

Tiptree Inc. NasdaqCM:TIPT

FQ4 2022 Earnings Call Transcripts

Thursday, March 9, 2023 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2018-		
	CONSENSUS	ACTUAL	SURPRISE
EPS Normalized	NA	0.00	NA

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Call Participants

EXECUTIVES

Michael Gene Barnes

Executive Chairman of the Board

Sandra E. Bell

CFO & Principal Accounting Officer

Scott McKinney

ANALYSTS

Chris Colvin

Breach Inlet Capital Management, LLC

Presentation

Operator

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

It is now my pleasure to introduce your host, Scott McKinney, Deputy Chief Financial Officer. Thank you, sir. You may begin.

Scott McKinney

Good morning, and welcome to our fourth quarter 2022 earnings call. We are joined today by our Executive Chairman, Michael Barnes; and CFO, Sandra Bell. A copy of our earnings release, investor presentation and annual report are on our website, tiptreeinc.com.

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.

During the call this morning, we will discuss non-GAAP financial measures, which are described in more detail in our 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

Good morning, everyone, and welcome to our fourth quarter earnings call. Although 2022 presented a number of significant market challenges, we were pleased with our results for the year.

Revenues for the year increased to a record \$1.4 billion, up 16% from the prior year, while contributing adjusted net income of \$63 million. Our specialty insurance business, Fortegra, continued to build upon its exceptional multiyear performance, producing a record adjusted return on equity of 26%, while growing top line premiums by 22% for the year.

Fortegra's growth was led by strength in its specialty and is remarkable over the past few years. More importantly, profitability has been maintained as the combined ratio has remained consistently low, registering an impressive 90.7% for the year. Our outlook for Fortegra remains bullish going forward.

With a robust specialty pipeline, \$2 billion of deferred revenues and unearned premium sitting on the balance sheet and a long history of consistent growth and profitable underwriting, we could not be more excited about the future of our insurance business. While the financial markets provided some challenges to the performance of the investment portfolio, it increased in size by 27% to \$1.2 billion. We take a conservative approach with the portfolio, and we anticipate future investment performance to be positively impacted by our ability to invest and reinvest in a higher interest rate environment.

Our other businesses in Tiptree Capital also performed well in 2022 with a combined return on average equity of 16.9%. Although interest rate movements negatively impacted residential mortgage origination volumes at Reliance, the mortgage servicing book as well as proactive cost management by the team kept the business profitable. As mortgage rates stabilize at these higher levels, we maintain a positive outlook for our mortgage business.

Tiptree Marine delivered strong results in 2022 as both the dry bulk and product tanker shipping sectors continued to experience increases in asset valuation and shipping rates. We took advantage of the elevated valuations. And in the fourth quarter, we sold the remaining 2 product tankers, which combined with the sale of our dry bulk vessels earlier in the year, put total proceeds at \$117 million or a net gain of \$35 million for the year.

In a tough year for many, we are pleased to announce we will increase our dividend by 25% to \$0.05 per share as of March 2023, reflecting our view of the underlying strength in our operating businesses. We are always looking for new investment opportunities with the objective of generating all-weather long-term absolute returns.

With no set holding period, we believe we have a distinct advantage, and we are able to take a very long-term view with our outlook for returns. We are starting our 2023 well positioned financially and are confident in the outlook for the company.

With that, I'll pass it to Sandra for the quarterly financial update.

Sandra E. Bell
CFO & Principal Accounting Officer

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

For the quarter, net income was \$0.9 million, driven primarily by the gain on sale of 2 product tankers and improved performance in our insurance business, offset by declines in mortgage volumes and deferred tax expense related to the Warburg transaction. Excluding investment gains and losses, revenues were up 11.5% for the quarter, driven by growth in insurance operations.

Adjusted net income for the quarter was \$14.6 million, representing an 11% annualized adjusted return on average equity. Contribution from the insurance business were partially offset by the year-over-year decline in our mortgage business. Book value per share of \$10.92 increased by 2.6% compared to the prior quarter and decreased by 1.3% over the prior year as a result of unrealized mark-to-market movements on our fixed-income securities, driven by the higher rate environment and the strengthening of the U.S. dollar. This was, in part, offset by the closing of the investment in Fortegra in the second quarter.

