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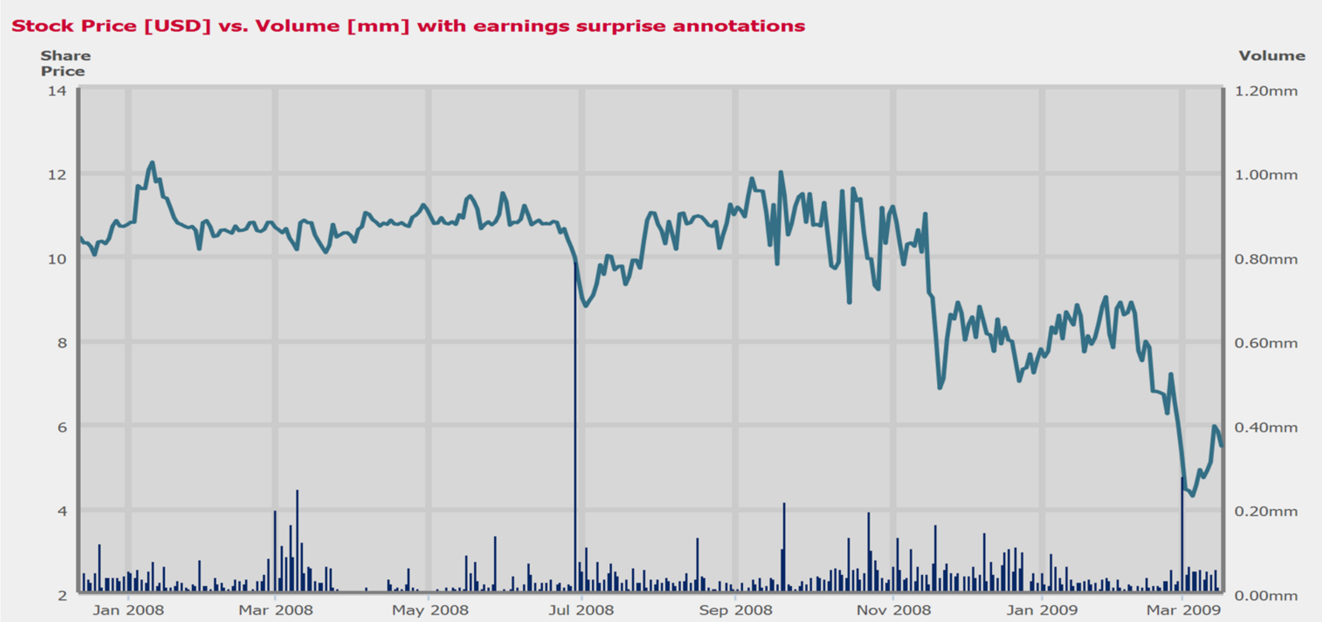
Tiptree Inc. NasdaqCM:TIPT

FY 2016 Earnings Call Transcripts

Tuesday, March 14, 2017 2:00 PM GMT

S&P Capital IQ Estimates

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



- 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

ANALYSTS

Andrew J. Cowen
Badge Investment Partners LLC

Darren Huber

John Sites

Presentation

Operator

Greetings, and welcome to the Tiptree Inc. Full Year 2016 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Sandra Bell, CFO for Tiptree. Ms. Bell, you may begin.

Sandra E. Bell
Chief Financial Officer

Good morning, everyone, and welcome to our 2016 earnings call. I am 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.

Prior to turning the call over to Michael, I just want to highlight a few of the key disclosures. This presentation supplements our SEC filings and is provided 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 law, we undertake no obligation to update any forward-looking statements.

We also use non-GAAP measures, which we believe provide additional 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 the GAAP equivalent.

Lastly, in the fourth quarter, we realigned our principal investments, formerly reported in the corporate segment into the new reportable segments, which better aligns with the company's operating strategy. Those recaps were made for the years ended 2016, 2015 and 2014.

