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FQ3 2018 Earnings Call Transcripts

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Call Participants

EXECUTIVES

Michael Gene Barnes
Executive Chairman of the Board

Sandra E. Bell
Chief Financial Officer

ANALYSTS

Walter Schenker

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Operator

Greetings, and welcome to the Tiptree Inc. Third Quarter 2018 Earnings 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. Please go ahead.

Sandra E. Bell
Chief Financial Officer

Good morning, and welcome to our third quarter 2018 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.

In addition, we use non-GAAP measures, which we believe provide supplemental information about our businesses 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.

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. Good morning, everyone. Thank you for joining us today. As we enter the final quarter of 2018, we continue to make progress on our objectives to grow our insurance business while maintaining consistent underwriting profitability, to grow our insurance portfolio in line with increases in net written premiums and to realign our investments within Tiptree Capital consistent with our total return investment philosophy.

Over the last 12 months, the combination of growth in book value per share plus dividends paid have generated a 12.7% total return to shareholders. In our specialty insurance business, we continue to see strong top line growth with a stable combined ratio in the low 90s. Gross written premiums year-to-date are up 10.5%, and net written premiums are up 11.3% over the prior year.

The insurance investment portfolio has grown 20.4%, ending the quarter at $438 million. Our actions to expand products and partner relationships are also benefited from the macro environment, including a robust U.S. economy and healthy consumer demand. We continue to look for attractive acquisition opportunities with a focus on insurance and warranty businesses that can expand our current product offering and technology.

As we stated last quarter, we will stay disciplined in any acquisition we pursue, seeking platforms at the right price where we can continue to underwrite profitably while building the investment portfolio and improving overall returns.

Over the last 2 years, we have sold select investments in Tiptree Capital and reinvested those proceeds in alternative assets and businesses, which we believe are in a more favorable point in their cycle. The exited assets were primarily credited focused and benefited from strong fundamentals over the past few years. Since the end of the second quarter, we have invested a portion of the sales proceed in dry bulk shipping, which we believe has an attractive long-term outlook. And as we mentioned in previous quarters, we sold our senior living business to Invesque in February. While Invesque's share price has generated unrealized mark-to-market losses in 2018, we believe the underlying business and long-term prospects remain strong. While we would expect the asset classes and businesses in Tiptree Capital to continue to evolve over time, the capital allocated between our insurance business and Tiptree Capital is expected to remain relatively consistent.

As we announced in March, we are executing on a share buyback plan of up to $20 million. At the end of the third quarter, we have repurchased 2.1 million shares at an average price of $6.51. Dividends paid year-to-date are $0.10 per share. Both actions reflect confidence in our businesses and will continue to be levers for creating long-term shareholder value. We believe the actions that we are taking to drive growth in our underlying operations improve our earnings profile, and streamlining of our story will provide attractive, long-term returns for new and existing investors.

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

Sandra E. Bell
Chief Financial Officer

Thank you, Michael. On Page 4, we highlight the company's key metrics for the third quarter and year-to-date 2018. Net losses for the third quarter were $0.5 million, an improvement of $2.9 million from the prior year period. The increase was primarily driven by improvements in specialty insurance underwriting and its fee-related income. Net income for the year-to-date period was $29.4 million, up significantly from 2017, primarily driven by our gain on the sale of Care, in addition to the positive factors impacting the quarter.

Within the year-to-date financials, we have taken $16.6 million of unrealized losses primarily from mark-to-market on our Invesque shares. Operating EBITDA for the quarter was $14.4 million, down slightly, while operating EBITDA for the year-to-date period was $38.4 million, down 9% from the year earlier period. Both periods were positively impacted by growth in both underwriting and investment income in our insurance operations, along with lower corporate costs. Year-to-date, that positive performance was more than offset by lower distributions from credit-related investments and reduced performance from mortgage operations in Tiptree Capital.

On the bottom of the page, we show a walk from operating EBITDA to pretax income, highlighting the key drivers of the differences between the 2 metrics. Book value per share increased to $10.77, up $1.10 from the prior year as the gain on sale of Care, improvements in insurance results and share buybacks overcame any negative factors.

Turning to Page 5. We highlight our allocated capital and respective returns to assist investors in valuing Tiptree. We have detailed our capital between specialty insurance and Tiptree Capital. When we consider capital allocation decisions, we look at total capital, which includes corporate debt. We evaluate our return on capital using trailing 12-month operating EBITDA, which, for the most recent period, was $57.1 million. Our total return of approximately 8.7% is relatively stable as compared to the prior year. These returns were slightly lower than we would expect as just over $45 million of excess liquidity has not yet been invested.

Now let's turn to our specialty insurance results. On Page 7, we highlight our insurance underwriting performance and then, on the following page, returns from the insurance investment portfolio. We continue to see positive top line growth across our product lines. Year-to-date, insurance revenues were up $61 million or 17%, driven by both higher net earned premiums and higher servicing fee income as well as improvements in investment income. We are beginning to see the benefits from growth in net written premiums in the current period results. For the 9 months of 2018, net written premiums grew $34.2 million year-over-year, up just over 11%. Retention of written premiums was stable at 54%. As we continue to expand product offerings, we expect that retention rate may expand slightly over time.

