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Tiptree Inc. NasdaqCM:TIPT

FQ3 2022 Earnings Call Transcripts

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The chart could not be generated due to the unavailability of pricing data

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Call Participants

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Michael Gene Barnes
Executive Chairman of the Board

Sandra E. Bell
CFO & Principal Accounting Officer

Scott McKinney;Deputy Chief Financial Officer

Presentation

Operator

Welcome to the Tiptree Inc. Third Quarter 2022 Earnings Conference Call. [Operator Instructions] I would now like to turn the conference over to Scott McKinney, Deputy CFO. Please go ahead.

Scott McKinney;Deputy Chief Financial Officer

Good morning, and welcome to our third quarter 2022 earnings call. We are joined today by our Executive Chairman, Michael Barnes; CEO, Jonathan Ilany; and CFO, Sandra Bell. A copy of our earnings release and investor presentation are on our website, tiptreeinc.com. 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. During the call this morning, we will discuss non-GAAP financial measures, which are described in more detail in our 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'll turn the call over to Michael.

Michael Gene Barnes
Executive Chairman of the Board

Thank you, Scott, and good morning to everyone. Before we dive into the quarter, I'm sure you've all seen the announcement that our CFO, Sandra Bell will be retiring at the end of March next year. Along with the rest of the Board, I want to personally thank Sandra for her leadership and contributions to Tiptree over the past several years. Sandra has been an integral part of our senior management team since joining us in 2015. She has built a top-notch finance organization that is well-positioned for the future. Taking over from Sandra will be Scott McKinney, our current Deputy CFO. Scott has been with us for many years, has a deep understanding of our businesses and is well-qualified and prepared to take on his new responsibilities. Both Jonathan and I, as well as the Board of Directors are excited to welcome Scott to his new role. Sandra and Scott have worked well together over many years and will ensure a smooth transition over the coming months.

Moving to the quarter. I plan to give a brief update, and then we'll let Sandra walk through the financial highlights. When we set out our plans for 2022, we had several key objectives in mind: first, closing the investment in Fortegra with our new partner, Warburg Pincus. -- second, continue to execute on the growth plan at Fortegra, including looking at ways to potentially accelerate the growth profile, all while maintaining the company's excellent underwriting track record. Third, generate solid returns on capital deployed within our businesses in Tiptree Capital. Burginkusan Fortegra closed in June.

Fortegra is quickly putting the fresh capital to work with substantial growth in E&S premiums. We remain focused on growing both the specialty insurance and service contract businesses. While we expect most of the growth to be organic through product and distribution expansion, we are always looking for complementary bolt-on acquisition. Fortegra's premiums and equivalents grew by 21% year-over-year to nearly $2 billion, led by strength in U.S. specialty insurance lines and service contract businesses in the U.S. and Europe.

The combined ratio remained consistent at 91% as the team has executed its growth plan while keeping underwriting discipline and a steady cost infrastructure. For the year, Fortegra's adjusted net income was $60 million, up 29% from 2021, which represented an adjusted return on equity of 26%. We continue to take a conservative approach with a $1.1 billion investment portfolio. At quarter end, the fixed income portfolio was AA+ rated with a 2.1 year duration and notably, 1/3 was held in cash or money market funds. We believe there will be near-term opportunities to deploy a significant amount of this cash into higher-yielding investments while continuing to maintain our long-term conservative view.

Like many other insurance companies, we experienced unrealized losses on fixed income securities this year, representing approximately $1.55 of Tiptree book value per share as a result of several market factors, most notably the dramatic rise in interest rates. As we have stated on prior calls, our investment approach is geared towards the long term. We expect to recover most of the unrealized marks over the coming years as bonds mature and will invest available cash at attractive higher yields.

In our Marine business, we had an active 9 months with both dry bulk and tanker investments producing strong returns. In the quarter, we sold the remaining 2 dry bulk vessels, putting total proceeds at $68 million or a net gain of $21 million. We also signed definitive agreements to sell our 2 product tankers for an aggregate of $49 million or a gain of 44%. We expect those sales to close before year-end.

Finally, while the broader mortgage markets are experiencing significant headwinds, our mortgage business produced positive returns through 3 quarters, driven by the servicing side of the business and active cost management. While volumes and margins have compressed, -- over the past 2 years, the business has grown retained earnings substantially, and we now hold an MSR asset worth $42 million on our balance sheet. As we look ahead, we believe Tiptree is well positioned for the future. Our capital position is strong. We are now debt-free at the holding company, and we continue to look for opportunities that will drive long-term value, including buying back shares as opportunity presents themselves. With that, I'll pass it to Sandra for the quarterly financial update.

Sandra E. Bell
CFO & Principal Accounting Officer

Thank you, Michael. On Page 3 of the presentation, we highlight Tiptree's key financial metrics compared to the prior year period. For the quarter, net income was $14.2 million, driven primarily by the gain on the sale of the dry bulk vessels and improved performance in our insurance business. Excluding investment gains and losses, revenues were up 18% for the quarter, driven by growth in insurance operations and increases in shipping revenues.

