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Tiptree Inc. NasdaqCM:TIPT

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S&P Global Market Intelligence Estimates

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

Table of Contents

Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman of the Board

Sandra E. Bell
CFO & Principal Accounting Officer

ANALYSTS

Unknown Analyst

Walter M. Schenker
MAZ Capital Advisors, LLC

Presentation

Operator

Greetings, and welcome to Tiptree Inc. First Quarter 2022 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn this conference over to your host, Ms. Sandra Bell, Chief Financial Officer. Thank you, ma'am. You may begin your presentation.

Sandra E. Bell
CFO & Principal Accounting Officer

Good morning, and welcome to our First Quarter 2022 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

Thanks, Sandra. Good morning, and welcome to our earnings call. In the first quarter, our operating businesses continue to produce excellent returns, with revenues increasing 10% to $325 million and adjusted net income improving 17% to $15 million.

Fortegra posted another great quarter, with premiums and equivalents of $601 million, 26% growth from the prior year, led by strength in the admitted and E&S insurance lines. The business continues to experience hard markets for its specialty E&S lines, which contributed to the record quarterly adjusted net income of $21 million and return on equity of 28%.

In early April, Fortegra also added a bolt-on acquisition in the U.K. for just over $15 million of net cash consideration, further establishing its footprint in the European auto warranty sector.

The Warburg regulatory approval process remains on track, and we expect to close within the second quarter. We anticipate using investment proceeds for additional growth capital in Fortegra Specialty lines and to repay Tiptree's corporate debt facility. Like many of our peers, our investments experienced negative mark-to-market for the quarter, both within our insurance investment portfolio and on our Invesque shares. We are likely to experience such volatility from quarter-to-quarter on publicly traded bonds and stocks. And therefore, we tend to look at performance over a much longer time horizon.

Our fixed income portfolio remains conservatively positioned with a AA+ rating and a 2.5-year weighted average duration. We feel confident that the majority of the unrealized losses from this quarter will be recovered over the coming years as bonds mature. As the portfolio grows and we reinvest maturing securities, the rising interest rate environment, as we observed in the first quarter, could be a meaningful driver of income over time.

As of the end of the quarter, our investment portfolio stood at nearly $900 million. Despite this quarter's unrealized marks, Invesque, our largest publicly traded equity position, continues to execute on its strategic initiatives to streamline its portfolio of senior care properties. It recently announced 3 separate sales, totaling $75 million that will allow the company to continue to reduce its overall debt profile. We are confident that over time, we will realize the value of this investment.

In our Marine business, we had an active quarter with both dry bulk and tanker investments producing solid returns. Given the elevated pricing levels for dry bulk tonnage, we signed a definitive agreement to sell 1 of our 3 vessels for $21.5 million, representing a 50% gain to first quarter carrying value. We also took advantage of an opportunity to repay debt on our tankers at a 10% discount level to the outstanding principal balance.

As we look forward, we believe there will be additional sale and purchase opportunities within the shipping sector.

Finally, our mortgage business produced positive returns in the first quarter, driven by mortgage servicing fees and value appreciation on our MSR asset, while volumes and margins have compressed in the beginning of 2022. Over the past 2 years, the business has grown retained earnings substantially, and we now hold an MSR asset worth approximately $38 million on our balance sheet.

In summary, we were pleased with our operating businesses for the first quarter of 2022 and believe there is a clear path for growth in future periods.

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 2022 compared to the prior year period. We incurred a net loss just shy of $1 million in the quarter, resulting from unrealized losses on investments, which was partially offset by continued growth in the insurance business and positive performance in our shipping operations. Excluding investment gains and losses, revenues were up 25% for the quarter driven by organic growth in insurance operations and increases in vessel charter rates.

Adjusted net income for the quarter was $15.5 million, representing a 15.8% annualized adjusted return on average equity. Book value per share of $10.51 decreased by 4.9% for the quarter, primarily a result of unrealized losses on our fixed income securities driven by higher rate environment.

