S&P Global
Market Intelligence

Tiptree Inc. NasdaqCM:TIPT

FQ4 2020 Earnings Call Transcripts

Friday, March 12, 2021 2:00 PM GMT

S&P Global Market Intelligence Estimates

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

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. Welcome to Tiptree, Inc. Fourth Quarter 2020 Earnings Conference Call. [Operator Instructions] Please note, this conference is being recorded. I would now like to turn the conference over to Sandra Bell, Chief Financial Officer. Thank you. You may begin.

Sandra E. Bell
CFO & Principal Accounting Officer

Good morning, and welcome to our year-end 2020 earnings call. We are joined today by our Executive Chairman, Michael Barnes. 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 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. Despite the many challenges this past year as a result of COVID-19, our controlled operating businesses continued to grow profitably in 2020, demonstrating the resilience of our diversified operations. Revenues, excluding mark-to-market, increased 17% and adjusted net income of $51.4 million, increased 86% from the prior year. That being said, Tiptree's total return for 2020, as measured by change in book value per share plus dividends paid, was negative 4%, primarily due to an unrealized loss on our holdings in Invesque, Inc., our real estate investment company focused on senior care properties, a sector hit particularly hard by the pandemic.

Even with this decline, we believe that Tiptree's overall intrinsic value increased significantly in 2020 and is materially greater than our GAAP book value would suggest. For our insurance and mortgage businesses, production and sales volumes are at all-time highs as management and employees have adapted well to the new environment, staying dedicated to serving our customers while continuing to pursue new opportunities. In addition, our investments in shipping were stable for the year. And for the first few months of 2021, we are in an environment of unseasonably high charter rates as a result of the current technical imbalance in global shipping supply and demand.

Given our confidence in the strength of these core operating trends, Tiptree repurchased close to 2.4 million shares in 2020, representing approximately 7% of the outstanding shares at year-end 2019. These repurchases were executed throughout the year at an average 43% discount to book value per share. In combination with shares that senior management has directly purchased in open market transactions, insider ownership has increased to approximately 32% as of December 31, 2020.

In our insurance business, the Fortegra management team continues to execute on its growth objectives. Gross written premiums and premium equivalents of nearly $1.7 billion were up 29% over 2019, driven by continuing growth in commercial and warranty programs as sales volumes accelerated in the second half of 2020. Our acquisition of Smart AutoCare completed at the beginning of 2020 has more than met our expectations, driving significant sales growth in our auto warranty product lines, contributing approximately $250 million of gross written premiums and premium equivalents. The launch of Fortegra Specialty Insurance Company in late September, gives us the ability to write business on an admitted and nonadmitted basis in specialty, commercial and niche personal lines in order to take advantage of a hardening market, which we expect will continue in the near to medium term.

Insurance margins remain consistent with our combined ratio of 91.5%, showing improvement relative to prior periods as our product mix shifts to more profitable lines. Our total investments in cash and cash equivalents within Fortegra ended the year at $713 million, up 26% year-over-year, in line with our underlying premium growth. We continue to maintain 83% of our portfolio in high credit quality and liquid securities with an average rating of AA.

One item I'd like to specifically note with regard to my earlier comments on Tiptree's intrinsic value. Given Fortegra's growth trajectory and its adjusted net income of $43.4 million, its value alone would significantly exceed Tiptree's book value with benchmark to earnings multiples of Fortegra's publicly traded peers.

Within Tiptree Capital, adjusted net income was $33 million for the year, up substantially from the prior year, driven by strong performance in our mortgage operations, which had a record year. Mortgage volumes were up 45% year-over-year, with notable improvements in gain on sale margins. In the share of market uncertainty, our mortgage business has shown its strength and serves as an example of our objectives when allocating capital, namely to sort scalable cash flowing businesses with great management and having embedded upside optionality while also providing portfolio diversification to Tiptree sources of revenue.

While Tiptree Capital generated strong operating results, it contributed a pretax loss of $30 million due to the unrealized mark-to-market losses resulting from a decline in Invesque share price, which I mentioned previously.

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 4 of the presentation, we highlight the company's key financial metrics for the fourth quarter and total year 2020. Net income before noncontrolling interest for the quarter was $16.2 million, an increase of $11.6 million over the prior year, driven by continued growth in our insurance business and strong performance in our mortgage operations.

The net loss for the year was $25.2 million, driven by unrealized mark-to-market losses on our holdings of Invesque. Excluding investment gains and losses, revenues were up 18% for the quarter and 17% for the total year, driven by improvement in insurance top line results, including contributions from our warranty acquisition and increased volumes and margins in our mortgage business.

Adjusted net income for the quarter was $16.2 million, up 54% from the prior year. For the total year 2020, that same metric was $51.4 million, up 86% compared to 2019. The growth in both periods was driven by the same factors that supported improvement in revenues.

On the bottom of the page, we show a bridge from adjusted net income to total pretax income highlighting the key differences between the 2 metrics. Book value per share as of year-end 2020 was $10.90, which represented a decrease of 5.4% versus the prior year, primarily due to negative marks on equities. Book value per share increased 5.2% in the fourth quarter of 2020, driven by net income and share buybacks during the quarter. Our capital and liquidity position remains strong, with cash and cash equivalents of $136.9 million as of the end of the year including $80 million held outside our statutory insurance companies.

