Tiptree Inc. NasdaqCM:TIPT

FQ3 2020 Earnings Call Transcripts

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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
Chief Financial Officer

ANALYSTS

Michael E. Santelli
Ancora Advisors, LLC

Walter M. Schenker
MAZ Capital Advisors, LLC

Presentation

Operator

Greetings, and welcome to Tiptree Inc. Third Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over 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 third quarter 2020 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.

Before I turn the call over to Michael, just a few additional housekeeping items. Today, 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 are 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. Our strong results for the third quarter show the continued resilience of our core operations with operating EBITDA of $31.9 million, up significantly from the prior quarter. Year-to-date revenues, excluding mark-to-market, were up 17%, and operating EBITDA for the same period was $70 million, an increase of 64% from the prior year.

Despite the challenges of operating under COVID-19 constraints, our businesses have continued their positive trends. Production and sales volumes are at all-time highs in many of our product lines and businesses, as management and employees have adapted well to the new environment, staying dedicated to serving our customers while pursuing new opportunities. Based on our belief in the strength and future growth of the company, Tiptree has repurchased close to 1.5 million shares so far this year at an average discount of 37% to book. In addition, senior management has also directly purchased approximately 425,000 shares this year in open market transactions, bringing insider ownership to approximately 31% as of September 30, 2020.

In our insurance business, gross written premiums and premium equivalents of nearly $1.2 billion year-to-date were up 26% over the same period last year, driven by continuing growth in specialty and warranty programs, as sales volumes returned to normal levels in the third quarter. The launch of Fortegra specialty insurance company in late September gives us the ability to write business on admitted and nonadmitted basis in specialty light commercial lines. We are currently observing a hardening market which we expect will continue in the near to medium term.

Insurance margins have held stable with our quarterly combined ratio showing improvement relative to prior periods at 90.4% as our product mix shifts. Our insurance products have very limited exposure to lines of business impacted by COVID-19, such as business interruption or other similar coverages. We continue to see market volatility for the end of the third quarter and into the fourth related to continuing economic uncertainty as COVID cases have been rising in North America and Europe.

Our insurance investment portfolio ended the quarter at $611 million, up 19% year-over-year, in line with our underlying premium growth. Within our investment portfolio, we take a long-term view. Therefore, variability and the timing of investment gains and losses is to be expected.

We continue to maintain over 85% of our portfolio in high credit quality and liquid securities with an average rating of AA. For Tiptree Capital, operating EBITDA was $36.1 million for the first 9 months, up substantially from the prior year, driven by strong performance in our mortgage operation. Mortgage volumes were up 54% year-over-year with notable improvements in gain on sale margins. Low mortgage rates due to the Fed intervention, combined with rising home prices in certain markets, has resulted in higher refinancing mortgage volumes. In this year of market stress and uncertainty, our mortgage business has shown its strength and serves as an example of our objectives when allocating capital, namely to source scalable cash flowing businesses, having embedded optionality, while also providing portfolio diversification to Tiptree's platform.

Our shipping operations held steady, generating stable cash returns over the past year. Charter rates for bulk commodities improved in line with improving Chinese demand, while rates for product tankers normalized, falling from the higher levels in the second quarter, driven by demand for floating storage. While Tiptree Capital's operating EBITDA for the quarter was $18 million, pretax income of $9.5 million was impacted by unrealized mark-to-market losses on our investment in Invesque as a result of a decline in their stock price. Like many companies operating in the senior care, skilled nursing and medical office sectors, Invesque's management is continuing to take positive steps to conserve liquidity, including corporate cost reductions, deferral of capital expenditures and suspension of its dividend.

In summary, we have seen a significant recovery in our business operations for the past 6 months. Despite current global economic uncertainties, we believe our diverse set of businesses and long-term view will position us to take advantage of opportunities in the fourth quarter and into 2021.

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

Sandra E. Bell
Chief Financial Officer

Thank you, Michael. On Page 4 of the presentation, we highlight the company's key financial metrics.

