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Tiptree Inc. NasdaqCM:TIPT

FQ1 2021 Earnings Call Transcripts

Thursday, May 06, 2021 1:00 PM GMT

S&P Global Market Intelligence Estimates

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The chart could not be generated due to the unavailability of pricing data

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Michael Gene Barnes
Executive Chairman of the Board

Sandra E. Bell
CFO & Principal Accounting Officer

ANALYSTS

Unknown Analyst

Presentation

Operator

Greetings. Welcome to the Tiptree Inc. First Quarter 2021 Earnings Conference Call. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Sandra Bell, Chief Financial Officer. Thank you. You may begin.

Sandra E. Bell
CFO & Principal Accounting Officer

Good morning, and welcome to our first quarter 2021 earnings call. We are joined today by our Executive Chairman, Michael Barnes; and CEO, Jonathan Ilany. You can find the slides that accompany this review on our Investor Relations website.

Please note that some of our comments today will contain forward-looking statements based on our current view of our business and actual future results may differ materially. Please see our most recent SEC filings, which identify the principal risks and uncertainties that could affect future performance.

In addition, we will discuss certain adjusted or non-GAAP financial measures, which are described in more detail in this morning's presentation. Reconciliations of non-GAAP financial measures and other associated disclosures are contained in our SEC filings, the appendix to our presentation and posted on our website.

With that, I will turn the call over to Michael.

Michael Gene Barnes
Executive Chairman of the Board

Thank you, Sandra, and good morning to everyone. We are pleased to announce that the first quarter 2021 was a record quarter for Tiptree with all of our holdings contributing to first quarter profits. Both revenues of $295 million and net income of $30.6 million were all-time highs for a single quarter, driven by the particularly strong performance of Fortegra, our specialty insurance business; Reliance, our mortgage business; and gains on investment holdings across the company.

Revenues, excluding mark-to-market, increased 26% and adjusted net income of $13.2 million increased 90% from the prior year. For our insurance and mortgage businesses, production and sales volumes are at all-time highs, and the management teams continue to drive growth while expanding margins. Given our confidence in the strength of these core operating trends, Tiptree repurchased close to 500,000 shares in the first quarter and 2.3 million shares over the past year, representing approximately 7% of outstanding shares. These repurchases were executed at a deep discount to bulk and an even further discount to intrinsic value.

In our insurance business, the Fortegra management team, led by Rick Kahlbaugh, continues to execute on its growth objectives. Gross written premiums and premium equivalents of $505 million were up 29% over first quarter 2020, driven by strong organic growth of 28% with contributions from all business lines and geographies. Revenue growth and an improving combined ratio led to adjusted net income of $12.8 million, up 46% from the prior year. This performance translates into an annualized adjusted return on equity of 17.9%.

As our shareholders are well aware, over the past several months, we have worked toward a potential IPO of Fortegra that will provide access to efficient long-term capital to accelerate its growth. Additionally, we saw several potential strategic benefits to Tiptree shareholders, including greater transparency of Fortegra's intrinsic value. Although last week, we decided to hold off on proceeding with the IPO, what has been made clear throughout this process and as both 2020 and first quarter 2021 results demonstrate is a distinctly attractive value for Fortegra's business platform. We expect to see no disruption to Fortegra's robust growth prospects and are continuing to maintain consistent best-in-class combined ratios and adjusted return on equity metrics.

We believe that capital-light warranty business, combined with the niche insurance lines, are a unique offering from a specialty insurer. We believe that Fortegra will ultimately be rewarded for the growth profile and durability of its model, and we will continue to explore all available options to support Fortegra's growth and achieve our stated objectives. As a roughly 30% owner of Tiptree, I am confident in Fortegra's future and that Fortegra's true value will ultimately be reflected in Tiptree's share price.