Of our net written premiums, 24% was warranty and other specialty programs, consistent with the prior year. Year-to-date, underwriting margin grew $9.9 million, driven by strong performance in our credit protection lines. The 19% year-over-year growth in unearned premium reserves and deferred revenue on our balance sheet is consistent with past quarters, underlying our future revenue potential. Our combined ratio for the quarter was 93.1%, a modest improvement from this time last year as we continue to underwrite our growth on a profitable basis.

Turning to the insurance investment portfolio. Our net investments grew by almost $74 million, up 20.4%. Net investment income was $13.7 million, up 14%, driven by growth in the portfolio and rising interest income on our floating rate assets. Approximately 25% of our $438 million portfolio is floating rate, with additional upside potential as rates rise. Net portfolio income was $7 million for the year-to-date period, up approximately $13.7 million, driven by the lower unrealized losses and a reduction in interest expense.

On Page 10, we present the results of Tiptree Capital. Asset management and credit investment operating EBITDA year-to-date was $2.9 million, down $6.7 million over 2017, driven by the reduced earnings on credit investments mentioned earlier. Mortgage operations were impacted by lower volumes and margins as mortgage interest rates have risen substantially over the past 12 months, providing near-term headwinds for this business. As of September 30, 2018, our investment in Invesque held in Tiptree Capital represents $102 million. The remaining $22 million is held in our insurance portfolio.

For the year-to-date period, the primary driver of operating EBITDA from other investments is dividend income of $6.7 million on the Invesque shares. The key driver of the difference in operating EBITDA and pretax income related to other investments is unrealized losses on the shares, net of the accretion of the new liquidity discount relating to our existing transfer restriction. As a reminder, all of our transfer restrictions end by August of 2019.

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

Michael Gene Barnes
Executive Chairman of the Board

Thanks, Sandra. To provide a quick summary, year-to-date, we have executed on several strategic objectives to expand our insurance business and simplify our corporate structure. We expect to continue to grow our insurance investment portfolio in line with the business and to leverage Tiptree's investment expertise to increase the total return of the insurance portfolio over the long term. Within Tiptree Capital, we expect our investments to change over time as we sell assets and businesses which we believe have generated attractive returns and invest in other opportunities, which we believe have favorable fundamentals and the potential to meet our long-term return targets.
With that, we can open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Walter Schenker with MAZ Capital.

Walter Schenker

A couple of questions actually but won't be a lot. What form did the investment in dry bulk shipping take? Is it direct investment in ships, loans, investment in companies in the dry bulk shipping business?

Michael Gene Barnes
Executive Chairman of the Board

Walter, this is Michael Barnes. Thanks for the question. The initial investments that we've made in the shipping sector -- in the dry bulk shipping sector are in actual ships. The ships have not been financed, so these are equity investments in ships. As of September 30, we've made investments in 2 ships, but we anticipate making investments in others going forward.

Walter Schenker

And these are being operated by?

Michael Gene Barnes
Executive Chairman of the Board

We have a partnership or we outsource the management, both commercial and technical management, and as well as having as a coinvestor in these ships, a partnership and contract with A.M. Nomikos. And Nomikos is a -- I think they have about 40-some ships that they perform the commercial and technical operations for.

Walter Schenker

And will the investment in this area be consistent with your statement about the allocation of capital between the insurance business and Tiptree Capital? And therefore only to the extent you get substantial additional liquidity in Tiptree Capital, would this investment be substantially expanded? And you can always sell the mortgage portion.

Michael Gene Barnes
Executive Chairman of the Board

Yes. We look at our capital really in total. Then I'll say that with the capital that we have in Tiptree Capital, which we view as very long-term investment capital, not needed for claims paying in the same way that the insurance float is, I'd say we are very careful in terms of building out the investment portfolio on the insurance side to make sure that we have proper liquidity and that we have an appropriate higher -- high-quality, I'll say, primarily credit-related portfolio. It doesn't preclude us from potentially investing some of the capital from the insurance company into the shipping sector. But I would say that as a hard asset and obviously a less liquid asset, we want to be very careful with the liquidity needs on the insurance side. So I would say that it would not be a priority for us to invest the insurance company assets of the paid and premium float in 2 ships.

Walter Schenker

Okay. Just one other area of questioning. Obviously, the stock has sold at a substantial discount to book value for -- I want to say forever -- for some time. You have been active in buying back stock. You are very sophisticated financially. That will remain a primary, secondary, tertiary, depending on what other opportunities you have priority in capital allocation.

Michael Gene Barnes
Executive Chairman of the Board

It's a -- the answer is it's all of the above. Meaning, we very much are aware and in knowledge that the stock is trading at a substantial discount; not only the GAAP book value but to what we view as intrinsic value, which we see is actually, in my own view, higher than GAAP book value for various reasons. But we do try to balance our objectives of growing, which we think actually will ultimately make the company more attractive for investors and potentially bring in greater liquidity. But we try to balance the objective of growing, of looking at where we have investment opportunities, where we'd like to earmark capital or use our capital. We balance that with where we can buy back shares in the open market. So we did create a program to buy back shares in March of this year. We bought back about 2.1 million, roughly around 5% of the company, this year. Since 2016, we bought back about 23% of the shares outstanding. So we've tried to both be as aggressive as we're able to be in buying back shares while balancing our objectives of new investments, new opportunities and trying to grow the business as well.

Operator

[Operator Instructions] Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to management for closing remarks.

Sandra E. Bell
Chief Financial Officer

Thank you, Hector, and thanks, everyone, for joining us today. Obviously, if you have any questions, please feel free to reach out to me directly. This concludes our third quarter conference call.

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