Adjusted net income for the quarter was $19.4 million, representing a 14.8% annualized adjusted return on average equity. Contributions from our shipping and insurance businesses were more than offset by the year-over-year decline in our mortgage business. Book value per share of $10.68 decreased by 0.3% compared to the prior quarter and 4.7% over the prior year as a result of unrealized losses on our fixed income security driven by the higher rate environment and the strengthening U.S. dollar. This was in part offset by the closing of the investment in Fortegra in the second quarter.

The transaction with Warburg Pincus resulted in a $63 million pretax gain to Tiptree's equity, which was partially offset by $38 million of tax expense related to the tax deconsolidation of Fortegra. As a reminder, this deferred tax liability is only due if and when we decide to sell any of our Fortegra shares. Turning to Page 5. We highlight Fortegra's results for the quarter. where we continue to see strong momentum. For the third quarter, the business produced record quarterly premiums and equivalents of $761 million, which was up 29% year-over-year driven by growth in excess and surplus and warranty lines. deferred revenues and unearned premiums, which represent future earnings potential, stood at $2 billion, up 26% year-over-year.

The combined ratio remained stable at 91.5%. Operating efficiencies contributed to an improved expense ratio despite continued investment in people and technologies to fund our growth, while the underwriting ratio increased due to the shift in business mix toward lines with higher loss ratios and lower expense ratios. Adjusted return on equity was approximately 25% on an annualized basis.

Going forward, Fortegra's scalable, efficient platform remains positioned for growth and consistent return on equity. Equivalents have increased 28% with the vast majority coming from organic growth. The combined ratio is not only stable, but has shown consistent improvement over time, moving from 92.8% in 2019 to 91% in 2022. Adjusted net income increased to $60 million for the 9 months, representing a 39% growth rate over the past 3 years. Adjusted return on equity has improved to 26% over the respective period.

Ortega benefits from the diversity of its product offering. At the moment, specialty commercial and excess and surplus lines are growing dramatically. Several years ago, other lines were contributing more meaningfully to the growth in premiums. That ability to adjust resource and capital allocation provides a competitive advantage over the long term and generating consistent growth and consistent returns to shareholders. On Page 7, we present the insurance investment portfolio, which ended the quarter at just above $1.1 billion, up 34% year-over-year, in line with the underlying premium growth. 91% of the portfolio is invested in a combination of cash and high credit quality liquid securities with an average rating of AA+. Book yield stands at 2% at quarter end, up from 1.2% in the second quarter, driven by improving yields on money market funds.

The fixed income portfolio has a relatively short duration at 2.1 years, similar to our weighted average liability duration. As we mentioned earlier, while unrealized marks have impacted book value, we generally have the ability to hold these securities to maturity. We believe there is an opportunity for improvement in investment income with rising rates and just over 1/3 of the portfolio held in cash and equivalents without impacting credit quality. Fortegra's capital and liquidity position remains strong with a growing equity base, strong cash flow from operations and the recent refinancing and extension of its $200 million revolving debt facility, we believe the platform is well positioned for future growth. On Page 9, we present the results of Tiptree Capital, which consists of our mortgage and shipping operations as well as our Invest shares.

Pretax income for the quarter was $18.1 million compared to $1.6 million in the prior year, driven by the performance of our shipping investments. For the quarter, shipping contributed $20 million of pretax income, including the gains from the sale of the 2 dry bulk vessels in addition to elevated tanker charter rates. Year-to-date, we recognized gains of $21 million on the sale of all 3 dry bulk vessels, $14 million of which impacted the third quarter.

As expected, our mortgage results have declined substantially from the record years of 2020 and 2021. Year-to-date volumes are down 20%, and margins have tightened compared to the prior year, although less than the broader market, rising mortgage rates and declining affordability has impacted originations across the industry. We expect to continue to face headwinds from a volume and margin perspective, but believe our mortgage servicing portfolio and active cost manager like Tiptree some of the parts value reflecting the impact of the investment in Fortegra -- based on the transaction multiple of trailing 12 months, adjusted net income implicit in Warburg's investment, Tiptree's retained ownership of Fortegra on an as-converted basis represents approximately $748 million or nearly $20 per diluted Tiptree share. As you can see, including our other holdings, we believe Tiptree sum of the parts value to be $26.39 per diluted share. Now I will turn the call back to Michael to conclude our prepared remarks.

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. While markets have been volatile, we are pleased with the operating performance of our businesses this year. Fortegra continues to post record premiums and deliver attractive returns. The pipeline of new opportunities remains robust and specialty market conditions remain favorable. For the past several years, the contributions from the investment portfolio have been modest given the short duration and low-interest rate environment. As we look forward, we see significant opportunities to create value from a combination of underwriting income and fees as well as investment profitability. And finally, we remain focused on deploying capital with the objective of long-term shareholder value appreciation. With that, we will open the line for questions.

Operator

[Operator Instructions] There are no questions at this time. I'll turn the call back over to Scott McKinney for any closing remarks.

Scott McKinney;Deputy Chief Financial Officer
Thank you, [Sachi], and thanks, everyone, for joining us today. If you have any questions, please feel free to reach out to me directly. And this concludes our conference call this morning. Thank you.