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FQ1 2016 Earnings Call Transcripts

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S&P Capital IQ Estimates

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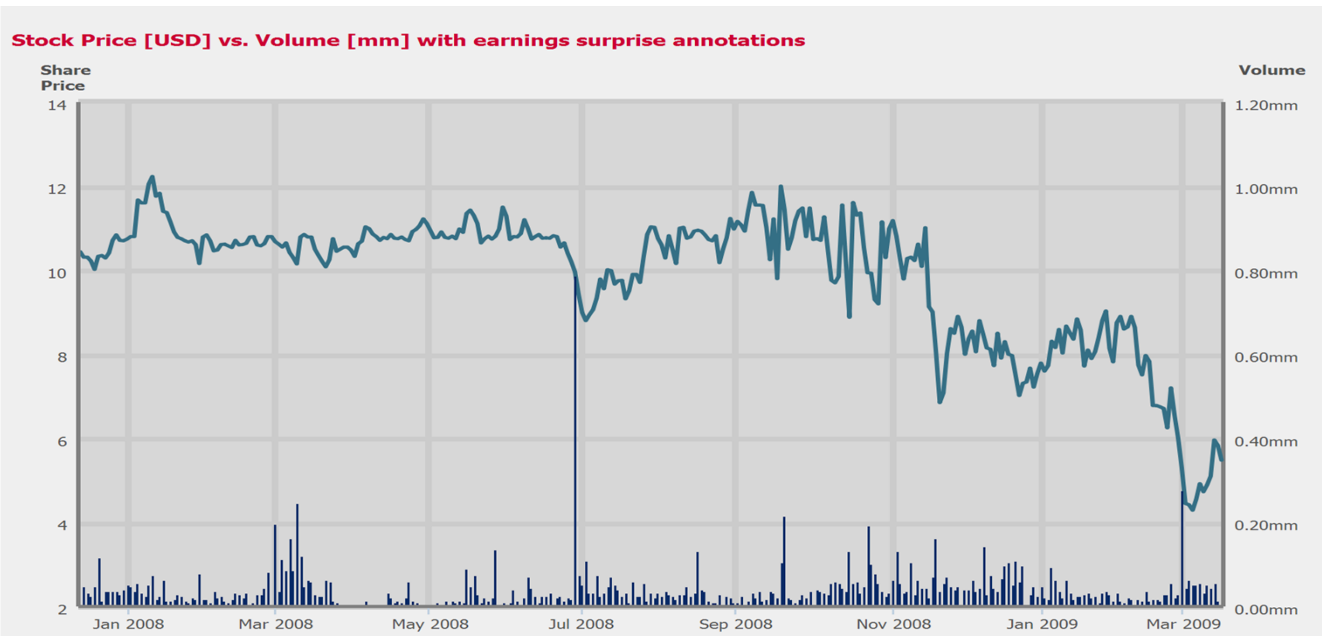

Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman

Sandra E. Bell
Chief Financial Officer

ANALYSTS

Andrew J. Cowen
Badge Investment Partners LLC

Presentation

Operator

Greetings, and welcome to the Tiptree Financial Inc. First Quarter 2016 Earnings Call. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Sandra Bell, Chief Financial Officer. Thank you, you may begin.

Sandra E. Bell
Chief Financial Officer

Good morning. And welcome to our first quarter 2016 earnings call. I'm joined today by our Executive Chairman, Michael Barnes; and CEO, Jonathan Ilany. I'm Sandra Bell, Chief Financial Officer of Tiptree Financial. Prior to this call, we posted the earnings release and presentation on our website at tiptreefinancial.com.

The presentation provides supplemental information to our prepared remarks, which we will refer to by page during the call.

We list our required disclosures in detail on Page 1 of the presentation. Our remarks on this call are qualified in their entirety by the disclaimers on this page.