The transaction with Warburg Pincus resulted in a \$63 million pretax gain to Tiptree's equity, which was partially offset by \$45 million of tax expense related to the tax deconsolidation of Fortegra. As a reminder, this deferred tax liability is only due if and when we decide to sell any of our Fortegra shares.

Turning to Page 5. We highlight Fortegra's results where we continue to see strong momentum. For the fourth quarter, quarterly premiums and equivalents were \$724 million, which were up 26% year-over-year, driven by growth in excess and surplus and warranty line. The quarterly combined ratio remained stable year-over-year at 89.8%.

Operating efficiency contributed to an improved expense ratio even with investments in people and technologies to fund our growth, while the underwriting ratio increased due to a shift in business mix towards lines with higher loss ratios and lower expense ratios. Adjusted return on equity for the year was approximately 26%.

Going forward, Fortegra's scalable, efficient platform remains positioned for growth and consistent returns on equity. We include Page 6 each quarter, so you can see the insurance company's financial trends over time. Gross written premiums and equivalents have increased at a compounded annual growth rate of 27% with the vast majority coming from organic growth. Many of Fortegra's products are multiyear policies, where premiums are earned over the life of the policy.

As we grow our written premiums, our earned premiums will lag, creating a balance sheet item known as unearned premiums and deferred revenue. We will continue to highlight this balance sheet metric, which has grown to \$2 billion, up 21% from the prior year-end. This unearned premium provides a solid and stable base for Fortegra's future earnings. The combined ratio has not only been stable, but has shown consistent improvement over time, moving from 92.4% in 2019 to 90.7% in 2022. Adjusted net income increased to \$84 million for 2022, representing a 37% growth rate over the past 4 years.

On Page 7, we present the insurance company investment portfolio, which ended the quarter at just above \$1.2 billion, up 27% year-over-year, in line with the underlying premium growth. 92% of the portfolio is invested in a combination of cash and high-credit quality liquid securities with an average rating of AA+. The fixed income portfolio has a relatively short duration at 2.3 years, similar to our weighted average liability duration.

As we mentioned earlier, while unrealized marks have impacted book value in 2022, we generally have the ability to hold these securities to maturity. Book yields stand at 2.7% at year-end, up from 1.3% in the prior year, driven by improving yields on money market funds. We believe there is an opportunity for material improvement in investment income without impacting credit quality with rising rates and just over 1/3 of the portfolio held in cash and equivalents. Throughout 2022, we actively carried a greater portion of the portfolio in cash in order to deploy it in the higher interest rate environment in 2023.

In summary, 2022 was a record year for Fortegra, with premiums of \$2.7 billion, adjusted net income of \$84 million and adjusted return on average equity of 26%. Its differentiated platform delivered excellent returns from insurance lines alone at an 18% return on equity, and we continue to see a significant lift from warranty services, which contributed an additional 8 points to the ROE.

Capital and liquidity remain robust for the company. With a growing equity base, strong cash flow from operations, and the recent refinancing and extension of its \$200 million revolving debt facility, we believe Fortegra is well positioned 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 invest shares. Pretax income for the quarter was \$8.5 million compared to \$7.6 million in the prior year, driven by the performance of our shipping investments. For the quarter, shipping contributed \$13 million of pretax income, including the gain from 2 product tanker sales. For the year, we recognized gains of \$35 million on the sale of all 3 dry bulk vessels and 2 product tankers.

As expected, our mortgage results have declined substantially from the record years of 2020 and 2021. In 2022, volumes were down 29% and margins tightened compared to prior years, although less than the broader market. Rising mortgage rates and declining affordability have impacted originations across the industry. Many of Reliance's competitors saw volumes decline as much as 70% year-over-year. We expect to continue to face headwinds from a volume and margin perspective, but believe our mortgage servicing portfolio and active cost management will partially offset the earnings impact from our origination activity.

