

# **Tiptree Inc. NasdaqCM:TIPT**

## **FQ3 2021 Earnings Call Transcripts**

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**S&P Global Market Intelligence Estimates**

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# Call Participants

## EXECUTIVES

**Michael Gene Barnes**

*Executive Chairman of the Board*

**Sandra E. Bell**

*CFO & Principal Accounting Officer*

## ANALYSTS

**Andrew Cowen**

# Presentation

## Operator

Greetings, and welcome to Tiptree Inc.'s Third Quarter 2021 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.

## Sandra E. Bell

*CFO & Principal Accounting Officer*

Good morning, and welcome to our third quarter 2021 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. 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. In addition, 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*

Good morning, everyone. Thank you all for your time, and welcome to our third quarter earnings call. Our performance in the quarter and throughout all of 2021 reflects the strength and diversification of our underlying operating businesses.

Year-to-date revenues of \$881 million and net income of \$38.6 million were both up substantially from 2020 driven by the particularly strong performance of Fortegra, our specialty insurance business; Reliance, our mortgage business; and our dry-bulk shipping investment. After removing the impact of investment gains and losses, year-to-date revenue grew 34% and adjusted net income of \$47 million increased 33% from the prior year. We are pleased with the strength in our businesses demonstrated by the growth in these financial metrics.

In early October, we announced a \$200 million strategic investment in Fortegra from Warburg Pincus, a leading global private equity firm focused on growth investment. As we have stated before, this capital investment represents a significant step forward for Fortegra and Tiptree and will provide many strategic benefits in advancing Fortegra's position as a global specialty insurer.

Our primary objectives in this transaction were to source growth capital for Fortegra, to refine and recapitalize our balance sheet and to create greater transparency of Fortegra's value for investors and thereby seek to close the gap between Tiptree's stock price and intrinsic value. This transaction goes a long way in accomplishing these goals, and we believe it will provide a solid runway to continue Fortegra's growth over the next 2 to 3 years.

Before transitioning to the quarterly performance, I would like to thank both the Fortegra and Tiptree teams for their efforts in getting this transaction across the finish line. It was a true team effort, an example of how Tiptree's ownership can benefit our subsidiaries and one that we believe will offer many opportunities for growth in shareholder value over the long term.

This year, Fortegra has continued to deliver on its growth objectives while maintaining focus on the underwriting discipline that has contributed to such consistent results over the past several years. For the year-to-date period, Fortegra's revenues have grown 50% and adjusted net income was \$46 million, up 56%, driven by revenue growth and an improved combined ratio. The adjusted return on average equity was 21%, improving from 14% in 2020.

Gross written premiums and premium equivalents were \$1.7 billion, up 44% versus the prior year, driven by strong organic growth across all business lines. As we look forward, we expect this performance to continue, led by a growing top line and consistent combined ratio.

Outside of the insurance business, our 2 primary investments in mortgage origination and maritime shipping generated positive net income year-to-date. And it is worth noting that the Tiptree Capital -- that Tiptree Capital on a stand-alone basis now has \$175 million of book value. Adjusted net income within Tiptree Capital was \$24 million for the year, up slightly from the prior year, driven by strong performance in our mortgage and shipping operations.

The mortgage business continued to deliver, as home price appreciation and the mortgage rate environment provide positive tailwinds. Over the past 2 years, we have built a servicing portfolio, which has become a large contributor to our results through a combination of higher servicing fees, a source for higher margin recapture volume and acting as a potential hedge during rising interest rate environments.

Within our maritime operation, we are experiencing cyclical highs in shipping charter rates on our 3 dry bulk vessels. This serves as a great example of the embedded optionality that we often speak of when allocating capital, whereby we look to source investments that generate solid cash returns during ordinary times and also have the potential for outsized returns when the option comes in the month.

Overall, we are very pleased with year-to-date performance and believe Tiptree is well positioned for the fourth quarter of 2021 and going forward.

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 3 (sic) [ Page 4 ] of the presentation, we highlight Tiptree's key financial metrics for the third quarter 2021 compared to the prior year period.

Net income for the quarter was \$2 million, driven by continued growth in the insurance business and positive performance in our mortgage and shipping operations, offset by mark-to-market equity losses primarily from Invesque. Excluding investment gains and losses, revenues were up 31% for the quarter. driven by organic growth in insurance operations, continued strength in mortgage volumes and margins and increases in dry bulk charter rates.