This presentation is being provided as a supplement to our SEC filings solely for information purposes. Throughout the presentation, there are forward-looking statements. Our businesses are subject to risks and uncertainties, which are outlined in our SEC filings, and which could impact our expectations of future results. Except as required by securities laws, we undertake no obligation to update any forward-looking statements.

Lastly, we use non-GAAP measures throughout the presentation. We believe these measures provide supplemental information useful to investors. As these measures are non-GAAP, they should not be used as a substitute for GAAP. The appendix provides a reconciliation of each of these non-GAAP measures to their GAAP equivalent.

With that disclaimer, let me turn it over to Michael.

Michael Gene Barnes
Executive Chairman

Thanks, Sandra. Good morning, and thank you for joining our call. Tiptree had a strong start to the year, as we are seeing positive momentum in many of our businesses. On a consolidated basis, total revenues grew 48% to $132 million while contributing $15.3 million of adjusted EBITDA.

Net income attributable to our publicly traded shares was $5.6 million. Earnings and other performance measures were up significantly against the first quarter of 2015.

We continue to execute against our strategic priorities. On Page 3, we summarize some of the key achievements for the quarter. Fortegra's adjusted EBITDA was up 46%, with net revenues growing 15%. Growing demand for credit protection and specialty insurance products were the catalyst for improvement in this segment. Care, our seniors housing business, continued its strategy of building out our real estate portfolio by acquiring $55 million of new investments. Throughout 2016, we expect to see benefit from recent acquisitions, as actions taken to improve property occupancy levels and net operating income flow to the bottom line.

We continued adding to our investment in nonperforming mortgage loans, ending the quarter with a portfolio of $52 million. Towards the end of March, we began to see the volatility in middle market term loan prices stabilize, which allowed Telos Asset Management to launch its 7 CLO in early April.

Tiptree purchased $26 million of subordinate notes similar to prior CLOs. We believe leveraging our credit skills to invest in middle market loans generally with tighter covenants and greater spread will generate stable cash distribution and CLO Asset Management fees over time.

We completed tax restructuring to form a consolidated group, which further simplified our structure and will result in go forward efficiencies.

Consistent with our decision to exit noncore assets, we sold our interest in Star Asia on April 8 for proceeds of $13.4 million, which is 49% of our December 31 book value.

Additionally, we exited the remainder of a legacy tax-exempt loan portfolio managed by MFCA for proceeds of $8.9 million, with approximately $1 million loss versus our December 31 book value.

Lastly, the company returned $1.8 million to shareholders in the form of dividends and stock buybacks.

On the next page, we wanted to share our priorities for the remainder of the year. Within our core businesses, we are focused on growing revenues, growing adjusted EBITDA and optimizing capital allocation by continuing to exit noncore or underperforming assets. As of yesterday, May 10, Fortegra was upgraded by A.M. Best to an A- Excellent rating as a result of actions taken by Tiptree to improve Fortegra's balance sheet.

This upgrade should open new channel opportunities and allow us to further distribute our core product offerings. Over time, the additional written premiums should increase the size of our investment portfolio. As of March 31, the Fortegra investment portfolio was $208 million, which represented an increase of 17% over prior year. Within our other segments, we remain positive in our expectations for continued growth and market improvement at a specialty finance and senior housing businesses, as well as the growth in Asset Management through the creation of new CLOs and managed accounts.

We are, as always, looking to opportunistically acquire and invest in high returning cash flow businesses. In order to fund this activity, we expect to use excess liquidity from our primary source of the cash, which include distributions from Fortegra, Care, Telos and our principle investments, and capital generated from sales of investments and noncore assets.

With that, I will hand it back to Sandra, who will discuss the financial results.

Sandra E. Bell
Chief Financial Officer

Thank you, Michael. For the first quarter, we reported net income of $7.4 million for the operating company and $5.6 million for Tiptree financial.

This was up from prior period losses of $2 million and $1 million, respectively.