On Page 5, we have updated our KPI trends. For 2020, we have refined our key operating related non-GAAP measure, moving from operating EBITDA to adjusted net income. Both metrics remove realized and unrealized gains and losses, purchase accounting amortization, stock-based compensation and nonrecurring items. Adjusted net income differed from operating EBITDA does not add back corporate interest expense or taxes. We believe that adjusted net income better aligns with similar metrics that are used by our peers, particularly in the insurance industry. Organic growth in adjusted net income was 49% for the quarter and 77% for the total year. These strong operating results were driven by the outperformance of our mortgage business and continued stable positive earnings performance in our insurance operations.

We continue to see strong momentum in our insurance company top line results as evidenced by gross written premium and premium equivalents. For 2020, premiums and equivalents increased 29%, led by the acquisition of Smart AutoCare and expansion in commercial and other specialty programs. As a reminder, 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 $1.26 billion, up 48% 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 intrinsic value. In total, our 2020 adjusted return on average equity improved to 13.1%, an increase from 6.8% in 2019. Our insurance business, Fortegra, improved its adjusted return on average equity to 15.2% from 12.3% in the prior year, driven by growth in the capital-light warranty services contract business 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 growth in volumes and margins, 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 turn to our insurance company results. For 2020, improvement in sales volumes was driven by growth in warranty, commercial and other specialty programs. Gross written premiums and equivalents reached $1.7 billion, up 29% in total or 12%, excluding our acquisition of Smart AutoCare. In the fourth quarter, we saw premium growth accelerate to 36% year-over-year, led by U.S. warranty programs, which increased 71%; U.S. insurance programs, which grew 22%; and European warranty programs, which grew 83%.

For the year, underwriting and fee margin increased $30 million or 21%. Our combined ratio improved to 91.5%, demonstrating our ability to continue to grow profitably in our insurance business despite the economic headwinds we experienced in 2020.

Adjusted return on average equity continues to trend positively, reaching an annualized 18.6% in the fourth quarter of 2020. We expect continued growth through our capital light, vertically integrated warranty offerings and commercial and other specialty programs, the latter of which is benefiting from hardening markets.

In October, as part of our overall plan to increase financing capacity to support that growth, we finance -- 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 insurance investment portfolio on Page 9. Our total investments and cash and equivalents grew by $147 million year-over-year, up 26%. $589 million of our investments or 83% 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. For the year, net investment income was $9.9 million, up $1.2 million driven by the growth in the portfolio despite the low interest rate environment. For the year, net realized and unrealized losses were $11.9 million, driven by unrealized losses on our Invesque Holdings.

On Page 11, we present the results of Tiptree Capital, which today consists of our Invesque shares, shipping and mortgage operations. For the year, the pretax loss was driven by unrealized losses on our investment in Invesque mentioned earlier. 2020, adjusted net income in Tiptree Capital increased to $33.1 million, primarily driven by improvements in mortgage volumes and margin, and a full year 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 were 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 2020 results have demonstrated the benefits from our diversified portfolio of controlled operating businesses. In our insurance operations, the capital light, fee-generating warranty programs complement our niche specialty insurance focus. And with the addition of Fortegra's specialty, we have added substantial capacity and excess and surplus lines to complement our 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. And despite the uncertainty in the economy, our liquidity remains strong. During 2020, we refinanced our

borrowing facilities across the company, extending maturities and increasing capacity to support growth. 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 Walter Schenker with MAZ Partners.

Walter M. Schenker
MAZ Capital Advisors, LLC

This is for Michael. It's sort of a long-winded question, but there is 0 chance Tiptree will ever get the valuation it deserves as long as you have 2 very disparate operations between Tiptree Capital, which is a hedge fund where virtually anything goes and a very outstanding insurance business. As you pointed out, the insurance business alone [indiscernible] freestanding, I would argue itself for more than twice on a per share basis, where the total company is now trading. Why wouldn't you split the company, why won't you split the company now that it's big enough on insurance into 2 pieces to create shareholder value?

Michael Gene Barnes
Executive Chairman of the Board

Walter, thanks for joining today, and I think it's an excellent question. I'll tell you that, first, I agree with your -- with the back of the envelope valuation sort of determination in terms of the insurance company, having substantial value relative to what our GAAP book might state. And we do recognize that. I hear your point about the fact that we do have our Tiptree Capital, which is opportunistic and focuses on best allocation of capital. And I will say, we are always revealing how we can best provide value to our Tiptree shareholders. We take everything into consideration. We have certainly been watching the markets in terms of the valuations that insurers have right now, particularly in our category. So I will tell you that we are always reviewing options, and it is our priority to provide value to Tiptree shareholders. I think I'll leave my comments at that.

