S&P Capital IQ

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Tiptree Inc. NasdaqCM:TIPT

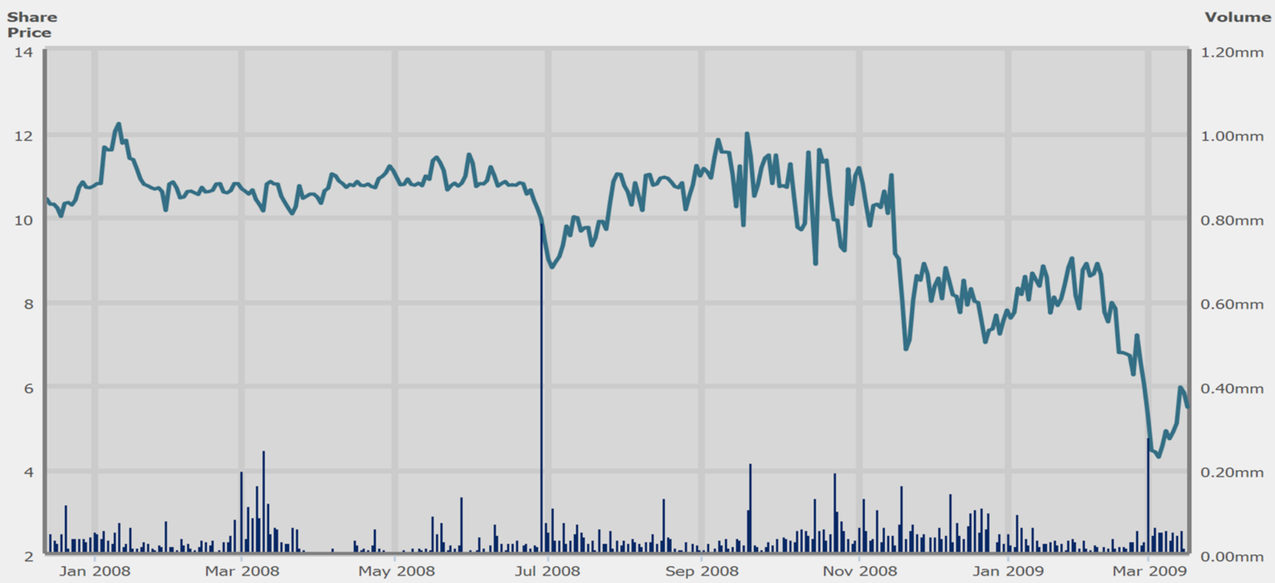
FY 2017 Earnings Call Transcripts

Thursday, March 15, 2018 1:00 PM GMT

S&P Capital IQ Estimates

Currency: USD
Consensus as of Nov-17-2008 11:09 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS
FY 2007	(0.05)
FY 2008	(0.10)

Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman

Sandra E. Bell
Chief Financial Officer

Presentation

Operator

Greetings, and welcome to the Tiptree Inc. Fourth Quarter and Full Year 2017 Earnings Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Miss Sandra Bell, Chief Financial Officer for Tiptree, Inc. Thank you, you may begin.

Sandra E. Bell
Chief Financial Officer

Good morning, and welcome to our 2017 Year-end Earnings Call. We are joined today by our Executive Chairman, Michael Barnes; and CEO, Jonathan Ilany.

We have posted the earnings release and presentation on our website at tiptreeinc.com.

Our remarks today are qualified in their entirety by the disclaimers on Page 1 of the presentation. This presentation supplements our SEC filings and is provided solely for information purposes.

Throughout the presentation, we make forward-looking statements. Our businesses are subject to risks and uncertainty, which are outlined in our SEC filings and which could impact our expectations of future results.

Except as required by securities law, we undertake no obligation to update any forward-looking statements. We use non-GAAP measures, which we believe provide supplemental information about our business and are useful to investors. As these measures are not GAAP, they should not be used as a substitute for GAAP disclosures. The appendix provides a reconciliation of each of these measures to their GAAP equivalent.

