S&P Capital IQ

CONTENTS

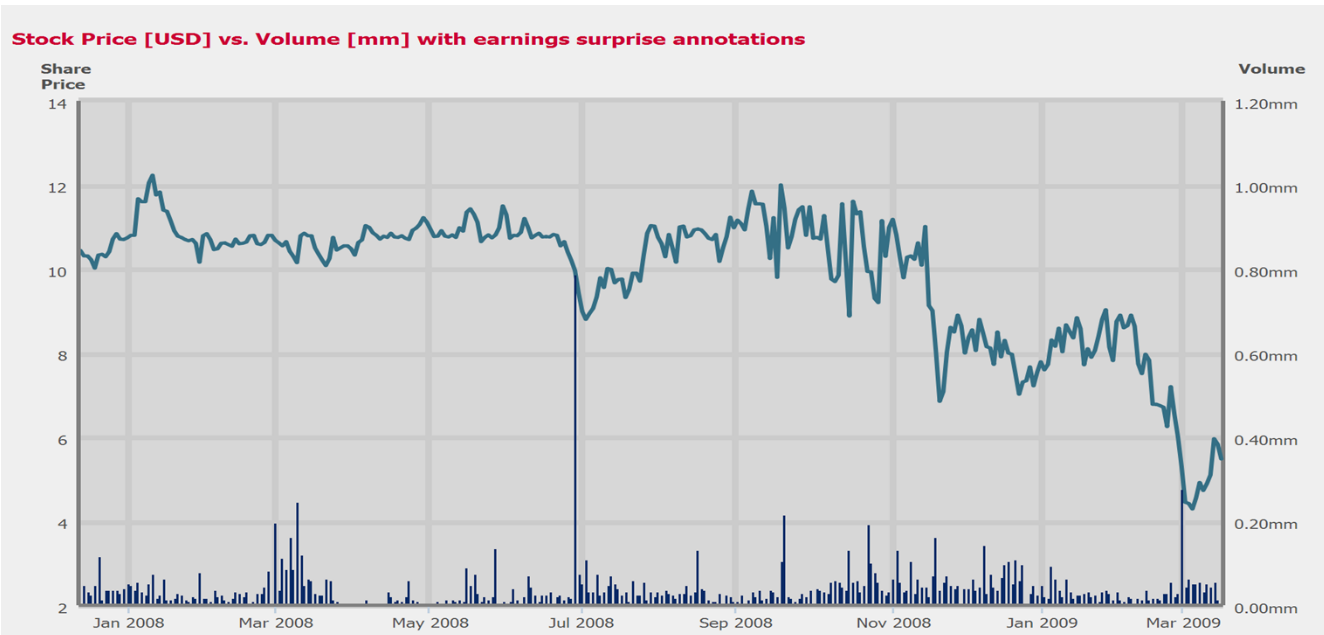
Tiptree Inc. NasdaqCM:TIPT

FQ3 2017 Earnings Call Transcripts

Wednesday, November 08, 2017 3:00 PM GMT

S&P Capital IQ Estimates

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



Call Participants

EXECUTIVES

Jonathan Ilany
Chief Executive Officer and Director

Michael Gene Barnes
Executive Chairman

Sandra E. Bell
Chief Financial Officer

ANALYSTS

John Clifton Sites
Wexford Capital LP

Walter Schenker

Presentation

Operator

Greetings, and welcome to the Tiptree Inc.'s Third Quarter 2017 Financial Results Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Miss Sandra bell, Chief Financial Officer. Thank you, you may begin.

Sandra E. Bell
Chief Financial Officer

Good morning, and welcome to our third quarter 2017 earnings call. We are 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. 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 law, we undertake no obligation to update any forward-looking statements. We also 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 provides a reconciliation of each of these measures to their GAAP equivalent.

With that, we will 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 call today. For the third quarter, while total revenues grew 24.5% year-over-year, we reported a net loss of $3.4 million and adjusted EBITDA of $4.8 million. Tiptree's as exchanged book value per share ended at $9.67, down 2.6% from this point last year. The net loss for the quarter and 9 months and the decline in adjusted EBITDA over the prior year were primarily driven by negative unrealized mark-to-market of approximately $11 million and $21 million, respectively, on equity securities which are held in our insurance investment portfolio. These unrealized losses masked the overall positive performance of our underlying businesses. Normalized EBITDA at our operating businesses improved approximately 6% from a year-over-year perspective, excluding these unrealized losses.

