

Tiptree Inc. NasdaqCM:TIPT

FQ3 2019 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

Chief Financial Officer

ANALYSTS

Brian Rohman

*Boston Partners Global Investors,
Inc.*

Presentation

Operator

Greetings. Welcome to Tiptree, Inc. Third Quarter 2019 Earnings Conference Call. [Operator Instructions] Please note, this conference is being recorded. I will now turn the conference over to your host, Sandra Bell, Chief Financial Officer. Ms. Bell, you may begin.

Sandra E. Bell

Chief Financial Officer

Good morning, and welcome to our third quarter 2019 earnings call. We are joined today by our Executive Chairman, Michael Barnes; and our CEO, Jonathan Ilany. We have posted our 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 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. In addition, 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 to the presentation provides a reconciliation of each of these measures to their GAAP equivalents. With that, we will turn the call over to Michael.

Michael Gene Barnes

Executive Chairman of the Board

Thank you, Sandra, and good morning to everyone. As we enter the final quarter of 2019, we are pleased with the performance of Tiptree's businesses, which have resulted in a year-to-date return to shareholders of 7% as measured by growth in book value per share and dividends paid.

At a macro level, we have not changed our overall view of anticipating a slowing of global economies over the next few years. However, we remain bullish on the long-term stability and continued expansion of the U.S. as well as the outlook for active global trade. With this view underlying our strategic perspective, we believe our core businesses are well positioned to benefit from these trends.

Fortegra continues to expand its insurance and warranty premium growth at double-digit rates. In addition to growing organically by adding new clients and supporting our existing clients through the addition of new products and services, we also continue to search for attractive acquisitions to accelerate our growth.

Within Tiptree Capital, we continue to see shipping offering attractive opportunities based on near-term technicals and long-term fundamentals. We anticipate allocating additional capital to this sector when opportunities present themselves.

Conversely, we continue to be cautious on high-yield corporate credit and believe we are near the back end of a decade-long credit recovery cycle.

Given our view, we have taken active steps over this past year to significantly reduce Tiptree's overall exposure to credit.

However, also with this concern in mind, we have earmarked a portion of our capital toward what we believe will be increasing opportunities over the coming years in stressed and distressed corporate credit, particularly in the middle-market sector.

We believe that our year-to-date results continue to demonstrate that our strategy is working and that Tiptree's core businesses are well positioned to continue to prosper for the long term and successfully withstand any shorter-term headwinds which may be coming.

With that, I'll pass it to Sandra, who will take you through the third quarter financial results in more detail.

Sandra E. Bell

Chief Financial Officer

Thank you, Michael. On Page 4, we have presented the company's key metrics for the third quarter of 2019. Net income for the quarter was a loss of \$0.9 million, a decline of \$0.4 million over the prior year period. The decrease was primarily driven by unrealized losses on shares of Invesque, partially offset by improved specialty insurance operating results. Net income for the year-to-date period was \$15.6 million, down from the prior year given the gain on sale of our senior living operations in 2018.

Excluding that gain and income from discontinued operations, net income before noncontrolling interest was up \$20.7 million. The primary drivers of this increase were improved operating performance in specialty insurance, the realized gain on sale of our Telos asset management business and realized and unrealized gains on investments in our insurance investment portfolio.

Operating EBITDA for the quarter was \$17.3 million, up from the prior year due primarily to the growth in insurance operations and contributions from our shipping and mortgage operations in Tiptree Capital.

Operating EBITDA for the year-to-date period was \$42.6 million, up 11.2% from the prior year period.

While both periods were impacted by the realignment of the insurance investment portfolio as we continue to reduce our exposure to corporate credit and nonperforming loans, the year-to-date results were more than offset by insurance underwriting growth and contributions from shipping and mortgage operations.

On the bottom of the page, we show a walk from operating EBITDA to total pretax income, highlighting the key differences between the 2 metrics. Book value per share increased to \$11.43, up \$0.64 from the year-end 2018, driven by improved earnings, in addition to share buybacks over the past 3 quarters at an average 40% discount to book.

Turning to Page 5. We highlight our capital allocated between insurance and Tiptree Capital along with their respective returns to assist investors in understanding Tiptree's enterprise value.

When considering capital allocation decisions, we look at total capital, which includes corporate debt held at both the holding company and at our insurance subsidiary.

We evaluate our return on capital using trailing 12-month operating EBITDA, which for the most recent period was \$59.2 million. Our total return of approximately 8.8% is composed of a 13.8% return in specialty insurance and a 9.8% return in Tiptree Capital.