Our businesses continue to produce strong operating cash flows, which gives us the ability to hold these securities to maturity. The higher interest rate environment allows us to invest new money and improved yields, which we expect will be a benefit over the long term.

Turning to Page 4, we highlight Tiptree's some of the parts value, reflecting the impact of Warburg's $200 million investment in Fortegra. Based on the transaction multiple of trailing 12 months adjusted net income, which is implicit in Warburg's investment, Tiptree's retained ownership on Fortegra on an as-converted basis represents approximately $739 million or $20 per diluted Tiptree share. $140 million of proceeds will go to the Tiptree holding company to fully repay outstanding debt, with the remaining to be deployed as growth capital within Fortegra. After the transaction closes, when you include the book value of Tiptree Capital and holding company assets, we believe Tiptree's some of the parts value to be approximately $26 per diluted share.

On the next page, we highlight Fortegra's results for the quarter. As Michael mentioned, we continue to see strong momentum in Fortegra's performance. For the first quarter of 2022, premiums and equivalents increased 26% year-over-year, driven by growth in all lines of business, including admitted excess and surplus and warranty lines. The roughly $600 million represented the largest single quarter of written premiums in Fortegra's history.

Deferred revenues and unearned premiums, which represent future earnings potential, stood at $1.75 billion, up 33% year-over-year. The combined ratio improved 100 basis points year-over-year to 90.5% as operating and technology efficiencies contribute to an improved expense ratio, while the underwriting ratio remained relatively consistent with prior periods.

Fortegra continues to experience hard market conditions in specialty commercial lines, both from a pricing and terms and conditions perspective. We are constantly monitoring inflation and loss costs trending and maintain a cautious approach to underwriting. Thus far, the impacts of inflation on the business have been minimal as we have generally been able to mitigate any rising costs with offsetting premium increases.

Fortegra's 12.9% expense ratio for the quarter continues to benefit from economies of scale with underwriting and fee revenues growing faster than operating expenses. Operating return on equity was approximately 28% on an annualized basis. Fortegra's low expense ratio and scalable, efficient platform remains in a strong position to continue its growth and best-in-class returns going forward.

On Page 7, you can see the insurance company financial trends. Gross written premiums and equivalents have increased 34% over this period with a 28% organic growth rate. Specialty commercial lines have grown 61% through the addition of new agents and programs and the expansion of E&S offerings. Personal lines have increased 7% and benefited from the bounce back in commercial spending in 2021 and early 2022. And warranty lines have tripled through increased market penetration.

Fortegra's vertically integrated product offerings to agents, dealers and retailers has provided a strong platform for growth when combined with significant expansion in Europe. The combined ratio is not only stable, but it shown consistent improvement over time, moving from 94% in 2019 to 90.5% in 2022.

Adjusted net income increased to $21.1 million for the first quarter, representing a 48% growth rate over the past 3 years. Adjusted return on equity has improved from 10% to 28% over the respective periods. Of note, this puts Fortegra just above $75 million of trailing 12-month adjusted net income, a figure we expect will continue to grow in future periods.

Turning to the insurance investment portfolio on Page 8. Total investments and cash and cash equivalents ended the quarter at $892 million, up 23% year-over-year, in line with the underlying premium growth. 86% of the portfolio is invested in high credit quality and liquid securities with an average rating of AA+.

The fixed income portfolio has a relatively short duration. As we mentioned earlier, while unrealized marks have impacted book value Generally, we have the ability to hold these securities to maturity. We view reinvestment as an opportunity for improvement in investment income with rising rates a positive for Fortegra's investment portfolio in the long run.

Fortegra's capital and liquidity remains strong, with $294 million of stockholders' equity, debt capacity of nearly $200 million and an ability to draw $60 million of capital upon the Warburg transaction closing, all of which put the business in a solid position for future growth.