Turning to Page 12. We highlight Tiptree's sum of the parts value, reflecting the impact of the investment in Fortegra. Based on the transaction multiple of trailing 12 months, adjusted net income, implicit in Warburg's investment, Tiptree's retained ownership of Fortegra on an as-converted basis represents approximately \$779 million, or \$20.45 for diluted Tiptree share. Including our other holdings, we believe Tiptree's sum of the parts value to be \$26.54 per diluted share for more than \$1 billion.

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

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. 2022 was a strong year for Tiptree with our businesses performing well. Fortegra delivered record premiums and returns. The pipeline of new opportunities remains robust and specialty market conditions remain favorable. As we look forward, we see significant opportunities to create value from a combination of underwriting income and fees as well as investment profitability.

Despite the market challenges, we are comfortable raising Tiptree's dividend given our long-term prospects. And finally, 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 Chris Colson (sic) [Chris Colvin] with Breach Inlet Capital.

Chris Colvin

Breach Inlet Capital Management, LLC

Michael, congrats on the progress last year. Fortegra's success has certainly been remarkable, and we look forward to seeing what Warburg and Rick can do together. And we also appreciate that you opportunistically divested shipping vessels and locked-in gains. I was hoping to hear your kind of latest thoughts on how you plan to close the gap between your conservative estimate at fair value of over \$26 a share and the current trading price of less than \$16. And when you answer that, maybe do you think potentially the best approach could be to spin off Tiptree Capital into its own public entity so that your team retains its permanent capital vehicle and allows public investors to invest alongside you and thereby converts tipped the current public company and to Fortegra, which eliminates future potential tax leakage and also highlights the stand-alone value.

Michael Gene Barnes

Executive Chairman of the Board

Thanks, Chris, and appreciate the compliment and appreciate the question. So let me address the question in terms of closing the gap. The differentiation in terms of what we see is our sum of the parts versus where we trade is certainly something we focus on continually. We are highly incentivized given our incentive structure as a management team to close that gap and to achieve that.

We closed on the Warburg investment in Fortegra, which as you remarked, has had remarkable growth, and we want to see that growth continue. So part of our objective in forming a partnership with Warburg was to bring in capital to continue that growth trajectory. That closed at the end of June. So we've had about 8 months to start to implement that. And as you've seen in the last 12 months, we've made a couple of bolt-on acquisitions that we see as further enhancing our cash flow to Fortegra. So we see that trajectory as positive and continuing. And I remarked in that in my comments.

We certainly -- as you well know, we've explored the idea of an IPO in the past. It's certainly something that as we look forward, creating efficiencies of capital and to the extent that we would like to raise more capital or with a private equity partner down the road if there's the objective of that partner achieving some monetization event, certainly either an IPO or a considered sale is something that sits in the back of our mind. But right now, we're focused on growth.

And we believe that as we are out there communicating for Fortegra, its businesses, what is unique about Fortegra, that message will certainly sink in. As it relates -- and if and when we pursue a potential IPO to establish efficiencies of capital and potentially for the growth Fortegra, we think the transparency of that public print would hopefully filter through to the shareholders of Tiptree as well. So we're certainly going to be out there telling our story. We're going to be out there communicating separately for Fortegra, and its uniqueness and its continued growth. We're going to look to potentially establish an independent and more efficient capital platform, capital raise platform for both debt and equity for Fortegra opportunistically. So those are the steps we're going to be taking.

What -- I think I'd say with regard to the consideration of efficiency of taxes, et cetera, that is something we always think about. And you've been very proactive, let's say, in reaching out to us to make suggestions, et cetera, which we appreciate. We have a team internally that meets regularly to consider taxes overall for organization.

One of the items on list certainly is as we look forward, to potentially doing an IPO of Fortegra or any other monetization event, what impact it would have to our shareholders. And it certainly would be our objective to maintain as much value for shareholders as possible. We'll explore all options and take the one that we think is best for shareholder value. So I think I'll end my answer there. But thank you for the question, Chris.

Operator

[Operator Instructions] It appears there are no further questions at this time. I would now like to turn the floor back over to Scott McKinney for closing comments.

Scott McKinney

Thank you, Maria, and thanks, everyone, for joining us today. If you do have further questions, please feel free to reach out to me directly, and this will conclude our conference call. Thanks.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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