Switching to Tiptree Capital. Our 3 primary investments in senior housing, mortgage origination and maritime transportation all generated positive net income for the quarter. And it's worth noting that Tiptree Capital on a stand-alone basis now has over $190 million of book value. Adjusted net income within Tiptree Capital was $8 million for the quarter, up substantially from the prior year, driven by strong performance in our mortgage operations. Mortgage volumes were up 34% year-over-year. Our mortgage business continues to show its strength and serves as an example of our objectives when allocating capital, namely to source scalable cash flowing businesses with strong management and having embedded upside optionality while also providing portfolio diversification to Tiptree's sources of revenue.

In addition, our investments in shipping were stable for the quarter. We entered this sector with a long-term thesis based on continued global economic growth and a potential supply and demand imbalance in shipping capacity, given limited new builds and higher scrapping rates for seaborne vessels. Current charter rates are beginning to reflect that thesis, particularly in the dry bulk sector.

With that, I'll pass it to Sandra, who will take you through the financial results in more detail.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Michael. On Page 3 of the presentation, we highlight Tiptree's key financial metrics for the first quarter 2021 compared to the prior year period.

Net income before noncontrolling interest for the quarter was $30.6 million, driven by continued growth in the insurance business, strong performance in mortgage operations and unrealized gains on investments in the current period as compared to unrealized losses in the prior year period. Excluding investment gains and losses, revenues were up 26% for the quarter, driven by organic growth in insurance operations and increased volumes and margins in our mortgage business.

Adjusted net income for the quarter was $13.2 million, representing a 13.7% annualized adjusted return on average equity. The value per share increased to $11.63, which represented an increase of 19.5% versus the prior year. Our capital and liquidity position remains strong with cash and equivalents of $124 million as of the end of the quarter, including $78 million held outside of statutory insurance companies available to support growth across our businesses.

On Page 4, we have updated our KPI trends. We evaluate the performance of our operations using adjusted net income, which removes realized and unrealized gains and losses, purchase accounting amortization, stock-based compensation and nonrecurring items. We believe that adjusted net income better aligns with similar metrics that are used by our peers, particularly those in the insurance industry who have a high proportion of both capital-light warranty businesses and fee-based revenues.

Adjusted net income for the quarter increased 90% to $13.2 million from $6.9 million in the prior year. These strong operating results were driven by the outperformance of our mortgage business and continued positive earnings performance in Fortegra's business. We continue to see strong momentum in Fortegra's top line results. For the first quarter of 2021, premiums and equivalents increased 29% year-over-year, driven by growth in all lines of business, particularly commercial, credit and warranty programs. Of note, organic growth was 28%, achieved through increased production per agent and the continued addition of new distribution partners and agents.

As a reminder, particularly with respect to longer duration warranty contracts, much of the increase in this metric ends up on the balance sheet as GAAP recognizes the revenue over the life of the contracts. Deferred revenues and unearned premiums, which represent this future earnings potential, stood at $1.32 billion, up 27% year-over-year.

Turning to Page 5, we highlight our capital allocated between Fortegra and Tiptree Capital, along with their respective returns to assist investors in understanding Tiptree's intrinsic value. Over the last 12 months, adjusted return on average equity improved to 15.6%, an increase from 8% in the prior year. Fortegra's adjusted return on average equity improved to 17.3% from 13.3% in 2020, driven by organic growth in capital-light warranty businesses and growth in commercial and personal lines programs, all while maintaining a consistent combined ratio in the low 90s. Our mortgage business generated outsized returns on capital, driven by improvement in both volumes and margins, which have benefited from a strong housing market, both of which were partially offset by increased interest expense resulting from our upsized corporate borrowing facility completed in early 2020.

With that, let's dive deeper into the insurance company's results. But before doing so, I would like to take just a moment to remind everyone of the key characteristics of the business model that support such consistent profitability and the opportunity for future revenue and earnings growth at Fortegra. Fortegra is a specialty insurer that focuses on underwriting small premium [per] risk insurance, underwriting programs that are geared towards more frequent but less catastrophic, low-severity losses.