Results from continuing operations were positively impacted period-over-period by the improved profitability at Fortegra, increases in principle investment income, increased rental income at Care, both from recent acquisitions and improving results at existing properties, and the benefits associated with the cash restructuring mentioned earlier.

This was partially offset by reduction in specialty finance organic volumes combined with higher expenses as we increased headcount to drive future sales growth, declining interest rates quarter-over-quarter, resulting in a $1.4 million fair value loss on interest rate swap in our real estate segment, and higher corporate expenses to enhance our controls and infrastructure.

On Page 7, we've laid out the components of our revenue and adjusted EBITDA growth by segment. First quarter revenue grew $43 million, primarily driven by 23% growth in insurance and 48% growth in real estate.

Adjusted EBITDA from continuing operations increased $10.5 million over the prior year, driven by Fortegra margin improvement, increased Care NOI both from acquisitions and improving yields on managed properties, and higher principle investment income and unrealized gains.

With that, we will now transition to a more detailed analysis of each segments performance and outlook.

Starting on Page 9. We highlight 3 metrics that we used to measure our insurance and insurance services segment results as adjusted revenue, as adjusted net revenue and adjusted EBITDA. All 3 are non-GAAP measures that remove the purchase accounting adjustments from their comparable GAAP metric. We use these metrics to review relative performance year-over-year, while purchase accounting values acquired contracts, adds them to our balance sheet and amortizes them over time. The single line item amortization eliminates visibility in comparing the performance of the older contracts with newly generated contracts, in particular relative to the decision to reinsure or retain risk. As such, we believe that reallocating the amortization to the appropriate revenue and expense line items facilitates a better understanding of how the business is doing period-over-period. For the quarter, adjusted EBITDA was $12 million, up from $8.2 million in the prior year.

As adjusted net revenues were up $4 million or 15%, as a result of favorable claim activity and credit protection and increased top line growth in specialty products.

Investment income improved as we have begun to more actively manage the investment portfolio as Michael mentioned earlier.

Net written premiums of volumetric, a leading indicator of future revenues, increased by 49%, with all 3 product lines gaining momentum. This is particularly encouraging as warranty net written premiums reverse trend and were up nearly 25%.

Going forward, while we expect earnings growth to be supported by expansion in product revenues and investment income, we expected to be at a lesser pace than that, that we've seen this quarter.

Moving to specialty finance on Page 10. Adjusted EBITDA was a loss of $730,000 for the first quarter, a $1.3 million decline over 2015. This was driven by seasonal declines in our mortgage volume and weakening market demand for refinancing as interest rates have remained relatively flat year-over-year.

Mortgage originations for the overall market were also down 16% versus the first quarter of 2015, which was in line with our organic volume performance, excluding the impact of the Reliance acquisition.

We invested in additional headcount in mortgage, which was up approximately 20% from last year, along with the expenditure of higher marketing costs for these new loan officers, with the strategy of adding additional volume to drive market share in the second half of 2016 and beyond.

Siena, our middle market lending platform, increased average earning assets by 24%.

Turning to the real estate segment on the following page. We continue to see improvement as a result of additional property acquisitions and improving margins on existing properties. Adjusted EBITDA was $2.1 million, up significantly from last year, driven by NOI increases of $1.8 million.

The acquisitions over the last 18 months were primarily managed properties where we partner with existing operators to focus on facilities that are undergoing capital expenditure upgrades and enhancements to allow them to operate more efficiently.

On the bottom left of the page, you can see the improvements to date, as NOI margins on managed property are up from 23.7% to 26%.

As the newer facilities ramp up and stabilize, we expect our results to reflect additional improvement.

For asset management, on the next page, adjusted EBITDA was down slightly year-over-year from a combination of reduced fee earning assets under management and the timing of bonus accruals in the first quarter of 2016.

As Michael mentioned, Telos 7 was launched in early April. We expect to see modest increases in fee revenue in subsequent quarters and are continuing to pursue opportunities to increase AUM for this segment.