As we have mentioned before, we are focused on continuing to build a company that can generate a high portion of stable and repeatable earnings from operations. We evaluate the performance of our insurance portfolio on a total return basis, focusing on investments that provide cash flow from interest in dividends and the potential for capital gains over a long-term horizon. As a result, we may experience volatility on these positions from quarter-to-quarter as we have seen this year.

Our investment portfolio has grown to $364 million, a 20.6% increase from this time a year ago. Over the next 12 months, we anticipate that portfolio will continue to grow as we expand written premiums and fee revenues from longer duration products.

With regard to our insurance business, we are continuing to see growth across our product offerings. For the third quarter, gross written premiums were $209 million, up 15%, driven by growth in our credit protection and warranty products. Year-to-date, warranty written premiums were $83 million, an increase of 88% as we are seeing the new programs take hold. Net written premiums for the quarter were $119 million, more than 2x the third quarter 2016 as we retained a greater portion of our credit insurance book through our captive reinsurer starting in late 2016.

In October, we completed a 40-year $125 million junior subordinated note at our insurance subsidiary. Proceeds from this transaction were used to repay an existing credit facility and solidify the A.M. Best rating. This offering was the second part of our strategic plan to improve our insurance financial strength rating, which in addition to the $100 million of capital we contributed in 2016, positions our insurance business for greater growth and expanded product offerings in the coming years.

Within the quarter, our asset management business completed its first risk retention compliant CLO with our insurance company purchasing a vertical tranche in its investment portfolio. As of October, total gross assets in our senior living sector were $430 million with approximately $130 million of invested capital.

For the quarter, NOI margins were down as recent acquisitions and recently upgraded properties are gradually ramping up towards stabilized occupancy levels. We believe this business has attractive long-term prospects. As we pointed out before, our target demographic is the fastest-growing segment of the U.S. population.

In the near term, the industry is facing challenges with new supply and competition. However, we believe supply and demand will ultimately rebalance and lead to attractive returns in this business.

As of October 1, 2017, we exited our position in Siena, an asset-based commercial lending platform, which is part of our plans to divest noncore investments. Lastly, for the year, we have returned $10.6 million to shareholders through dividends and share buybacks.

With that, I'll hand the call back to Sandra, who will discuss the financials in more detail.

Sandra E. Bell
Chief Financial Officer

Thanks, Michael. On Page 4, we highlight the company's performance relative to last year. For the 9 months ended September 30, 2017, we had a pretax loss of $10.1 million and adjusted EBITDA of $23.3 million. On the right-hand side of the page, we've provided a bridge for both metrics. As indicated in the bridge, pretax income from operations was down slightly at $1.4 million below 2016 and adjusted EBITDA from operations was up $3.7 million. The primary drivers of the improvement included growth in warranty products in our insurance segment, the impact of acquisitions in our senior living operations, improved operating metrics in specialty finance and reductions in corporate costs. We will go into these operating drivers in a bit more detail when we cover our segment operations later in the presentation.

As you can see in the bridge, our insurance portfolio investment income, excluding the unrealized losses, added $1.4 million, driven by increases in portfolio assets. Offsetting the positive contributions from operations were $2.7 million of stock-based compensation, granted based on the improvements in underlying performance in prior years and which are accounted for over the vesting period. Several nonrecurring items also impacted 9 months pretax income.

As we discussed in Q2, Reliance's strong performance over the last 12 months drove an increase of $3 million related to an earn-out granted to its selling shareholders at the time of acquisition, which is paid in Tiptree shares calculated based on our book value per share.

In 2016, we recorded realized gains on sales of certain equity positions, primarily related to our liquidation of noncore assets, which were also not repeated in 2017.

Lastly, as Michael has already mentioned, the single largest contributor to our comparable year-over-year performance was the negative unrealized mark-to-market on equities in 2017 versus unrealized gains in 2016, which combined for $27.6 million in the 9 months.

On the next page, we outlined our capital allocation snapshot for the quarter. Book value per share as exchanged declined 2.6% year-over-year. The decline was the result of the unrealized losses previously mentioned, the issuance of shares relating to the exercise of an option and the Reliance earn-out, along with dividends paid. Excluding these items, operations contributed $0.65 of EPS over the trailing 12 months along with a $0.07 benefit from repurchasing shares below book for a total improvement of $0.72.

