in this segment.

On Page 10, we continue to see improvement in our senior living segment, both as a result of additional investments in new properties and improved margins on existing properties. Pretax income improved by 61% versus the prior year as increases in rental revenue outpaced added depreciation from new acquisitions. Adjusted EBITDA for the quarter was $3 million, up from $2.1 million last year, driven by increases in net operating income of 28.6%.

Most of the acquisitions over the last 2 years were managed properties where we partner with existing operators on facilities that are undergoing enhancements to allow them to operate more efficiently. On the bottom left of this page, you can see the improvements to-date as NOI margins on managed properties are up from 26% to 27.2%. As the newer facilities ramp up and stabilize, we expect our results to continue to improve.

In addition to growing organically, we are continuing to invest, with nearly $36 million of acquisitions to-date in 2017, including one in April where we established a new operating relationship with Phoenix Senior Living.

Now I will pass it 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 and as our mix of business trends toward longer duration products, we expect our invested assets to grow accordingly. Our strategic objective is to leverage Tiptree's investment expertise to increase investment income 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 assets under management potentially into other asset classes. Our senior living pipeline remains strong and we continue to make further acquisitions and increase NOI. 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] Ms. Bell, it appears we have no questions at this time.

I would now like to turn the floor back over to you for closing comments.

Sandra E. Bell
Chief Financial Officer

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

Operator
Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.