On Page 10, we present the results of Tiptree Capital, which consists of our mortgage and shipping operations as well as our Invesque shares. While pretax income was impacted by the unrealized marks on Invesque in the quarter, 2022 adjusted net income for the first quarter was $1 million. Our mortgage business has benefited from several tailwinds over 2020 and 2021, including higher refinance volumes, supported by both low rates and rising home prices as well as the growing servicing book.

As of March 31, 2022, the equity in our mortgage business was $58 million, after distributing nearly $20 million of capital to Tiptree over the past 3 quarters. While origination volumes were down 16% from the prior year and margins compressed to pre-COVID levels, we believe our mortgage servicing portfolio and home price appreciation will offset some of the impact on originations as rates rise.

For the quarter, our shipping business contributed $2.5 million of adjusted net income as both dry bulk and tanker charter rates remain at robust levels. Given elevated charter rates and a strong demand for shipping assets, we believe the fair value of our vessels to be well in excess of our first quarter net book carrying value of $83 million.

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

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. The diversification of our businesses supported the strong operational results in the first quarter. Fortegra posted record adjusted net income and return on equity. Given the strong pipeline and favorable market conditions, we expect this profitable growth to continue.

Within the shipping sector, both bulker and tanker markets are performing well, which provides us the opportunity to drive near-term returns, and we remain focused on deploying capital with the objective of long-term shareholder value appreciation.
With that, we will open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of [Alex Bazendan with Veredus Capital].

Unknown Analyst

Great job. Just 1 for me. We really appreciate companies like yours where management is really aligned with shareholders. And Michael, you and the rest of the team own a lot of stock, and so that really helps. And the compensation agreement that you guys had last year had some great IRR targets and it's long term and again, really align you guys with shareholders.

The question I have is just kind of going forward, do you guys have a framework of how we should think about dilution or grants kind of going forward and what they would look like? And I'm asking that in light of the proposal to increase the incentive shares in the proxy statement. And so I'm kind of thinking how we should think about what the cadence of grant looks like going forward?

Michael Gene Barnes
Executive Chairman of the Board

Yes. Thank you, Alex, and I appreciate your comments. We actually did try to take our -- put forth a thoughtful incentive plan. As our businesses have changed, as our stock price is appreciated, we wanted to create an incentive that, to your point, really aligned senior management with shareholders.

Already, we're the largest shareholders. I'm going to continue to own my shares and will likely be exercising an old warrant that's coming up and coming due soon to increase my ownership. So I'm going to continue to be a strong owner.

And as it relates to dilution, I'm going to be the #1 person wanting to avoid seeing our shareholders diluted, particularly me, I'll say. And in that regard, one of the things we changed in our incentive plan a bit over a year ago was also changing the allocation of RSUs, restricted units, to other officers. We gave them an option to elect to participate up to a percentage of a year-end bonus with a matching if they agreed to walk in to not have those vest for a 3-year period. So we look at that also as opposed to forcing RSUs upon individuals. Oftentimes, we didn't like seeing those getting sold in the market. So we like an alignment and a long-term objective of our senior management and senior officers.

As it relates to other types of allocation of shares, we do have a liquidity conversion option on certain of our subs as they hit incentive targets to vest into Tiptree shares, which will provide them, over time, some liquidity and what would otherwise be private ownership of their subs or of our subs, but we don't want to see any material dilution to shareholders other than as a result of our businesses hitting their targets. And so these are incentive units that are meant to be allocated based upon success in our businesses. I think that answers the question.

But I'll ask if you have any follow-up to that.

Unknown Analyst

That's -- I think that this is a great high level. Maybe I'll just be super blunt, do you guys envision -- last year, I think the grant total was something like 10%. They were definitely performance-based, and there were high IRR targets associated with it. I think the request for increasing the shares a lot now is something like 10% again. Do you see you envision kind of material grants in the next, say, 3 to 5 years of -- would we see more than 5% of shares being issued in any given year?