From a competitive point of view, large standard insurers who prefer to individually underwrite each transaction and touch every claim avoid small premium [per] risk insurance because the infrastructure and personnel costs required preclude them from underwriting profitably. Fortegra uses proprietary technology to overcome this challenge. These high-frequency, low-severity characteristics of both our U.S. insurance and U.S. and European warranty offerings generated a significant component of fee-based earnings and stable and consistent profitability. In addition, Fortegra's warranty product offerings benefit from being capital-light due to a combination of unregulated earnings and predictable loss ratios.

For the quarter, underwriting and fee margin increased $12 million or 29%. The combined ratio improved by 210 basis points to 91.5% as compared to 93.6% in the first quarter 2020. This was driven by a shift in mix toward more profitable commercial and warranty programs improving the underwriting ratio, along with the continued scalability of the technology and shared services platform improving the expense ratio. We maintain strong economic alignment with our distribution network, which is important in delivering a consistent combined ratio.

Several of the programs Fortegra underwrites have variable retrospective commission structures. Meaning, as a book of business is profitable, we will share that underwriting profitability with our agents. If it is not profitable, we will reduce their commission and the economics are rationalized. Importantly, Fortegra has averaged a 91.6% combined ratio for the last 5 years with very little variance while growing premiums and equivalents at approximately 20% per year. We are extremely proud of this performance and expect Fortegra to be able to sustain this stability in its combined ratio in the future.

Turning to the next page. We believe the hallmarks of Fortegra's business model underlie the opportunity for consistent growth and consistent underwriting profitability, combining underwriting and unregulated fee revenues, which leads to more consistent and predictable cash flows and enhanced returns. This is done by having 3 legs of the stool. The first 2 legs are, number one, admitted programs; and number two, surplus line programs, both in U.S. insurance. And the third leg is the balance sheet-light programs, which is warranty solutions. We believe it is the combination of these 3 and the complementary nature of these revenue streams that allows Fortegra to grow and to grow profitably regardless of where pricing is in the P&C market cycle.

On Page 9, we've highlighted the key growth considerations. First, Fortegra has a high persistency rate with its agents, which generates a large volume of recurring revenue. Over the past 5 years, revenues have grown at a 13% compounded annual growth rate and 11% organically. Second, we write multiyear contracts that generate significant upfront cash flow to the balance sheet and provides great visibility into the upcoming year's revenue base. Third, new programs are added from both existing agents and from new agents. Our technology gives us the ability to identify opportunities to expand participation by our agents' clients in the programs we offer to underwrite new programs profitably given the amount of data available to us to analyze the risks and to scale volumes efficiently when we add new agent relationships.

Lastly, the business continues to expand geographically. We're very pleased with the opportunities in Europe, where we can leverage our broad experience in the warranty space. We have a strong presence in Central and Eastern Europe and are growing into Western Europe and even the Pacific Rim. As you can see by the size of these addressable markets, we believe Fortegra has the opportunity to substantially expand its volumes and agent relationships to maintain strong growth and consistent underwriting profitability.

Turning to the insurance investment portfolio on Page 10. Total investments and cash and cash equivalents ended the quarter at $723 million, up 23% year-over-year, in line with underlying premium growth. We continue to maintain 77% of the portfolio in high credit quality and liquid securities with an average rating of AA. For the quarter, net investment income was $2.8 million, down from the prior year, driven by the reduced interest rate environment. Net realized and unrealized gains were $9.7 million for the quarter, driven by unrealized gains on equities.

On Page 12, we present the results of Tiptree Capital, which, as Michael mentioned earlier, consists of our Invesque shares, shipping and mortgage operations. For the quarter, the pretax income was driven by unrealized gains on our investment in Invesque, which is marked-to-market based on its share price, in addition to higher volume and margins in our mortgage business. First quarter 2021 adjusted net income in Tiptree Capital increased to $8 million, primarily driven by improvement in mortgage volumes and margins versus the first quarter of 2020.