Walter M. Schenker
MAZ Capital Advisors, LLC

Okay. And then for Sandra, just one other question, there are always a lot of moving pieces in your quarterly reports. In looking at an outstanding fourth quarter, operationally, if I -- as you present non-GAAP operational earnings, what was in the fourth quarter which was singularly atypical so that I can't -- why can't I then look at the fourth quarter and say, this is, again, at least from an insurance standpoint, a base going forward. And therefore, for the next year, and you're not going to forecast, but if I do that and I grow some, I would expect the year to be something on the order of 4x where the fourth quarter was. I realize on the capital mortgage had a great year. Invesque is going to do somewhat better. Shipping is doing better, but those are all different pieces and hard to forecast.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Walter. Nice to have you on the call. So your observations are right on. The first half of the year was obscured a little bit by the impact on Invesque, and then the COVID related slowdown across the country. I agree with you 100% on the insurance side. We have a little bit of seasonality in the second half of the year just because things like going back-to-school, the way autos are bought. But I think if you take the fourth quarter, which is also reflective of the growth and annualizes the way you're thinking about, it is a good trajectory for the insurance business specifically.

I will say on the mortgage side, we are continuing to see strong volumes consistent with both the low interest rate environment and obviously, the uptick in home prices. So the big difference in the fourth quarter, to be perfectly honest, was the operating performance wasn't obscured by either of those first 2 factors I mentioned.

Walter M. Schenker
MAZ Capital Advisors, LLC

Okay. And so my last comment, and I'm smiling, but I do that a lot, and it's giving me an opportunity to buy stock, too. I guess the good news about having a convoluted, hard to understand company is it's allowed insiders of the company and investors to buy stock at what seems to be a silly price relative to the values of the pieces.

Operator

[Operator Instructions] Our next question is from Alex [indiscernible]

Unknown Analyst

Just 2 quick ones. Could you guys comment a little bit on -- you made a small acquisition, it looks like in December or early January on the insurance side. Could you talk about that, your framework for making acquisitions at insurance specifically and some of the criteria that you look for? And if you're able to comment on just valuation ranges that you typically try to pay?

And then the second question is just on capital allocation. You've been clear in the past, but I'm just curious if there's any update. If I look back over the past few years, outside of the great warranty purchase that you made this last year, the capital was deployed in really interesting ways, shipping was a big one. And so I guess kind of going forward, can you just help us understand where you guys sort of see the market now and what the best uses of capitals are today from your perspective, looking over the next couple of years?

Michael Gene Barnes
Executive Chairman of the Board

Sandra, why don't I start and then Sandra, I'll ask you to add anything to my answer. But Alex, first, thanks for the question. Both good questions. And I'll start with acquisitions. So we are always looking to acquire add on businesses, bolt-on acquisitions that complement our existing operations and where we see, obviously, a value creation, ideally from either a preexisting relationship, which often our acquisitions come from or where we can acquire it with very little capital commitment and which is additive in terms of overall fee income.

And so we are always looking for acquisitions, bolt-on acquisitions. And if you see through our history, that has been something, I'd say, that's been consistent. The Smart Auto being 1 of the more significant we've made in the last year, and you've seen that be very accretive to overall returns. I'd say that's true across all of our investments, all of our businesses, although insurance has been, I'd say, 1 of those that's been most opportunistic.

As it relates to the allocation of capital, we are fully allocated, I'd say, in terms of our businesses, although we do like keeping a fair amount of liquidity, as was previously noted. We are always looking for opportunities to allocate capital. And I think I already characterized our focus, which I did in our comments earlier, we are always looking for positive cash flowing operating businesses with repeatable income, great management teams, scalability but if there's, I'd say, a characteristic we're always looking for in our businesses, it's to have a good return on capital in a normal environment ideally limitations on downside or countercyclical relative to recessions, like our warranty business has some element of.

And you'd see in our mortgage business with lower rates having some elements of but what we're always looking for is the ability to have embedded optionality with, I'd say, a skewed upside in terms of the opportunity set. I think we've seen that certainly in our warranty business. We've seen that just more recently in our mortgage business. That is always what we are looking for. Right now, I think some of the best returns on capital that we're getting are from our existing businesses. So to the extent we can continue to provide capital as required to our existing businesses, that's our first priority, acquisitions as part of that, and then we are also always looking for new acquisitions. To date, I'd say that we have not seen a lot that we find attractive in terms of new acquisitions as well as our desire to support our existing operations.

Sandra, do you want to add anything to that?

Sandra E. Bell
CFO & Principal Accounting Officer

I'll just add 1 quick thing. Alex, to your first question, a small acquisition we made at the end of the year was to basically add a direct-to-consumer channel to our auto warranty business. So it's very complementary to the platform we bought in Smart AutoCare. And it's a good example of how we're looking for capital-light warranty type businesses to continue to generate cash flow that allows us to use our capital much more efficiently, for example, in the context of the E&S business that we are growing in a hardening market. So I just note, it's a good example about how we think about acquisitions, particularly in the warranty -- in the Fortegra business.

Operator

We have reached the end of our question-and-answer session. I would like to turn the conference back over to Sandra Bell for closing remarks.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Jen. 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 conference call for the year-end 2020. Thank you.

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