With that, let me turn the call over to Michael, who will begin on Page 3 of the presentation.

Michael Gene Barnes
Executive Chairman

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

2016 was a strong year for Tiptree. On a consolidated basis, total revenues grew 29% year-over-year, while generating $32.3 million of net income and $78.9 million of adjusted EBITDA. Tiptree's as exchanged book value per share ended at $10.14, which, combined with dividends, resulted in a total return for the year of 15.1%.

Over nearly a decade of operations, we have successfully transformed Tiptree's strategy away from an opportunistic asset investor to a long-term owner of operating companies. Our primary focus this past year was continuing to build a company that can generate a high portion of stable and repeatable earnings.

With regard to our insurance business in 2016, we took steps to leverage our investment experience to differentiate Fortegra's operations by combining strong underwriting results with higher yielding investment income. We acquired Fortegra because we find the financial characteristics of this specialty insurance sector to be attractive, particularly the ability of insurers to receive premiums upfront and pay claims later. As their net written premium volume increases, we are able to retain incremental premiums, which can be invested to generate attractive risk-adjusted returns.

For 2016, our investment portfolio grew to $352 million, a 31% increase from 2015. The return improved from 2.5% in 2015 to 8% in 2016, primarily driven by an increased allocation to higher-yielding investments. As we look forward, our focus will be to grow underwriting profits through increased net written premiums in warranty and specialty business at an attractive combined ratio and continuing to invest the excess premium flow.

Our asset management business improved significantly in 2016, contributing pretax earnings of $25.3 million compared to a loss of $6.8 million in 2015. Fee-earning assets under management remained steady at $1.9 billion as we issued our seventh CLO, which partially offset runoff from our older vintage CLOs. In January 2017, we took steps to reduce our capital exposure to CLO equity by selling our sub-notes in Telos 5 for a gain over year-end values and a potential 2017 tax benefit.

Our senior living business continued to grow in 2016. We completed 5 acquisitions for $106 million and increased revenues for the year to $61 million, while NOI margins continued to expand. Our senior housing pipeline remains strong and we anticipate continued growth through acquisitions and further NOI improvements at existing properties.

We are pleased with the financial results over this past year. Each of our companies is contributing, and we are optimistic that we will continue to see growth in our core operating businesses into 2017.

With that, I will hand it 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 improvement in our financial performance versus prior years. In 2016, diluted earnings per Class A share was $0.78. Our as exchanged book value per share grew to $10.14. The key drivers of our improvement in book value are the growth in earnings, net of $4 million of dividends paid, and the benefit of $43.8 million of shares repurchased at an average 30% discount to book value. The total number of Class A and Class B shares outstanding now stands at 36.4 million, which represents $369 million of book value and $526 million of total enterprise value.

In 2017, we will face headwinds related to book value per share. We currently have an outstanding option issued in 2007 that was in the money as of year-end and expires in June of this year. Given this strike price, the option is exercised, we dilute book value per share by approximately $0.19.

On Page 5, we've laid out the components of our 2016 operating performance by segment. In total, pretax income from continuing operations was $43.3 million, up $55.7 million from the prior year, and adjusted EBITDA was $78.9 million, an increase of $20.5 million or 35%.

Our specialty insurance segment contributed $60.5 million of adjusted EBITDA, which was up over the prior year, driven by growth in net written premiums and improved investment income. Of the total 2016 adjusted EBITDA in this segment, $24.6 million was from investment income. Of that amount, unrealized gains on equities and loans were $10 million.

We expect net investment income to be a significant contributor to our financial results over the long-term. A significant portion will be repeatable interest and dividends, but some will continue to be more volatile realized and unrealized gains and losses.