Netted in our GAAP equity is accumulated depreciation on our real estate assets as well as purchase accounting amortization of Fortegra. These combined represent a reduction in value of $1.67 as of September 2017 as compared to $1.28 at this point in 2016. On the bottom left, you can see how our capital is currently allocated across our businesses with over half concentrated in the insurance sector. This is a new non-GAAP measure we are introducing this quarter and which we expect to provide on an ongoing basis. We believe that this measure will assist investors in understanding the capital allocation portion of our overall strategy. We also provide trailing 12-month normalized EBITDA, which is a non-GAAP metric that excludes realized and unrealized gains and losses, stock-based compensation and adjust for noncontrolling interest in order to provide a view of the underlying operational performance over time.

In total, normalized EBITDA was $60.8 million, up $3.6 million or a 6.3% improvement. Normalized EBITDA's written on total capital was 9.5% over the last year with strong performances from our insurance, asset management and specialty finance businesses.

Over the past year, we have invested additional capital in senior living properties and expect to see improvements in underlying performance as the more recently acquired properties achieve stabilized levels.

Lastly, our corporate expenses are declining as we have made substantial improvements in our reporting and controls infrastructure.

Moving to Page 7, we provide further details regarding our specialty insurance performance. This discussion is divided into 2 components; first, we will focus on insurance operations and then on the next page performance from the insurance investment portfolio. We continue to see positive top line growth from all of our product lines. For the 9 months, gross written premiums grew by 3.8% over the prior year, contributing to higher unearned premiums and deferred revenue, which were up a combined 12.7% from last year. The increase in these 2 balance sheet items show the impact of growth in the longer-term contracts and the opportunity to enhance net investment Income over time with additional portfolio assets. As we replace some of our shorter-duration products, we would expect to see these balance sheet items continue to grow and earn premiums recorded over extended periods of time.

The increase in net written premiums was driven primarily by the increased reinsure retained by our captive insurance subsidiary. Pretax income and adjusted EBITDA from insurance operations were down year-over-year. Adjusted underwriting margin, a key measure of insurance product performance was up $2.4 million and trended positively, driven by credit protection and warranty improvements. This was offset by $2 million in stock-based compensation, along with $4 million in other expenses, primarily related to premium tax increases as written premiums continued to grow.

The adjusted combined ratio for the quarter was 92.8%, up 3.4 percentage points from the prior year but lower than the 9 months, the latter of which was primarily impacted by the carryover stock compensation expense from 2016. This metric is within our parameters of expected underwriting performance from quarter-to-quarter. The increase from our historical combined ratio of approximately 90% is primarily driven by increased investment in the platform to grow our warranty and program products.

Looking forward,, we plan to continue to expand our warranty product offerings and programs business to drive written premium growth.

Turning to the insurance investment portfolio on Page 8. You can see the growth in net investments over the past year. This growth was driven by a combination of several factors, including the assumption of third-party credit protection, reinsurance contracts and organic growth in written premium.

Our investment portfolio earnings in the first 9 months of 2017 were down primarily due to the unrealized equity losses. Excluding those losses, net portfolio income for the 9 months was $13.3 million, up $2.4 million, driven by increases in dividend, interest income and improvement in realized gains from the sales of nonperforming mortgage loans.

As we move forward, volatility related to our mark-to-market investments will continue from quarter-to-quarter, but our objectives remain the same. To balance our portfolio between cash and liquid short-term investments to cover claims and select alternative investments with a focus on enhanced risk-adjusted total returns over the long term.

On Page 9, asset management pretax income year-to-date was $13.1 million, down $1.6 million over 2016. The earning assets under management declined to $1.6 billion as our older vintage CLOs continue to runoff. Our financial results for the 9 months were positively impacted by the fair value adjustments of $3.4 million on our investments in CLO sub notes versus losses of $2.8 million in 2016 and increased incentive fees on the older CLOs. Partially offsetting those increases were declines in distributions as a result of smaller sub note holdings and lower base management fees as our assets under management decline. The fair value gains similar to the first half were driven by the strengths in the loan market and the refinancing of one of our CLOs.

On Page 10, we continue to see growth in our senior living adjusted EBITDA, primarily driven by additional investments in new properties. Adjusted EBITDA for the first 9 months was $8.3 million, up $1.1 million from last year, driven by increases in net operating income of 26.5%.