The key drivers of our returns for the period were growth in insurance operating EBITDA across all product lines, consistent and stable dividends from our Invesque shares, positive contributions from shipping and mortgage operations in Tiptree Capital and relatively stable corporate expenses.

Now let's turn to our specialty insurance results. On Page 7, we highlight our underwriting performance, and then on the following page, returns from the investment portfolio. We continue to see positive top line growth across our product lines, including our European warranty program.

For the first 3 quarters of 2019, gross written premiums grew \$117 million year-over-year, up 19%, and net written premiums grew 29%. We believe that there are a number of fundamental factors which provide support to continue this growth moving forward even in a slowing economy.

Within warranty, our opportunities exist partly because of the size and growth trajectory of the overall market. We have made great strides penetrating this sector and believe it has a long runway for growth, both from the acquisition of new clients and from expanding product and service offerings.

Second, the nature of the claims we incur do not change substantially through different economic cycles.

And lastly, consumers tend to keep their cars and appliances longer in a slowing economy, which we believe may increase demand for extended service contracts.

Underwriting margin was up 12.9% and our combined ratio held steady at 92.8%, demonstrating our ability to continue to grow profitably in our insurance business.

Unearned premiums and deferred revenue on the balance sheet stands at \$790 million as of the end of the quarter, up 26% from this time last year. Unearned premiums and deferred revenue amortize into revenue over the life of the underlying contracts, which is expected to average 3 to 4 years.

This growth is key to our future earnings both from underwriting profit as well as contributions from the growing investment portfolio of paid-in premium.

Turning to the investment portfolio on Page 8, our net investments grew by \$75 million year-over-year, up 17%, driven by our growth in net written premiums. Year-to-date, net investment income was \$10.7 million, down \$3 million as we reduced our exposure to corporate loans, thus decreasing our interest income.

We ended the quarter with \$99.4 million of insurance company cash, which is available for investment.

Net portfolio income was \$14.8 million, up approximately \$7.8 million versus the prior year period. The improved performance was driven by a reduction in 2019 unrealized losses versus the prior year period combined with lower asset-based interest expense.

On Page 10, we present the results of Tiptree Capital, which primarily consists of our Invesque shares and shipping operation.

Over time, we would expect that our investments could shift as we recognize returns in 1 asset class or business and reinvest in others.

Our senior living results are included in our 2018 results to facilitate period-over-period comparison.

As of the end of the third quarter, our Invesque position represents \$111 million, of which \$92 million is held in Tiptree Capital. The remainder is in our insurance portfolio. The final transfer restrictions on our Invesque shares expired on August 1, 2019.

The remaining discount also accreted into income over the third quarter.

Year-to-date, real assets operating EBITDA was \$10.5 million, which includes dividends on our Invesque shares and the addition of results from our shipping operations for the full period.

Specialty finance operating EBITDA increased due to higher mortgage origination volume, while pretax income was stable. Now we will turn the call back to Michael to conclude our prepared remarks.

Michael Gene Barnes

Executive Chairman of the Board

Thanks, Sandra. We are pleased with our operating results for the year-to-date period. Our book value increase plus dividends produced a return of 7%, and growth in operating EBITDA was in line with our objective. The capital we have allocated this year to dividend and share buyback reflect our positive view of the cash flow that our businesses can generate. As we move toward year-end, we expect to see continued growth in our insurance business. While our improved results have been achieved primarily through organic growth, finding the right acquisitions, we believe, would add to that success.

And within Tiptree Capital, we will continue to allocate capital to operations and investments that present attractive long-term return, given our strategic outlook. With that, we will open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Brian Rohman of Boston Partners.

Brian Rohman

Boston Partners Global Investors, Inc.

A question about the shipping business. Just how do you account for that? Does it just show up in asset? Do you -- I mean, are these assets regarding a yield? How do you do this?

Sandra E. Bell

Chief Financial Officer

It's 100% owned. We have a small minority interest with one of our shipping partners, so we consolidate all of the revenue, earnings and assets.

Brian Rohman

Boston Partners Global Investors, Inc.

Okay. And what sort of -- 37% of \$198 million, so it's like \$65 million. What sort of yield does -- what sort of yield does a ship provide?

Sandra E. Bell

Chief Financial Officer

Today, we can speak to what that is on an operating EBITDA basis. If you go to the Tiptree Capital page, the last one in the presentation, within real assets, we've laid out the...

