

Tiptree Inc.

Second Quarter 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

Michael Barnes, *Executive Chairman*

Jonathan Ilany, *Chief Executive Officer*

Sandra Bell, *Chief Financial Officer*

Scott McKinney, *Deputy Chief Financial Officer*

PRESENTATION

Operator

Good day, and welcome to Tiptree Inc. Second Quarter 2022 Earnings Conference Call. Please note this event is being recorded. I would now like to turn the conference over to Mr. Scott McKinney, Deputy CFO. Please go ahead, sir.

Scott McKinney

Good morning, and welcome to our second 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 today, 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 Barnes

Thank you, Scott, and good morning to everyone.

Tiptree is off to a solid first half of 2022 with each of our operating businesses producing positive results. Fortegra had another excellent quarter of premium growth and underwriting results. Our Marine business had its best quarter yet from strong charter rates and the gain on sale of one dry bulk vessel, and our mortgage business was profitable despite the headwinds from rising interest rates.

Revenues for the first six months increased 12% versus last year to \$665 million, and adjusted net income improved 12% to \$29 million. In June, we closed on the \$200 million investment in Fortegra by Warburg Pincus. As I have stated before, we are extremely bullish on Fortegra's growth prospects and believe the partnership among Tiptree, Fortegra and Warburg Pincus will lead to fruitful results for years to come.

Fortegra posted premiums and equivalents of \$1.2 billion, up 16% from the prior year, led by strength in the specialty admitted and E&S insurance lines. Fortegra's adjusted net income was \$40 million, up 49% from 2021, which represented an adjusted return on equity of 26%. Specialty markets remained favorable, and we continue to see improvement in the combined ratio from operating efficiencies.

We remain focused on growing both the specialty insurance and warranty 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 acquisitions. Our most recent acquisition, ITC Compliance, further establishes Fortegra's footprint in the U.K. auto warranty sector.

During the first half of this year, several market factors impacted our book value. Interest rates rose dramatically, risk assets dropped significantly, and in the last quarter, the U.S. dollar also significantly appreciated against major foreign currencies. As a result, Fortegra's fixed income portfolio, like many insurance companies, incurred a pretax unrealized mark-to-market loss of \$45 million through the first half, in addition to other unrealized losses on Invesque and other securities.

Our investment approach is geared towards the long term. Thus, Fortegra's fixed income portfolio remains conservatively positioned with AA plus rating and relatively short duration. Additionally, we expect to recover most of the unrealized marks over the coming years as the bonds mature.

As I said on our last earnings call, over the long term, higher interest rates will benefit Fortegra. As of the end of the quarter, the investment portfolio stood at just over \$1 billion. We expect the rising interest rate environment will be a net positive as Fortegra's growing portfolio can be invested at higher yields.

In our Marine business, we had an active first half with both dry bulk and tanker investments, producing solid returns. Given the elevated valuations for dry bulk vessels, we decided to exit our dry bulk positions, which will ultimately lead to gains of approximately \$21 million or 45% above our carrying costs. One of our three dry bulk vessels closed in the second quarter, with the remaining two dry bulk vessels under contract expected to close in the third quarter of this year.

As we look forward, we believe there will be additional sale and purchase opportunities within the shipping sector. Invesque, our largest publicly traded equity position, continues to execute its strategic initiatives to streamline its portfolio of senior care real estate. Over the past 12 months, the company has sold just under \$300 million of non-core assets with most of the proceeds used to reduce its overall debt profile.

Finally, our mortgage business produced positive returns in the first half, driven by mortgage servicing fees and value appreciation on our MSR asset. While volumes and margins have compressed in the beginning of 2022, over the past two years, the business has grown retained earnings substantially, and we now hold an MSR asset worth \$41 million on our balance sheet.

In summary, we believe Tiptree is well positioned for the future. Our capital position is strong. We are now debt-free as a holding company after paying off \$113 million in June, and we continue to selectively buy back shares as opportunities present themselves.