Our asset management segment was up significantly, driven by increases in management incentive fees and the recovery of fair market value on our CLO sub-notes versus the marks taken in 2015. Senior housing improved as a result of expanding NOI margins at existing properties and acquisitions increased our overall revenues. Improvements in volumes and margins in the mortgage business, along with growth in Siena's loan portfolio, drove positive results in specialty finance. These increases were partially offset by higher performance-related compensation and increased audit and consulting spend as we work through 2016 to improve our financial infrastructure.

As of year-end, I am pleased to report that we have remediated all our material weaknesses. And as a result, we expect third party-related expenditures at the corporate level to normalize and decline over 2017 and 2018.

Turning to Page 7. Our specialty insurance operations had a strong year, delivering increases in revenue, pretax income and adjusted EBITDA. In the second quarter, we made a strategic decision to contribute approximately $103 million of capital to Fortegra to better capitalize the company. Subsequently, Fortegra's financial strength rating was upgraded to A- by A.M. Best. We believe that the improved rating will support opportunities for future growth and product expansion.

For the year, gross written premiums were $708 million, a 3.3% increase versus 2015, while net written premiums were up 85.2% to $337 million. The increase in net written premiums was substantially driven by our captive reinsurance subsidiary's assumption of $138 million of previously ceded credit protection premiums. As a result, we expect a decrease in our reinsurance cost and the benefit of incremental investment capacity. Despite the significant growth in net written premiums, we were able to maintain a combined ratio of 89.5%.

Our as adjusted underwriting margin was $107.7 million, down $2.3 million from 2015. As we have mentioned before, this was primarily due to volume and margin pressures in our mobile protection product line. The negative impact was offset by growth in our credit protection and program product offerings. Going forward, we expect earnings growth to be supported by further expansion in warranty and program products, along with enhanced investment income.

On Page 8, we highlight the components of our insurance investment portfolio. For 2016, the portfolio grew to $352 million, a 31% increase from 2015. As Michael mentioned, we actively manage our insurance investments across multiple asset classes, sectors and geographies. Our objectives are to balance our portfolio between cash and liquid short-term investments on the one hand to cover near-term claim obligations and select alternative investments with a focus on enhanced risk-adjusted returns.

In 2016, investment returns improved from 2.5% to 8% and were driven by both the increased size of the portfolio and an increased allocation to higher-yielding assets. Our goal to achieve balanced returns was evidenced from the mix of interest and dividends, realized gains and unrealized gains on loans and liquid equity position. The detailed breakdown is highlighted on the top right of this page.

Turning to asset management on the following page. 2016 pretax earnings of $25.3 million were up substantially compared to the loss of $6.8 million in 2015. Fee-earning assets under management remained steady at $1.9 billion and contributed $12.2 million of management and incentive fees.

Our financial results were positively impacted by the fair value adjustments on our investments in the CLO sub-notes. This was primarily driven by a rebound in the credit market. Historically, our earnings have been exposed to market volatility as a result of these investments.

In January 2017, we elected to reduce our total investment to $41.4 million, which should decrease our exposure to market volatility in this segment. Going forward, we're focused on growing assets under management by leveraging our investment performance to target raising funds in other vehicles or managed accounts.

On Page 10, we continue to see improvement in our senior living segment, both as a result of additional acquisitions and improved margins on existing properties. Pretax income improved by 39% versus 2015 as increases in rental revenue outpaced added depreciation from new acquisitions. While depreciation from real estate provides us with favorable tax benefits, it reduces the value of the real estate holdings on our balance sheet for GAAP reporting purposes. As a result, we believe it creates an economic separation between our GAAP book value and what we believe is the intrinsic value of our real estate assets. Total accumulated depreciation on our properties was $38.2 million as of December 31, 2016.

Adjusted EBITDA in this segment was $10.5 million, up significantly from last year, driven by NOI increases of 37%. The acquisitions over the last 2 years were primarily managed properties where we partner with existing operators on facilities that are undergoing enhancements to allow them to operate more efficiently.