Net income before noncontrolling interest for the quarter was $14.7 million, an increase of $15.7 million over the prior year, driven by stable and continued growth in our insurance business and strong performance in our mortgage operations. Excluding investment gains and losses, revenues for the quarter were up 17%, driven by improvement in insurance top line results, including contributions from our warranty acquisition.

Operating EBITDA for the quarter was $31.9 million, up 84% from the prior year. Year-to-date, that same metric was $69.9 million, up 64% compared to 2019. The growth in both periods was driven by the same factors that supported improvement in net income.

On the bottom of the page, we show a walk from operating EBITDA to total pretax income, highlighting the key differences between the 2 metrics. Book value per share at the end of the third quarter was $10.36, an increase of 4.3% versus the prior quarter, primarily due to our strong operating performance for the quarter.

Our capital and liquidity position remains strong with cash and equivalents of $103.5 million as of the end of the third quarter, $72.4 million of which is outside our statutory insurance companies.

On Page 5, we have updated our KPI trends. Operating EBITDA grew organically 80% in the quarter and 59% year-to-date. While much of the growth is being driven by the mortgage business, our insurance business continues to show stable and positive earnings performance. The growth in our insurance business can be seen in premiums and premium equivalents. As a reminder, much of the growth in this metric ends up on the balance sheet as GAAP recognizes the revenue over the life of the contracts. Year-to-date, premium and equivalents were up 26%, led by the acquisition of Smart AutoCare and the growth in light commercial and other specialty programs.

Additionally, deferred revenues and unearned premiums, which represent future earnings potential, stand at $1.15 billion, up 46% year-over-year, driven by 20% organic growth and the acquisition of Smart AutoCare.

Turning to Page 6. We highlight our capital allocated between our insurance business and Tiptree Capital along with their respective returns to assist investors in understanding Tiptree's enterprise value. We evaluate our return on capital using operating EBITDA which, for the latest 12-month period, was $90.8 million, up 53% from the latest 12-month period ending Q3 2019.

Our operating return on invested capital of approximately 16.5% is driven by a 16.6% return in insurance and a 25.8% return in Tiptree Capital. The key drivers for the period were growth in underwriting income and fee revenue in warranty service contracts and in light commercial specialty programs, positive contributions from mortgage and shipping operations in Tiptree Capital and reduced corporate expenses, driven primarily by lower incentive compensation.

With that, let's turn to our insurance company results. For the first 3 quarters of 2020, improvement in sales volume was driven by growth in warranty, light commercial and other specialty programs. Year-to-date, gross written premiums and equivalents were $1.2 billion, up $239 million, of which $148 million was incremental from our acquisition of Smart AutoCare.

In the third quarter, warranty programs grew substantially, up $82 million from the prior year. Excluding the acquisition, warranty premiums were up 16%. Specialty and light commercial programs were up $38 million or 86% over the third quarter of 2019. Net written premiums decreased by $56 million, primarily driven by softness in consumer credit and the seeding of certain credit protection business at the end of 2019. For the 9 months, underwriting margin was up $22 million or 21%. Our combined ratio improved to 91.8%, demonstrating our ability to continue to grow profitably in our insurance business despite the current economic headwinds.

We continue to expect future growth to come through our vertically integrated warranty offering and specialty programs. As part of our overall plan to increase financing capacity to support that growth, in October, we refinanced our asset-based premium finance facility, extending the maturity for 3 years and upsizing the amount to $75 million. This complements the refinancing of Fortegra's revolving credit facility completed in the second quarter.

Turning to the investment portfolio on Page 9. Our net investments grew by $97 million year-over-year, up 19%. $527 million of the portfolio or 86% is held in liquid, highly rated fixed income securities or cash. The average rating on that portion of the portfolio is AA which we believe provides excellent strength to our capital base despite the current volatile markets.