Adjusted net income for the quarter was \$20.7 million, representing a 20.5% annualized adjusted return on average equity. For the year-to-date period, adjusted net income was \$47 million, up 33% versus the prior year. These strong operating results were driven by the growth in revenues as well as the consistent combined ratio at Fortegra.

Book value per share of \$11.37 increased by 11.3% versus the prior year. Compared to the second quarter 2021, book value per share declined by \$0.22, primarily driven by the exchange of certain diluted securities and our third quarter dividend, the combination of which offset the impact of positive earnings on book value per share for the quarter.

Turning to Page 4, we highlight Tiptree's sum of the parts value, reflecting the impact of Warburg's \$200 million investment in Fortegra. As we discussed on the transaction announcement call in October, \$140 million of the investment will occur once regulatory approvals are received, with the next \$60 million to be drawn as Fortegra needs the funds. Once the full \$200 million is invested, Warburg's ownership of Fortegra will be divided between 17.5% attributable to their common stock and 6.6% attributable to their convertible preferred shares on an as-converted basis.

Based on the investment transaction multiple of trailing 12-month adjusted net income, Tiptree's retained ownership of Fortegra represents approximately \$644 million or \$19 per outstanding Tiptree share. The \$140 million of proceeds will be used to fully pay down the \$116 million of holding company debt at the Tiptree level, with the remaining proceeds to be used for general corporate purposes. When you include the book value of Tiptree Capital and the holding company assets, after the transaction closes, we believe Tiptree's sum of the parts value to be \$26.16 per share, well above yesterday's closing price.

With that, let's turn to Fortegra's results on Page 6. As Michael mentioned, we continue to see strong momentum in both Fortegra's top line and bottom line results. For the third quarter 2021, premiums and equivalents increased 32% year-over-year driven by growth in all lines of business, including admitted, excess and surplus and warranty lines.

As a reminder, particularly with respect to longer-duration warranty contracts much of the increase in this metric ends up on the balance sheet as GAAP recognizes the revenue over the life of the contract. Deferred revenues and unearned premiums, which represents this future earnings potential, stood at \$1.6 billion, up 36% year-over-year.

For the quarter, underwriting and fee margin increased to \$66 million, up \$22 million or 50%. And the combined ratio improved by 100 basis points to 89.6% for the third quarter as operating and technology efficiencies contributed to an improved expense ratio and the underwriting ratio improved given the changing business mix.

On Page 7, we highlight the KPI trends over the past 3 years. Gross written premiums and equivalents have increased 34% over this period, with a 24% organic growth rate. Importantly, the combined ratio is not only stable, but has shown consistent improvement over time, moving from 92.8% in the 2019 period to 91% for the 2021 year-to-date period. Fortegra's business model maintained strong economic alignment with its distribution network, which is important in delivering consistency in the combined ratio.

Several of the underwritten programs have variable retrospective commission structures, meaning if the book of business is profitable, Fortegra will share that underwriting profitability with this agent. If it is not profitable, Fortegra reduces their commission and the economics are rationalized.

We evaluate the performance of the business using adjusted net income, which removes realized and unrealized gains and losses, purchase accounting amortization, stock-based compensation and nonrecurring items. This metric improved to \$46.4 million in the first 3 quarters of 2021, representing a 35% growth rate over the past 2 years. Adjusted return on equity has improved from 10% to 21% over the respective periods.

Turning to the insurance investment portfolio on Page 8. Total investments and cash and cash equivalents ended the quarter at \$832 million, up 28% year-over-year, in line with the underlying premium growth. 82% of the portfolio is invested in high credit quality and liquid securities, with an average rating of AA. Year-to-date, net investment income was \$9.3 million, up slightly as the overall portfolio increased in line with premiums. Net realized and unrealized gains were \$5 million for the first 3 quarters, driven by unrealized gains on equities.

The capital and liquidity position remains strong at Fortegra, with \$295 million of stockholders' equity, debt capacity of \$200 million and an ability to draw \$60 million of capital upon the transaction closing, all of which put the business in a solid position for future growth.