On the bottom left of this page, you can see the improvements to-date as NOI margins on managed properties are up from 24.6% to 27.8%. As the newer facilities ramp up and stabilize, we expect our results to continue to improve.

In addition to growing organically, we are continuing to invest, with nearly $25 million of acquisitions to-date in 2017.

Now, I will pass it back to Michael to conclude our prepared remarks.

Michael Gene Barnes
Executive Chairman

So to summarize, we are pleased with our 2016 performance. Our financial results improved, a higher portion of our earnings are now stable and repeatable, and we returned a significant amount of capital to our shareholders. We believe Tiptree is well-positioned as a result of the changes implemented over the past 2 years.

Our insurance business is investing in growing net written premiums in warranty and other specialty products, and we expect to leverage Tiptree's investment experience to increase net investment income over the long-term as we grow float, while maintaining our underwriting standards. Our asset management business is stable, and we are focused on growing AUM through other fund vehicles or managed accounts over the coming years. Our senior living business is making further acquisitions and continues to increase revenue and NOI. Third party expenses at corporate should decline over time now that our infrastructure is established and our controls and processes are in place.

Our board has approved a 20% increase in the dividend to $0.03 per share, which is payable in the first quarter. We believe our efforts to better position the company for growth and to increase clarity and transparency in our financial reporting should allow investors to better understand Tiptree's intrinsic value. With that, we would like to open the line for questions.

Question and Answer

Operator

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

Andrew J. Cowen
Badge Investment Partners LLC

Just a couple of questions. So the -- nice seeing the float grow. Is that the pace that you expect the float to grow, given the underwriting pace you're at right now?

Michael Gene Barnes
Executive Chairman

Sandra, why don't I let you take that?

Sandra E. Bell
Chief Financial Officer

Okay, Andrew. One of the things that drove float this year was the acquisition of the reinsurance book from London by Fortegra's reinsurance subsidiary. So it grew at a slightly larger pace than we would expect to happen organically.

Having said that, we continue to look at opportunities to assume other potential books if they meet our underwriting standards.

Michael Gene Barnes
Executive Chairman

Andrew, I just would add that the growing float is an important part of our future business plan. And we see sort of a -- bringing together our investment experience and then separately running a profitable insurance-related business and warranty business with, I think, a fantastic combined ratio. We see that as a great business model that we're going to continue to expand.

Andrew J. Cowen
Badge Investment Partners LLC

Yes, absolutely. I mean, that combined ratio is very attractive as well.

The next question relates to the CLOs. So you reduced your -- the CLO investments down to $41 million. How much of that remaining $41 million do you have to hold for regulatory purposes?

Michael Gene Barnes
Executive Chairman

0. We're not required to hold the CLO equity for any reason. We'll make strategic decisions on each investment and decide based on price as well as kind of future expected cash flow as to whether we're going to sell or not.

I would say, generally, it's our current objective to look to decrease our leverage exposure to corporate credit in the current market. That's part of why we just announced the reduction in our CLO equity. And so I -- that's something you should expect to see as we go forward.

Andrew J. Cowen
Badge Investment Partners LLC

Okay. Sounds good. And then, lastly, I think the amount of depreciation you guys have taken in total between the Velva [ph] and the depreciation in real estate has been fairly material. Just in the Velva [ph] issues, those seem to be going away and they are what they are. Obviously, it's -- the insurance business has been gaining value rather than depreciating. But related to the real estate, of that accumulated depreciation of $38 million, how much of that do you think is depreciation that would be matched by like a CapEx amount that you'd have to invest back into the properties?

Michael Gene Barnes
Executive Chairman

Andrew, we -- in each of our real estate investments, there are certain reserves set aside to maintain properties and for CapEx. So in that regard, depreciation, we -- as Sandra stated in the content of the call, we view that in some ways that it does not accurately reflect the intrinsic value of the properties. There's -- in real estate alone, there's over, I think, about a buck of depreciation and amortization that's accumulated today. So we see the properties as being valued based upon, I'd say, a more traditional metric of NOI and a cap rate. And so that's how we would look at the intrinsic value.