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

Michael Gene Barnes
Executive Chairman

Thanks, Sandra. Good morning, and thank you, for joining our call today.

In 2017, we refined and advanced Tiptree's strategic goals to expand our insurance business organically and through acquisitions with a focus on warranty products to maintain a combined ratio in the low to mid-90s, and we continued to build our insurance investment portfolio, which we believe will allow us to earn enhanced investment returns over the long term when compared to market benchmark.

In our insurance business, we took 2 key actions this year, which are designed to position the business to achieve our growth objectives.

In October, we refinanced our senior credit facility, with the issuance of 40-year Junior Subordinated Notes, which will serve to support our organic growth initiatives.

We also took steps to expand our insurance products into Europe.

Beginning in 2016 and continuing in 2017, we initiated a review of our other business holdings, with the goal of simplifying our structure and redeploying our capital into areas where we believe we can drive improved returns.

As previously announced, we sold our senior living business to Invesque effective February 1, 2018 for 16.6 million publically listed shares.

This transaction will result in an estimated increase to book value of $0.91 per share as exchanged which will be recognized in the first quarter of 2018.

We also expect the transaction to be accretive to both GAAP earnings and cash flow, as we effectively exchange GAAP depreciation and overhead cost for dividend income.

The combined Invesque platform now has greater scale and more diversification. We expect this will also lead to better capital market access and a lower cost of capital to support Invesque's future growth.

We have confidence in the leadership and experience of the Invesque management team, and feel the senior living sector still has solid long term prospects.

And we now also benefit from the flexibility of potential future liquidity in our Invesque shares should we choose to use it.

In the fourth quarter, we also sold our commercial lending business and entered into an agreement to sell our jumbo mortgage business for a combined $20 million in proceeds and an approximate $2 million gain.

Lastly, during the year, we sold CLO subordinated note and related hedges for $68 million, and recorded fair value gain of $3.9 million, resulting in the deconsolidation of our remaining CLO as of year-end.

The combination of these actions reduced our balance sheet leverage by more than half while providing approximately $90 million of available liquidity.

The actions taken in 2017 reducing leverage, strengthening our capital base, increasing liquidity and simplifying our structure are key steps in positioning Tiptree to meet our long-term strategic objectives.

We continue to believe that our share price does not reflect the intrinsic value of Tiptree.

As we enter 2018, we are focused on increasing investor awareness of Tiptree and the value of its businesses.

Now let's turn to a few financial highlights, outlined on Page 3.

For 2017, while total revenues grew 14.9% year-over-year, we reported net income of $5.2 million and adjusted EBITDA of $38 million, both down from 2016.

Tiptree's as exchanged book value per share ended at $9.97, down 1.7% from last year.

Our 2017 results were primarily driven by negative unrealized marks of approximately $23.8 million on equity securities, held in our insurance investment portfolio.

Normalized EBITDA, a non-GAAP measure which exclude these marks as well as stock-based compensation was up slightly, relative to last year, reflecting the strength of our core businesses.

In our insurance business, gross written premiums were $767 million, up 8.3%, driven by growth in both credit protection and warranty products.

Net written premiums for the year were $418 million, up 24% compared to 2016, driven by our decision to retain a greater portion of our premium through our captive reinsurer starting in late 2016.

2017 was a record year for catastrophic event with respect to hurricanes, earthquakes and wildfires. Yet none of these events had a material impact on our insurance underwriting results.

Our strategy of focusing on high frequency and low severity products with limited catastrophic exposure combined with a high portion of fee earning and the effective use of risk management tools supported sustained profitability and helped combined ratios in the low 90s.

Our insurance investment portfolio has grown to $396 million, a 10.8% increase from this time a year ago.

Over the next 12 months, we anticipate that portfolio will continue to increase as we expand written premium.

Our asset management business completed its first risk retention compliant CLO in 2017, with our insurance company purchasing a vertical tranche in its investment portfolio.

Lastly, for the year, we have returned $11.8 million to shareholders through dividends and share buybacks.