As Michael mentioned, our mortgage business has benefited from several tailwinds, including higher refinance volumes supported by both low rates and rising home prices. And lastly, we've been able to retain mortgage servicing rights at relatively low valuation, providing opportunity for value appreciation in the future with rising interest rate environments.

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

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. Our first quarter 2021 was a great start to the year. Tiptree's total return, as measured by change in book value per share plus dividends paid, was 21.2% over the past year.

As I mentioned in my earlier remarks, we have a fantastic business in Fortegra and a collective management team that is energized to execute the growth plan and to continue looking at alternatives to accelerate it. The capital-light, fee-generating warranty programs complement Fortegra's niche specialty insurance focus. And with the addition of Fortegra Specialty in late 2020, there is substantial capacity in excess and surplus lines to complement growth in admitted programs. The earnings strength of our mortgage business in a low interest rate environment serves as a great example of the embedded upside optionality and diversity of our capital allocation.

We continue to believe that Tiptree's overall intrinsic value has increased significantly and is materially greater than our current stock price would suggest. As we look forward, we believe Tiptree is well positioned to continue executing on our long-term growth objectives.
With that, we will open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from [Alex Fideredecci] of Morgan Stanley.

Unknown Analyst

Could you talk a little bit about your maritime transportation business, the dry bulk sector? And just elaborate on your positioning in that business.

Michael Gene Barnes
Executive Chairman of the Board

Sure. I'd be happy to. And thanks for the question, Alex. So we started looking at this business probably about 4 years ago. And it was a long-term view that we had in terms of the anticipated growing of global economies and how we liked the embedded optionality in shipping, while producing current attractive cash-on-cash returns with the ability to expand in a lot of different directions and a very scalable model. I'll say that the pandemic certainly set that back somewhat.

However, it also created some anomalies in terms of the supply-demand, particularly in dry bulk as certain -- as it became more challenging to change crews as certain -- as China certainly started keeping certain ships offshore and as other kind of anomalies hit that -- hit the shipping sector, there were fewer ships available. And what we've seen over the course of the last, let's call it, 6 months, maybe even 12 months is an increase in rates as a result of that supply-demand shift.

So part of our outlook from the beginning was not just the growth in global economies, but also what we viewed as a shift in terms of that supply-demand of ship availability versus demand in growing economies. So what we're seeing now as economies are reopening and -- is exactly that. We're seeing that optionality that we felt was embedded in the sector start to be untapped. We'll see how far it goes. But right now, we're enjoying the environment, particularly in the dry bulk sector with respect to rates.

We're also in the tanker sector, the product tanker sector. We entered that a few years ago as an expansion to our focus in shipping. There, we also saw some anomalies as the pandemic hit. And also as Saudi Arabia and Russia got into a tiff, we saw oil and related products plummet, but that actually created a storage need. And we saw product tankers suddenly come into demand from a storage demand. And now more recently, with the recovery taking place, we're seeing a normal resumption of shipping in that sector.

So this is an area that we have taken a very long-term view. I think we've got great leadership, and we're continuing to expand in the sector.

Unknown Analyst

I don't know if I'm still on. I was just going to say, how many ships do you have in the dry bulk sector?

Michael Gene Barnes
Executive Chairman of the Board

Right now, we have 3 ships in the dry bulk sector.

Unknown Analyst

Okay. And are they at fixed rates currently? Or are they open to the spot market?

Michael Gene Barnes
Executive Chairman of the Board

We have a combination of being participants in a pool as well as doing long-term charters. And so the answer is that we tend to do longer-term charters and not expose ourselves to the volatility of day rates.

Operator

[Operator Instructions] There are no more questions at this time, and we have reached the end of the question-and-answer session. I will now turn the call back to Sandra Bell for closing remarks.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Hillary, and thanks, everyone, for joining us today. If you have any additional questions, please feel free to reach out to me directly. This concludes our first quarter 2021 conference call. Thank you.

Operator
This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation, and have a great day.