For the quarter, net portfolio income was $2.9 million, up $0.7 million, driven by the growth in the portfolio. While we saw recoveries in certain of our portfolio securities in the third quarter, the low interest rate environment will continue to impact net interest income. For the 9 months, net portfolio loss was $14 million, driven by unrealized and realized losses of $22 million on equities and other securities in the portfolio, $13.8 million of which was related to Invesque.

On Page 11, we present the results of Tiptree Capital, which today consists of our Invesque shares, shipping and mortgage operations. For the first 3 quarters of the year, the pretax loss was driven by unrealized losses on our Invesque shares, which is tied to mark-to-market based on its share price. Year-to-date, operating EBITDA in Tiptree Capital increased to $36.1 million, primarily driven by increased mortgage volumes and margins and a full quarter of operations from the vessels purchased in 2019 in our maritime shipping business.

As Michael mentioned, our mortgage business has benefited from several tailwinds, including higher refinance volumes, supported by both low rates and rising home prices. Margins are 150 to 200 basis points higher than normal, driven by COVID-related capacity constraints.

And lastly, we've been able to retain mortgage servicing rights at relatively low valuations, providing opportunity for value appreciation and future rising interest rate environment.

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 third quarter results have demonstrated the resilience of our operations as we have recovered positive earnings and sales trends across our businesses. Year-to-date, we have benefited from the diversification of our operations as our mortgage performance has complemented the stable and growing insurance and warranty services platform. Despite the uncertainty in the economy, our liquidity remains strong, and we've refinanced our borrowing facilities across the company, extending maturities and increasing capacity to support growth. And despite unrealized marks on our equity investments, our capital position remains strong to support our growth and objectives well into 2021 and beyond.
With that, we will open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Michael Santelli with Ancora.

Michael E. Santelli
Ancora Advisors, LLC

It seems like you've got a fantastic business in Fortegra in the insurance operations that's -- stand-alone would trade probably at a multiple book. Then you've got a couple of, let's say, problem children or one problem child in Invesque. And I'd love to hear you, what your thoughts are on that in terms of is this a permanent impairment of capital there? Or is there a path to recovery? And then I've talked off-line with Sandra and -- about this corporate expenses. And it's going in the right direction, it's still kind of a pretty large drag for a company your size. So I'm just curious as to where you think that's going? Or are you -- is your plan to kind of leverage it up in terms of building -- making more acquisitions and whatnot and making that a smaller percentage of the whole going forward? So I guess it's a long-winded question there.

Michael Gene Barnes
Executive Chairman of the Board

No, I think I got it, Michael. Thank you for your question. Let's start with Invesque. As you know, we are a minority holder of Invesque, although we do sit on the Board of Invesque. And we will keep our comments to public information given that they will be reporting their earnings November 11. Invesque, as you know, has invested in the senior housing, skilled nursing and medical office space. And so with coronavirus, it's certainly like others in the space certainly has dealt with the issues of the spread of coronavirus amongst our various properties.

Operationally, the publicly reported information has through -- that they've put out statements, I think, since the -- through August has stated that their operators have continued to generally perform in terms of payments on their leases and about 94%, if I remember correctly, has been collected without issue, although there are some properties that they're clearly working with who have certainly been affected by coronavirus.

With regard to Invesque as a problem child or as a long-term investment, et cetera, look, we invested in the senior care business going back to 2010. It's an area we know well. And although even before coronavirus, there were certainly issues that the senior care business was facing. Whereas Invesque in its current form is a thinly traded stock on the Toronto Stock Exchange. The small volume clearly has -- can create significant volatility. I think management has taken important steps to maintain its liquidity and be in a defensive to posture through this crisis period. They've cut expenses, they reduced capital expenditure, and they've cut the dividend. They're cutting the dividend, I think, as a REIT-type stock. It is not technically a REIT, but it's REIT-type stock. I think clearly had an impact in terms of the retail investment appetite. And I think what we've seen is the response to that. So the stock has traded down. I would say that from our own standpoint, we do not feel that the current stock price is reflective anywhere near what we would consider fair value. But there's still tightening and there's things to play out in both the resurgence of coronavirus on a global scale as well as the individual properties continuing to perform. I'd say government bailouts have also helped operators through this period in terms of bridging and allowing them to continue payments, but what continues is to be seen.