But to your point, we don't view all of the depreciation in the case of the real estate as "real." I think, like all properties, some of it is depreciation. But quite frankly, given the CapEx that we aside to maintain properties, we view the value of our properties as materially higher in intrinsic value than our carrying book value.

Andrew J. Cowen
Badge Investment Partners LLC

That's great. So you've already set aside sort of maintenance CapEx and repair CapEx.

Michael Gene Barnes
Executive Chairman

Correct.

Andrew J. Cowen
Badge Investment Partners LLC

Stuff like that. So that $38 million, you could almost completely add back to the value of the properties?

Michael Gene Barnes
Executive Chairman

I'll leave that up to you.

Andrew J. Cowen
Badge Investment Partners LLC

From a book value perspective, yes. Yes, well, and then there's book value and then there's cap rate, which not necessarily the same as well.

Operator

[Operator Instructions] Our next question comes from the line of Darren Huber with Fintan Partners.

Darren Huber

I'm calling -- I would like to know if you could set a little more color on your decision to decrease your corporate exposure?

Michael Gene Barnes
Executive Chairman

Our corporate credit exposure, is that what you're referring?

Darren Huber

Yes, corporate credit. Yes. Sorry.

Michael Gene Barnes
Executive Chairman

So we've been in the CLO business for quite a while and I guess we view that business as a combination of both making investments in the levered credit equity portion of the CLO and warehouse that goes along with creating CLOs and then -- that's one part of the business. The other part of the business is then the fee-driven part of the business where we receive both senior subordinate and performance fees. The objectives of the capital we've allocated to that business in the past has been to periodically sell down our exposure in the equity of the CLOs and to reinvest that in new CLOs. As retention rules have come online, and frankly, as the yields of CLO equity have gotten to very low levels, we have to constantly reevaluate our objectives of wanting to reinvest and continue to grow CLOs as opposed to look for other ways to grow mandates -- asset management mandates in the corporate credit space, which we are doing.

So right now and as we've described, we would prefer to be downsizing our exposure to levered corporate credit in the form of CLO equity, particularly given, I'd say, the rebound in prices that occurred toward the end of last year and the beginning of this year, and to focus on creating more diversified asset management platforms and managed accounts in corporate credit. So that's our objective.

Operator

Our next question comes from the line of John Sites with Wexford Capital.

John Sites

Sandra, I have a question. I have to confess I wasn't paying as much attention as I should. But you mentioned that you have an option that, if exercised, could reduce the book value of your shares by, if I remember, $0.19. Can you go over what that option is? And do I have my numbers right and explain it a little bit?

Sandra E. Bell
Chief Financial Officer

Yes. Certainly, John. In 2007, as part of the origination of Tiptree, there was an option granted to Tricadia at the same price as original investors invested in Tiptree. That option is in the money today and expires in June. Absent any other factors, positive or negative, if that option is exercised, given the strike price, you are correct in that it would be a $0.19 dilution to the book value per share. It does provide new liquidity and underlying liquidity to the market price, so that's a positive.

John Sites

Okay. And if exercised, how much -- what does it provide to the company in terms of incremental liquidity?

Sandra E. Bell
Chief Financial Officer

Approximately $8 million.

Michael Gene Barnes
Executive Chairman

And John, I'll just point out that, that option is described in some detail on F-63 of our K that was just posted.

Operator

There are no further questions at this time.

I would like to turn the call back over to Ms. Bell for closing remarks.

Sandra E. Bell
Chief Financial Officer

Thank you, Michelle, and thanks, everyone, for joining us today.

If you have any additional questions, please feel free to reach out to me directly.

We look forward to speaking with you again shortly after the first quarter results are in.

This concludes our conference call.

Operator
This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.