Brian Rohman

Boston Partners Global Investors, Inc.

Sure. On Page 13?

Sandra E. Bell

Chief Financial Officer

Yes. On Page -- Page 10, actually. Within real assets, there are 2 things there. The Invesque dividend, which I think quarter...

Brian Rohman

Boston Partners Global Investors, Inc.

I think you have a different -- by the way, I think you have a different slide because page -- I don't have a Page 10, but there's a Page 10, but it's just like a marker page. Are you talking about the slides with the capital allocation?

Sandra E. Bell

Chief Financial Officer

Financial performance highlights, which is towards the end of the deck, right before the appendix, the second-to-last page -- sorry.

Brian Rohman

Boston Partners Global Investors, Inc.

Specialty insurance, invest, book value per share.

Sandra E. Bell

Chief Financial Officer

So I can just give you the numbers.

Brian Rohman

Boston Partners Global Investors, Inc.

Yes. Please. Please do. I'm sorry, I mean...

Sandra E. Bell

Chief Financial Officer

That's no problem. I thought it would be helpful. In real assets, year-to-date, you see operating EBITDA of \$10.5 million, roughly 9 -- \$8.5 million of that is the Invesque dividend. So if you take that out, you're left with roughly \$3 million, and then we have roughly \$74 million total investment in shipping. One of those investments was in the third quarter, so it hasn't really generated a lot of income. But if you take that, you take the \$3 million over the \$74 million, you get a rough operating EBITDA return on the business year-to-date?

Brian Rohman

Boston Partners Global Investors, Inc.

Right. And what is the expectation of what this investment is supposed to provide?

Michael Gene Barnes

Executive Chairman of the Board

Brian, I'll take it. It's Michael Barnes. We were attracted to shipping for a number of reasons. Number one, I'll say, is the partnership that we formed that we work with in terms of both identifying ships to purchase as well as the management of the ships. But I'll say that we -- beyond just the partnership we have and the partners we have, we like the sector based upon where it was current -- where we could source ships versus where rates were in terms of leasing those ships, either day rates or longer-term leases for those ships.

We started with the dry bulk, we have now purchased our first tanker. Generally speaking, I'll say what I like about shipping is the fact that there were certain year-end technicals for this year that is -- as ships have to retrofit with respect to certain environmental standards, we anticipated that there would be less ships. And as well as on a forward-looking basis, we see that there are less ships being built than we anticipate being scrapped. And so we see that as leading us to conclude that it's a very positive environment for sourcing and purchasing and operating ships. I look at it as getting paid to take optionality to get a free option. Meaning we anticipated that rates were near lows. When looked at average -- when we look at historical averages, it could have a long way that it could go up in terms of rates as to where ships could be leased.

Expenses generally stay fixed. So when purchasing ships, you may be getting relatively simple yields of between 6% to 8% unlevered. And then with leverage, potentially more. We have not yet levered our ships. All of those ships we purchased with core capital of Tiptree.

But in the longer term, we see this as earning an attractive cash-on-cash return along with maintaining optionality to the upside. That's how we think about just about every investment that we look at.

Brian Rohman

Boston Partners Global Investors, Inc.

So you think you're buying them at a good price. Is there room for more ships in your portfolio or is 3 enough?

Michael Gene Barnes

Executive Chairman of the Board

Well, we actually purchased our fourth ship in the last quarter, in the third quarter. We will look to purchase ships when we feel that the price is right, that the environment is right, again, that -- where we

are in the cycle with respect to scrapping versus new builds as well as utilization expectation. So we'll buy opportunistically when we see the right price and the right environment.

Brian Rohman

Boston Partners Global Investors, Inc.

Last question on ships. It's a fairly narrow field for investing. Do you have somebody on your team who has come in with that expertise to say this is a good ship, not a good ship? This is a good market, not a good market? Just where you get the expertise to do this?

Michael Gene Barnes

Executive Chairman of the Board

So the head of our -- of Tiptree Marine, which oversees our SwiftBulk investment vehicle, is an individual named Stefanos Kasselakis, and Stefanos comes with the expertise and history in the shipping sector. We also have a partnership with respect to the technical and commercial management of the ships who also co-invest with us in the dry bulk sector.

Operator

This concludes the question-and-answer session, and I will now turn the floor back over to Sandra Bell for closing remarks.

Sandra E. Bell

Chief Financial Officer

Thank you, Omar. And thanks, everyone, for joining us today. If you have any questions, please feel free to reach out to me directly.

This concludes our conference call.

Operator

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

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