With that, I'll hand the call back to Sandra, who will discuss the financials in more detail.

Sandra E. Bell
Chief Financial Officer

Thank you, Michael.

On Page 4, we highlight the company's key metrics for 2017.

Net income was $5.2 million, reflecting a $15.2 million net benefit from the new Tax Act.

This benefit is due to the required remeasurement of our net deferred tax liability at the new lower corporate rate of 21%, effective January 1, 2018.

We tend to have sizable deferred tax liabilities, related to the recognition of taxable income, and those are insurance and mortgage businesses.

For the year, we had a pretax loss for noncontrolling interest of $9.5 million, of which $3.3 million is from continuing operations and $6.2 million is from discontinued operations.

Adjusted EBITDA ended the year at $38 million on a combined basis.

Pretax income from continuing and discontinued operations declined a combined $52.8 million over 2016, and adjusted EBITDA was down $40.9 million.

However, normalized EBITDA, which excludes stock-based compensation, realized and unrealized gains and losses and adjusts for third-party noncontrolling interest was slightly improved.

Normalized EBITDA is a measure management considers when evaluating the ongoing earning capacity of our operations and our long-term return on invested capital.

Our insurance company's normalized EBITDA was up over 8%, supported by growth in both credit and warranty products.

Corporate cost improved by $5.7 million as external audit fees and consulting expenses were substantially reduced.

Interest expense was also reduced as we repaid a portion of our holding company indebtedness late in the year.

Offsetting the growth in insurance and reduction in corporate expenses, were declines in distributions of $8.8 million, related to our CLO subordinated notes sale and lower management fees as our AUM declined.

Our senior living business is now reported as discontinued operations.

The $6.2 million pretax loss attributable to those operations is expected to be replaced in 2018 by approximately $12.1 million in dividend income from our ownership of Invesque stock.

Several nonrecurring items also impacted our 2017 results. As we discussed in Q2, Reliance's strong performance over the 12-month period ended June 30, 2017, drove an increase in expense of $3 million, related to the earn out paid in Tiptree shares to the former shareholders.

At our insurance subsidiary, we recognized a $1.2 million charge related to debt extinguishment, as a result of the repayment of our senior credit facility.

Lastly, as Michael has already mentioned, the single largest contributor to our comparable year-over-year performance was the negative unrealized mark-to-market on equities in 2017 versus unrealized gains in 2016.

On this point, I'd like to mention that there has been a change in accounting for the insurance industry, beginning January 1. All insurance companies will begin to report their unrealized gains and losses on equity positions through income in the period recognized.

Previously, the insurance industry accounted for unrealized gains and losses on equities in AOCI, impacting book value but not earnings.

We have always reported our unrealized gain and loss positions on our equity securities through income, which has historically been a difference relative to our peers.

Going forward, the change in accounting will make for easier comparison.

On the next page, we outlined our capital allocation snapshot for the year.

Book value per share as exchanged declined 1.7% year-over-year. The decline was a result of the unrealized losses, the issuance of shares related to the exercise of the founder's option and the Reliance earn out along with dividends paid.

This was partially offset by a $0.35 per share tax benefit, resulting from the enactment of the tax act in late December.

In addition, operations contributed $0.27 of EPS, and we recognized a $0.07 benefit from repurchasing shares below book.

Still embedded in our GAAP equity as of year-end 2017 is the accumulated depreciation on our real estate assets, along with purchase accounting amortization at our insurance company.

These combined represent a reduction in value of $1.77 as of December 2017, as compared to $1.37 at this point in 2016.

We expect approximately half of this impact will be reversed in GAAP book value per share in the first quarter of 2018 when we report the gain on our Care sale.

On the bottom left, you can see how our total capital is currently allocated across our businesses, with approximately 70% concentrated in the insurance sector.

Normalized EBITDA, return on total capital was 9.6% over the last year, with strong performances from our insurance business, partially offset by declines in Tiptree Capital, primarily related to lower distributions on our subordinated note.