During the first 9 months of 2017, we added 2 managed properties and 10 triple net leases. And over the latest 12 months, we have acquired $90 million in new properties.

On the bottom left-hand portion of the page, you see the decline in NOI margins year-over-year, primarily due to the impact of industry-wide competition for occupancy, which Michael mentioned earlier. More specifically, increased competition has slowed the recovery of our properties that underwent renovation in 2016. Pretax income for the first 9 months was flat versus the prior year as increases in NOI were offset by incremental depreciation and interest expense on newly acquired properties.

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

Michael Gene Barnes
Executive Chairman

Thanks, Sandra. To provide a quick wrap, our insurance business is focused on growing premiums while maintaining profitable underwriting standards. As our mix of business trends toward larger duration -- longer duration products, we expect our invested assets to grow accordingly and generate additional growth in investment income.

Our strategic objective is to leverage Tiptree's investment expertise to increase the total return of the insurance portfolio over the long term as the insurance business grows, while maintaining an attractive combined ratio. Our asset management business is stable. We are looking to further leverage our investment expertise to expand AUM as market conditions continue to improve, potentially into other asset classes. Our senior living pipeline remains strong. Our focus over the near term will be to drive occupancy rates to increase NOI and NOI margin. The sale of Siena continues our commitment to focus our capital on core assets and to divest noncore assets when we can achieve attractive return. We believe our efforts to better position the company for growth and enhance transparency into our investment and operating performance should allow investors to better understand Tiptree's intrinsic value.
With that, we can open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of John Sites with Wexford Capital.

John Clifton Sites
Wexford Capital LP

Two questions. First is, on the subordinated note that you sold to pay off your commercial lending or your bank loans, what rate did you sell that for the year?

Sandra E. Bell
Chief Financial Officer

8.5%, John.

John Clifton Sites
Wexford Capital LP

All right. Okay. And the vertical slice, just for people like me who are little rusty, describe exactly what that is? Is it do you keep part of the equity or is it all nonequity slices?

Sandra E. Bell
Chief Financial Officer

Its top to bottom, so it starts with the super senior and goes all the way down to the subordinated notes and the subordinated notes -- the top total stack is about 5%.

Michael Gene Barnes
Executive Chairman

And John, you can -- this is Michael. And thanks for the question, John. You can think of that as really a pro rata participation in the loan portfolio itself given that we're taking from a top-to-bottom participation.

Operator

Our next question comes from the line of Walter Schenker with MAZ Partners.

Walter Schenker

Given that this is a very sophisticated financially oriented management team and given the discount to the asset value, I would like your top management's view about why an aggressive stock buyback program at about 2/3 of asset value is not a top priority in enhancing shareholder value?

Michael Gene Barnes
Executive Chairman

Sandra, shall I start with that and then I'll let you add.

Sandra E. Bell
Chief Financial Officer

Yes.

Jonathan Ilany
Chief Executive Officer and Director

First thing, thank you for the question. And we always look to balance our objectives of growing, which we think will also help achieve liquidity and ultimately, achieve a more attractive stock for our shareholders. But we balance that also with the opportunity to buy back shares. Each time you buy back shares, you do release capital out of the balance sheet of the company. In the past 2 years, we have repurchased approximately 20% of the shares outstanding. And so we -- and we currently have the authority from our Board of Directors to look for opportunity to buy back shares as long as we can do so ahead of official prices. So we're always looking to buy back shares, but we balance that with the opportunity to reallocate that capital to new investments and the objective of also growing our platform. Sandra, do you want to add anything to that?

Sandra E. Bell
Chief Financial Officer

No Michael, I think that's appropriate.

Walter Schenker

All right. To respond, there is very little you're investing in, which in theory has a higher return than the share buyback. I know you've brought back stock in the past, although it's largely been oriented to takeout in liquid and larger investors. So it just seems to be an inconsistency and the fact that you understand buyback and the fact that it's relatively inactive on a day-to-day basis, this is more a ramp than anything else. And I appreciate your response.

Operator

[Operator Instructions] There are no further questions at this time. I would like to turn the call back over to Ms. Bell for any closing remarks.

Sandra E. Bell
Chief Financial Officer

Thank you, Michelle. And thank you everyone for joining our call today. Certainly if anyone has any questions, please feel free to reach out to me directly. This concludes our third quarter call.

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