On Page 10, we present the results of Tiptree Capital, which as Michael mentioned earlier, consists of our mortgage and shipping operations as well as our Invesque shares. Year-to-date, 2021 adjusted net income in Tiptree Capital increased to \$23.6 million, primarily driven by sustained mortgage volumes and improvements over the prior year period in our shipping business due to increased dry-bulk charter rates.

Our mortgage business has benefited from several tailwinds, including higher refinance volumes supported by both low rates and rising home prices as well as a growing servicing book. As of September 30, 2021, the fair value of the MSR asset was \$26 million. Our shipping business contributed \$8.1 million of adjusted net income in 2021 as supply and demand imbalances in global trade have driven dry-bulk shipping rates to cyclical highs.

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

**Michael Gene Barnes**  
*Executive Chairman of the Board*

Thanks, Sandra. With the company's performance thus far in 2021 and the recently announced investment in Fortegra, we believe our businesses are well positioned to drive continued growth and value for Tiptree shareholders. 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. Within shipping, the demand-supply imbalance in the bulker market continues to play out and has benefited our business as global economies reopen.

Fortegra is a model of consistency, with top line growth at 24% over the past 4 years, while delivering best-in-class combined ratio of 91%. We believe these trends will continue and place a premium value on the consistency that the business generates year in, year out. With our new partner, Warburg Pincus. Fortegra enters its next phase of growth that we believe will lead to long-term value creation for Tiptree shareholders.

With that, we will open the line for questions.

# Question and Answer

## Operator

[Operator Instructions] Our first question comes from Andrew Cowen from Brean.

## Andrew Cowen

Really great quarter, congratulations. Two questions. So obviously, Warburg Pincus is an amazing investor to have, and congratulations on that deal and the valuation. Is there anything that they are looking to do in terms of accelerating growth within Fortegra that you could discuss?

## Michael Gene Barnes

*Executive Chairman of the Board*

So good question, Andrew, and thanks for that. And look, I think I can't speak for Warburg specifically, but what I can certainly say is that one of the things that -- through our discussions as they were doing their due diligence and deciding to make the investment, one of the things that certainly we all talked about was what they bring as a strategic partner, not just in their experience in the financial services sector and insurance, other related businesses that may have some synergies.

So we see this certainly as adding more than just the capital. We see this as them helping us be a true partner in the growth of Fortegra, possibly bringing into play other sectors that they're involved in that may relate. And certainly, as we do consider going forward to an IPO again, their experience and relationships, I think, are going to go a long way.

## Andrew Cowen

Okay. Fair enough. And also on the shipping business, do you have any idea on like what kind of -- obviously, ships are very volatile in terms of valuation and their cash flows. Do you have any idea in like what kind of gains you might have just sort of, in general, what those ships are worth now? And is there a price where you'd consider selling them?

## Michael Gene Barnes

*Executive Chairman of the Board*

So we're in this business for a very long-term view, Andrew, I'll say, and it was our objective and we continue to execute on that objective of building out to be larger than we currently are. We continue to add to the fleet opportunistically, both with regard to dry bulk and to probably tanker. I'll say that to your point, we're enjoying an environment in the dry bulk. There's about a 12-year high in terms of rates.

Certainly, as that has been sustained and I think as analysts continue to model this being sustained for an extended period, that does have an impact on the S&P market in terms of where ships are trading and where we would value our own ships. I think that there is -- that, that valuation always lags in terms of rates. But right now, we do believe we have a material appreciation in our investment value and certainly relative to our depreciated value.

And I'll just say that we are going to continue to look to source opportunities to expand the fleet, again, opportunistically, when we see that there's value there. Our objectives have always been to invest where we see solid return on capital invested. But where we feel that the rate environment will lead to upside optionality, we're seeing that in the dry bulk. We saw that in the tanker space in early 2020. We think we'll see that return in the tanker space going forward.

## Operator

[Operator Instructions] Ladies and gentlemen, there are no further questions at this time. I would like to turn the call back to Sandra Bell for any closing remarks.

## Sandra E. Bell

*CFO & Principal Accounting Officer*

Thank you, Joe, and thanks, everyone, for joining us today. As always, if you have any questions, please feel free to reach out to me directly. This concludes our third quarter 2021 conference call. Have a great day.

**Operator**

This concludes today's conference. You may disconnect your lines at this time. Thank you very much for your participation, and have a great day.



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