Michael Gene Barnes
Executive Chairman of the Board

Yes. Let's be clear -- let me just answer it Sandra, and I'm happy for you to add to it. Let's be clear, in creating the sort of stepped incentive plan that we put in place last year, it's low allocate -- you are correct, it amounts. Ultimately, if we were to achieve all of the targets over an extended period of time, it would result in that amount of shares being issued. I think your revenue is around 10%, depending on what other shares are outstanding as we go along.

But to be specific, only a small amount was achieved in hitting the first target as we hit other targets at higher levels, it is an incentive to hit those targets by allocating increasing amount of shares. I want to see the bulk of the shares come in the last 2, 3 targets, which are $45, $60 at the higher end of those last 2 targets, dollars per share.

So hitting those targets would result over a 10-year period and about a 19% IRR. That was approximately the IRR target. The proxy that just went out is actually approving shares to allow for that incentive plan. I wouldn't view it as duplicative.

And correct me if I'm wrong, Sandra, but I'll let Sandra, why don't you go ahead and answer that.

Sandra E. Bell
CFO & Principal Accounting Officer

Michael, that's actually what I was just going to say. Alex, they are to support the grants that were given last year. We didn't have enough shares to cover those. So that's the sole purpose of that $4 million.

Operator

Our next question comes from the line of Walter Schenker with MAZ Partners.

Walter M. Schenker
MAZ Capital Advisors, LLC

First, congratulations on selling one of the oceangoing ships. We're 1/5 of the way there, Michael. There are 4 more to go.

Michael Gene Barnes
Executive Chairman of the Board

It's an opportunistic environment for our dry bulk sector. We'll always look at taking ships off the table and then be patient in reallocating.

Walter M. Schenker
MAZ Capital Advisors, LLC

I mean -- and you've gone through enough of these calls and you've spoken enough of us investors. It is still clear that the stock selling at half or less than half of what you reasonably put a valuation per share on, that a major part of the disconnect is the diversity of the capital side of the business, not the Fortegra side of the business.

A question on mortgage side, which I am not very familiar with. It is, at least to me, somewhat clear, if you listen to [Powell], it should be reasonably clear that the interest rates are going to be moving higher mortgage rates have already started to move higher. Liquidity is going to not be pumped into the system and may even be drained due to the runoff.

In that environment, what changes from what we just saw in the mortgage business or we've seen the best of times, and I understand servicing becomes more valuable as an asset. But from an earnings standpoint, again, you've done this a long time, in that environment, which I've laid out, which may or may not come to pass, what's the outlook for the mortgage business over the next couple of years from an earnings standpoint? It's just a general way of looking at it.

Michael Gene Barnes
Executive Chairman of the Board

Yes, we're certainly not going to give guidance, but I'll tell you how we look at it. Look, first, this is an area that I'd say amongst the senior officers of Tiptree. It's an area that we have been deeply embedded in for all of our premiers. So in the case of Jonathan Ilany, myself, Sandra, this is an area that we've been focused on for the last 30 to 40 years for each of us. So it's an area we know well.

We've got a great team of Reliance. I'd say one of the most seasoned veteran teams out there in the mortgage origination business. What we've been doing as we have anticipated that rates may be rising given all the liquidity being pumped in the system these last few years, was building out our servicing book. Servicing does 2 things. It not only serves as a protection of the downside as rates rise and as refinancings become less common. But when you do have refi, it allows us a high percentage we capture in originations.

Reliance's business is primarily in refinancing. And as a result of that, as you see home price appreciation, we see that -- we anticipate that we're going to continue to see originations as people want to take money out of their home. So in spite of rates going up, it doesn't mean the business comes to a dead stop. It means that it's going to be more focused on refis, which is exactly how we're positioned. Our servicing book will serve to protect this and has done well, and you'll see that in the first quarter here in terms of our results.