Moving to Page 7. We provide further details regarding our specialty insurance performance. First, we will focus on insurance operations, and then on the next page, performance from the insurance investment portfolio.

We continue to see positive top line growth from all of our product lines.

For 2017, gross written premiums grew by 8.3% over the prior year. The impact of increases in gross written premium may not be seen immediately in our financial results, as a significant portion of the new premium will be earned over longer periods of time than our older products.

A 19.9% growth in unearned premium reserve and deferred revenue on our balance sheet will give you a perspective of the future revenues that we expect to earn over time.

Pretax income and adjusted EBITDA from insurance operations were down year-over-year. Adjusted underwriting margin, a measure of our product's profitability, was up $4.4 million and trending positively, driven by better performance in our credit protection and warranty program.

This was offset by $4 million in stock-based compensation, along with an increase of $5.6 million in other expenses, primarily related to premium tax increases, as written premiums continue to grow.

The adjusted combined ratio for the year was 93.2%, up 3.7 percentage points from the prior year. This metric is within our parameters of expected underwriting performance from year-to-year.

Looking forward, we plan to continue to focus on our warranty products and program businesses to drive premium growth.

Turning to the insurance investment portfolio on Page 8. You can see the growth in net investments over the past year. This growth was driven by a combination of several factors, including the assumption of reinsurance contracts and growth in written premiums.

Our investment portfolio earnings in 2017 were down primarily due to unrealized equity losses. Excluding those losses, net portfolio income for the year was $15.5 million, up $1 million, driven by increases in interest income, primarily related to LIBOR-earning assets, an improvement in realized gains from sales of nonperforming mortgage loans.

As we go forward, while volatility related to our mark-to-market investments are expected to continue from quarter-to-quarter, our objectives remain the same: To balance our portfolio between cash and liquid short-term investment; to cover claims; and select alternative investment with a focus on enhanced risk-adjusted total returns over the long term.

On Page 10, we present the result of Tiptree Capital, where we allocate our capital across a broad spectrum of investments.

Today, Tiptree Capital consists of asset management operations, mortgage operations and other investments.

Our senior living results, now discontinued operations, are included here for 2017.

Beginning in 2018, the dividend income from our ownership of Invesque will be reported in other investment as part of Tiptree Capital.

Asset management and credit investment pretax income for the year was $14.2 million, down $11 million over 2016.

Our financial results for 2017 were positively impacted by the fair value adjustment of $3.9 million on our investment in the CLO sub-note. The fair value gain similar to the first half were driven by the strength in the loan market and the refinancing of one of our CLO.

More than offsetting those increases, were the declines in distribution and lower base management fees mentioned earlier.

Mortgage operations were impacted by lower volumes as mortgage interest rates rose during 2017 and were only partially offset by improved margins.

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

Michael Gene Barnes
Executive Chairman

Thanks, Sandra. So to provide a quick summary.

In 2017, we refined and advanced our strategic objectives to grow our insurance business by growing premium, both organically and through acquisition, while maintaining profitable underwriting standards.

We expect to continue to grow our insurance investment portfolio, in line with the business and to leverage Tiptree's investment expertise to increase the total return of the insurance portfolio over the long term.
Within Tiptree Capital, our asset management and mortgage businesses are stable. We are looking to further expand AUM as market conditions continue to improve, potentially into other asset classes.
We have significant liquidity and a delevered balance sheet available to support our long-term growth objectives. We believe our strategic effort to better position the company for growth and stable operating performance, while continuing to simplify our overall structure, should allow investors to better understand Tiptree's intrinsic value. With that, we can open the line for questions.

Question and Answer

Operator

[Operator Instructions] Ms. Bell, it seems there are no questions at this time. I'll turn the floor back to you for any final comments.

Sandra E. Bell
Chief Financial Officer

Thank you, Melissa. And thanks, everyone for joining us today. If you have any further questions, please free to reach out to me directly. This includes our year-end conference call. Thank you.

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