Turning to the corporate and other segment on Page 13. Adjusted EBITDA was up by $6.8 million from the prior year, driven by a $3.9 million unrealized gain on Star Asia, which was subsequently sold in April.

Improved CLO equity earnings compared to the prior year, primarily as a result of reduced mark-to-market losses. Earnings of $2.8 million from our Telos 7 warehouse and credit opportunities fund plus other unrealized gains on our principle investments up $2.3 million. These increases were offset by increases in payroll expenses of $1.2 million and professional fees of $3.1 million, respectively, which reflect our efforts to improve the controls and reporting infrastructure.

And looking forward, we expect our NPL investments to generate realizations on sales of mortgage loans and/or RIO in the second half of 2016. Now I'll pass it back to Michael to wrap up.

Michael Gene Barnes
Executive Chairman

So to summarize Tiptree's results for the quarter. We had a good first quarter, with the company having adjusted EBITDA of $15.3 million and net after-tax income of $7.4 million, of which $5.6 million was attributable to the Class A shareholders.

Our insurance sector was ahead of expectations, and with the A.M. Best upgrade, we're optimistic that revenues will grow through increased product originations and returns on the investment pool. Our real estate sector made further acquisition to senior care facilities and continues to increase revenue and NOI. Our Asset Management sector is stable and aside from CLOs, we're working toward raising capital and other forms of managed accounts, our specialty finance sector was a bit light this past quarter, but partly because of our investments in further building out existing business, which should yield improved reduction in the future. Our corporate and other sector adjusted EBITDA was positive, which not only includes gains of our principle investment, but also incorporates our company's corporate expenses. And importantly, we continue to make progress on this year's objective of exiting noncore underperforming assets, reallocating to existing core businesses, and further building out our infrastructure.
And with that, we'll now open up for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Andrew Cowen from Badge Investment.

Andrew J. Cowen
Badge Investment Partners LLC

I had asked last quarter if there was any kind of guidance that you guys might be able to provide. I understand that there going to be certain things that are going to be tough to predict, like CLO marks and stuff like that. But is there any kind of guidance you can give by segment at least, just it seems like we're on kind of -- just sort of doing back of the envelope, but almost a cash earnings rate of about $1 a share. I was wondering if you could give any kind of confirmation or detail around anything like that?

Michael Gene Barnes
Executive Chairman

Andrew, it's Michael. We don't provide guidance really as more of -- I'd say our philosophy than anything. However, many of our businesses, as you just suggested, certainly have repeatable and predictable. We're not going to provide guidance on this call. We are certainly working each quarter as we seek to improve our financial disclosures to better communicate to investors our performance, and those businesses that we see continuing to perform well in the future. So I would say that although, philosophically we're not going to be providing guidance. We are certainly going to be working towards improving our disclosures in transparency so that investors can better understand the predictability of our cash flow. Thank you for the question.

Andrew J. Cowen
Badge Investment Partners LLC

Just a follow-up. Is there -- something like Fortegra, which is going to be somewhat predictable, or I guess your most predictable business beyond I guess ex-real estate. Are these numbers, sort of numbers we can look at going forward something like a $12 million EBITDA quarterly number or anything like that, and then maybe something in real estate or just asset management fee-based income.

Michael Gene Barnes
Executive Chairman

So Andrew, I'm going to have Sandra Bell answer this question. As you see, we're continuing to make acquisitions in our real estate sector. It's our objective to continue to grow our Asset Management business, not only in CLOs as we've done in the past, but also looking to expand and diversify their fee income to other types of managed accounts. So that's certainly something that we would look to grow in the future. With respect to Fortegra, Sandra, would like you to take that one?

Sandra E. Bell
Chief Financial Officer

Yes. Let me respond on this 2 ways. First, Andrew, when you look at the couple of the extra metrics we have added this quarter. Our net written premiums and net revenues as well as adjusted EBITDA, you can begin to see the alignments among those metrics. It is a relatively predictable business. And the contract term are couple of years long.