So making a -- kind of summarizing what you said, we continue to be an investor. We are a minority holder, although we sit on the Board. We see it as certainly a troubled sector in the coronavirus, but we also see the share price is not reflective of true value. What we do in the future, we'll see. We'll continue to evaluate the situation as we go along.

And the last thing I'll say is, currently, the company is not facing any liquidity issues. So having cut the dividend, reduced expenses, pulled back capital expenditure, we think it's in a position to try to get through this crisis and then realize what we would consider a fair value.

Before I move on to the expense question, does that generally answer the question on Invesque?

Michael E. Santelli
Ancora Advisors, LLC

Yes, basically. Let me ask another question if -- and this is totally speculative, if they do come into a liquidity crisis, would you be a provider of capital to get them through that?

Michael Gene Barnes
Executive Chairman of the Board

As I said, that's not an issue right now. If that worked -- it would not likely be an issue for some time as their debts are fairly strongly out and not immediately do they have anything really coming due or covenant issues to my knowledge. So the answer is we would have to evaluate it at that time. We certainly have been a long-term investor in senior care. We understand the space well. And we'd have to value the time what the issues would be and what capital would . I'd mention that we aren't alone in this investment, there's other large holders that we certainly would consider like-minded and very commercially minded in terms of wanting to certainly protect and realize a value that we would consider nearer to fair value than where it's currently trading. So if you certainly can look at the public share holdings and see there are other large investors that I would consider very like-minded to ourselves, that would likely want to see this investment continue.

With regard to expenses, Sandra, do you want to take this one? I'll just say before I turn it over to Sandra that our objective certainly is to grow. Now through a period where we've seen market volatility and again, our share certainly could be more broadly traded. We would certainly like to see a more active trading. But when the shares trade down, we will evaluate the opportunity to buy them. And so we have been buying shares as we said in our comments earlier. We've been a buyer of shares over the years as the opportunity presents itself and as we consider the value of the shares where we can acquire them in open market transactions or through programs. So our objective certainly is to grow. And I think by growing, it would diminish the percentage of our corporate ongoing expenses and bring that more in line with what we would consider appropriate. We certainly, I'd say, have done a very good job of looking for ways to reduce expenses. I'll give credit to Sandra and team who continue to evaluate how to reduce expenses. And I think they've done a great job there. Sandra, do you want to comment on that?

Sandra E. Bell
Chief Financial Officer

Michael, I think as we've spoken in the past, we do not need to add headcount at the corporate level. As a matter of fact, we have been investing in some technology, which allows us to be scalable just on the use of our people. Our main expenses are in public accounting and supporting capital investing. And we do believe that we don't need to add in either of those places and continue to scale and grow, so those expenses continue to decline as a percentage, as Michael said.

Michael Gene Barnes
Executive Chairman of the Board

Michael, does that answer your question?

Michael E. Santelli
Ancora Advisors, LLC

Yes. It's just frustrating from our perspective, we see something that there's really not much reason why this company should trade -- the stock should trade less than book, especially with the gem you got there in the insurance business. Instead of...

Michael Gene Barnes
Executive Chairman of the Board

Let's not forget our mortgage business that had a phenomenal quarter, but it's actually really kicked into gear. And you look at our businesses, we think -- we love all of our children equally, we think they're all great businesses and getting through this period of a corona, of a pandemic, we've really shown the resilience of our business, which is why we own them. But I appreciate your point, and I couldn't agree more. I think we are significantly undervalued to intrinsic value, let alone to GAAP book value. And I think any simple calculation of earnings potential with a market multiple could -- one can with a back of an envelope create a breakout value that would give a significant -- a sum of the parts value, let's call it, that would give a clear indication of our intrinsic value.