And when I look at the business, other than our servicing book, which occupies more than half of our book value in terms of what Reliance represents in our balance sheet, the remaining business doesn't need a huge amount of capital to operate and sells what it originates after a short-term warehousing period. So it's a very clean business and a very good cash flowing business. We love that.

As long as the expenses are controlled and as long as we continue to operate under what I would characterize as normal conditions, as rates start to hopefully stabilize and as the Fed takes action, but as we may see a slowing of the economy overall, rates may stabilize or come down, we'd expect that to be a normal operating business.

This is a business -- mortgages have been around for all of our lifetime for well many generations. They're going to continue to be around for a long time. As long as we're returning -- having a return on equity consistent with what we view as equity objectives when allocating our shareholder capital, which would be, in my opinion, in the high teens to 20s on a net basis, as long as we feel that, that is achievable, we're going to continue to be in this business.

And that embedded optionality that I often speak of in terms of allocating capital, we saw that these last 2 years. These last 2 years have been phenomenal. And you don't just throw it out -- throw the business out, once you have that optionality kind of come back in the line. You adjust your expenses, you build out your servicing to protect you, you adjust to the new market environment. of focusing on refis and home price appreciation. And I think we've got a great business. I think that business is going to continue to be a great business for us going forward.

Walter M. Schenker
MAZ Capital Advisors, LLC

Okay. Although just as a comment in passing, the only person who didn't refi over the last 3 years is death because approximately every 15 minutes on the radio, you hear in add for somebody telling you, you need to refi while rates are low, you need to refi before rates go up. And so I would think refis will continue but at a fairly limited basis, but I haven't been doing this for 40 years. I've been doing other stuff.

Michael Gene Barnes
Executive Chairman of the Board

Walter, one other thing I'd say is we're in a relatively healthy job environment. And as the job report this morning, certainly showed there's good employment in this country. Wages continue to step up. We've got a relatively healthy consumer, and there's going to continue to be new home formation, there's going to be continue to be people that move. There's going to continue to be people that want to send the kids to school, put on in addition, et cetera. You'll see refis continue as they have in the history of this country. So we're -- we like our business. It's a capital-light business relatively. And so we want to continue in this business.

Walter M. Schenker
MAZ Capital Advisors, LLC

And just last question. Once the -- which is supposed to happen this quarter, the transaction for the investment in Fortegra takes place and $100-plus million get -- go up to the parent, I know historically, the company has bought back a lot of stock. The stock is under half of what you think the value is. As you can't speak for the Board, you can speak for yourself, you may not want to, what is your view about buying stock at under 50% of your conservative or realistic value per share [indiscernible] half of the year? I'll pick a time frame.

Michael Gene Barnes
Executive Chairman of the Board

I'm going to get you been amongst one of the large -- we've probably bought back more shares of Tiptree over the last decade than most companies out there. So it's been an area of focus for us as we see us trading at a significant discount to intrinsic. We've been fortunate that we bought back a lot of those shares at a discount to even our GAAP book value, and we felt our intrinsic was well in excess of our GAAP book value.

So we are always going to evaluate where we're trading, cash availability, need for that cash and other -- in building our businesses. So we're always going to look to optimize the use of cash on hand. It is hard to pass up when you see our shares trading at half of intrinsic value, so we will consider that when looking at allocating capital. But we also want to make sure we maintain liquidity, and that we're conservative and we have capital to allocate when we want to grow. So we're going to just always be monitoring that, but it is always on our radar to consider buying back shares.

Operator

Ladies and gentlemen, we have reached the end of today's question-and-answer session. I would like to turn this call back over to Ms. Sandra Bell for closing remarks.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Laura, and thank you, everyone, for joining us today. As always, if you have any questions, please feel free to reach out to me directly. This concludes our first quarter 2022 conference call.

Operator
You may disconnect your lines at this time. Thank you for your participation. Enjoy the rest of your day.