So as you see written premiums grow, you can begin to translate that into trend. I just want to caution that the first quarter was an extraordinary good quarter for Fortegra. We do believe we'll see growth, and we do believe that we'll begin to see improved performance on the investment income. But I wouldn't expect to see continued growth around 46%, it will be little bit

Andrew J. Cowen
Badge Investment Partners LLC

No, no, I wasn't talking about the growth numbers more, just to put sort of more of a run rate steady-state EBITDA number could be.

Sandra E. Bell
Chief Financial Officer

Yes. It tends to be steady statement. It's a company that has disciplined cost controls as well, and that will support the steady state.

Michael Gene Barnes
Executive Chairman

And I think Andrew, now that we've owned it for more than a year, you can start to have comparison quarter-by-quarter with regard to the performance.

Sandra E. Bell
Chief Financial Officer

The other piece, just to answer your question about real estate, I think we've started to add NOI margins. And that's basically net operating income, which is property level metric over investment. And again, that metric will start to show you how we expect improving performance on what I would call a same-store sale type of basis.

Andrew J. Cowen
Badge Investment Partners LLC

Do you have any kind of FFO type numbers?

Sandra E. Bell
Chief Financial Officer

We have been providing NOI, because of the nature of the business. We have the 2 components triple-net leases and managed properties. We believe NOI is a better metric than FFO for this business.

Andrew J. Cowen
Badge Investment Partners LLC

Okay. And then just lastly, you went into some nice detail on all the depreciation line items, particularly as regard to the Vova [ph], but based on book value, I think it somewhere around, official book value of around $9.16. How much has book value been impacted by that total depreciation? So if we wanted to basically assume that a cleaner book value is I would imagine somewhat materially higher, because you've had such a big depreciation. Is there a cumulative affect on book value?

Michael Gene Barnes
Executive Chairman

Andrew, I'll just comment. You certainly have picked up on one of those things that when investing in real estate and also with respect to purchase of Fortegra. Depreciation, amortization both last year and as we continue to make acquisitions in real estate will always be reflected in the GAAP results that we report. And so it's one of those things that certainly depreciation as relates to real estate certainly goes against the GAAP book value. NOI is certainly one of the metrics that we look at in terms of both evaluation metric as well as we may increase overall performance metric. So your point is spot on with respect to depreciation, certainly affecting the GAAP reporting of book value. And certainly, it's our view, that intrinsic value very well exceeds what would say is reportable GAAP book value in our opinion.

Andrew J. Cowen
Badge Investment Partners LLC

Is there some sort of accumulative depreciation number we might be able to look at and maybe back -- add that back to some sort of official book value?

Sandra E. Bell

Chief Financial Officer

I would be happy to, Andrew. I don't have that on top of my head. And to put that together and off-line walk you through how to build that from our published financial statements.

Andrew J. Cowen
Badge Investment Partners LLC

Okay. Just one thing that notice such a big number that I said, while it looks like book value looks pretty materially understated versus true, call an intrinsic value. Any help on that front would be great.

Michael Gene Barnes
Executive Chairman

We acknowledge your point.

Operator

[Operator Instructions] Ladies and gentlemen, we have no further questions in queue at this time. I would like to turn the floor back over to management for closing comments.

Sandra E. Bell
Chief Financial Officer

Thank you, Adam. And thank you, everyone, for joining our call today. Certainly, if you have any questions, please feel free to reach out to me directly, and I will be happy to work with you in going through our disclosures. We look forward to speaking with you at our second quarter call. And this concludes our first quarter 2016 conference call. Have a nice day.

Operator
Thank you. Ladies and gentleman, this does conclude our teleconference for today. You may now disconnect your lines at this time. Thank you for your participation, and have a wonderful day.