Michael E. Santelli
Ancora Advisors, LLC

So how do you raise the profile of the company and the stock so that the investor community can configure this out?

Michael Gene Barnes
Executive Chairman of the Board

We've certainly taken steps to emphasize our insurance operation. We've also tried to simplify our financial reporting to really 2 components: our insurance reporting and our other, our Tricadia Capital reported. We've also -- and I'd attribute this to Jon Ilany, our CEO, has taken significant steps over the years to shed noncore, nonscalable businesses. We've also taken a lot of steps to exit exposure to the overall credit markets and to look for capital allocation to repeatable cash flowing of positive earnings. And so I think we've achieved that. But how do we differentiate? I would like to believe over time through growth in book value, dividend distributions that are consistent and hopefully increasing as we increase our book value and earnings. I'd like to think that people will ultimately recognize the value of our investments, the value of our company and want to own us.

Michael E. Santelli
Ancora Advisors, LLC

Well, we believe in the story. So hopefully others do too.

Michael Gene Barnes
Executive Chairman of the Board

Thank you. I appreciate the comment.

Operator

[Operator Instructions] The next question comes from Walter Schenker with MAZ Partners.

Walter M. Schenker
MAZ Capital Advisors, LLC

See the last Q&A was a perfect lead-in to my comments, which really relate to, and first, I commend management for steadily buying stock, and I complain about the company in not more aggressively buying stock. I realize there are limitations on what you can buy, but $1.5 million (sic) [1.5 million], I think that was the number, Sandra, I don't know exactly remember.

Michael Gene Barnes
Executive Chairman of the Board

1.5 million shares, 1.5 million shares, to be clear. That's about $10 million, yes, not including our dividend.

Walter M. Schenker
MAZ Capital Advisors, LLC

Okay. Okay. I'm sorry, I was in my car. But again, I think the most attractive, and I've been able to buy a moderate amount of stock since it has had some liquidity and stayed down here. I still believe that the most attractive alternative for the company is to maximize buying back stock. I know historically, not this year, maybe you only mostly responded to large blocks, but at $5 with a $10 book and the pieces which are worth a lot more, it seems to me that -- and maybe that's what you're doing. If that's the answer, I'll shut up. If you're maximizing what you can buy in the open market on a daily basis during the windows, which are not close to you, then I commend you as well as management, you being the company.

So the question is, are we maximizing our buyback because of these price levels relative to the values in this company? That is the most attractive thing you can do. I mean you just reported a great quarter that you shake a $10 stock and the stock's still $5. So the market -- it is what it is. But buying back stock accretes substantial value over time.

Michael Gene Barnes
Executive Chairman of the Board

Yes. Look, we agree with your sentiments and your comments and officially correct the point is 1.5 million shares we purchased this year. And we do try to balance both retained earnings and reinvestment of earnings and growth in businesses that we see continuing to grow, like our insurance business, for example. However, to your point, when we see the stock trading at what we consider just a perplexing discount to not only book but to intrinsic value which we consider materially higher than book, we'll buy. To your question though, there are constraints. We choose generally to buy in 10b5 programs. And that does limit the ability to purchase based upon volume restrictions, et cetera. So -- and I'll say we want to be defensive in this period. We want to be a little careful. It is a pandemic going onward. And like everybody, we want to be a little careful in terms of being defensive and conserve cash appropriately. But we are buying, we bought each year. I believe we have purchased more than 1 million shares for the last 5 years and materially more in certain years. So we are always evaluating the trade-offs or retaining earnings, reinvesting them, maintaining a dividend and buying back shares. I think over the course of the past number of years, we purchased back probably about north of 30% of the company at a discount of 37% a book. And so we will continue to evaluate that as we go forward.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. At this time, I'd like to turn the call back over to Sandra Bell for closing comments.

Sandra E. Bell
Chief Financial Officer

Thank you, Rob, and thank you, everyone, for joining us today. As in all quarters, if you have any questions, please feel free to reach out to me directly. This concludes our third quarter 2020 conference call.

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