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

Sandra Bell

Thank you, Michael.

On Page 3 of the presentation, we highlight Tiptree's key financial metrics compared to the prior year period. In the second quarter, our results were impacted in several ways by the closing of the investment in Fortegra by Warburg Pincus. In total, the transaction resulted in a \$63 million pretax gain to Tiptree's equity. This book gain was offset by \$39.6 million of tax expense related to the tax deconsolidation of Fortegra, split between the income statement and equity.

GAAP accounting does not require an entity to record a deferred tax liability for differences in book and tax basis related to a subsidiary, which is consolidated with its parent protect. Once the subsidiary is no longer consolidated for tax, the deferred tax liability is recorded in the parent's books. For that reason, we recorded \$25.5 million of deferred tax in the income statement related to the cumulative impact of our growth in book value since we acquired Fortegra. The remaining

amounts offset the pretax gain from the transaction and were recorded directly as equity. This deferred tax liability is only due if and when we decide to sell any of our Fortegra shares. Future primary issuances by Fortegra would not trigger any tax liability.

For the quarter, we incurred a net loss of \$22 million, driven primarily by the previously mentioned tax expense, along with unrealized losses on investments as compared to gains in the prior year period, partially offset by growth in insurance and shipping. Excluding investment gains and losses, revenues were up 16% for the quarter, driven by growth in insurance operations and increases in vessel charter rates. Adjusted net income for the quarter was \$14 million, representing a 12.3% annualized adjusted return on average equity.

Book value per share of \$10.75 increased by 2.7% compared to the prior quarter, primarily as a result of the gain on investment in Fortegra, which was partially offset by unrealized losses on our fixed income securities driven by the higher interest rate environment and the strengthening U.S. dollar. Our business's strong operating cash flows provide us with the ability to hold these securities to maturity.

Turning to Page 5. We highlight Fortegra's results for the quarter, where we continue to see strong momentum. In the second quarter, premiums and equivalents of \$595 million increased by 8% year-over-year, driven by growth in specialty commercial and warranty lines. Deferred revenues and unearned premiums, which represent future earnings potential, stood at \$1.8 billion, up 26% year-over-year. The combined ratio improved by 120 basis points year-over-year to 90.9%. Operating efficiencies contributed to an improved expense ratio despite continued investment in people and technologies to fund our growth, while the underwriting ratio increased modestly due to changes in the business mix.

Fortegra's 13.7% expense ratio for the quarter continues to benefit from economies of scale with underwriting and fee revenues growing faster than operating expenses. Adjusted return on equity was approximately 26% on an annualized basis. Going forward, Fortegra's scalable, efficient platform remains positioned for growth and consistent returns on equity.

On Page 6, you can see the insurance company financial trends over time. Gross written premiums and equivalents have increased 28% over this period with a 22% organic growth rate. Specialty Commercial lines have grown 46% per annum through the addition of new agents and programs and the expansion of E&S offerings. Personal lines have grown at a steadier 5% and benefited from increased consumer spending in 2021 and early 2022.

Lastly, warranty lines have tripled through increased market penetration and geographic expansion. The combined ratio is not only stable, but has shown consistent improvement over time, moving from 93.3% in 2019 to 90.7% in 2022. Adjusted net income increased to \$40 million for the first half, representing a 42% growth rate over the past three years. Adjusted return on equity has improved from 11% to 26% over the respective periods. Of note, this puts Fortegra at just above

\$80 million of trailing 12-month adjusted net income, a new milestone and one we expect to continue to improve upon in future periods.

Turning to the insurance investment portfolio on Page 7. Total investments and cash and cash equivalents ended the quarter at just above \$1 billion, up 24% year-over-year, in line with the underlying premium growth. Ninety-two percent of the portfolio is invested in high credit quality and liquid securities with an average rating of AA plus. The fixed income portfolio has a relatively short duration of 2.6 years.

As we mentioned earlier, while unrealized marks have impacted book value, we generally have the ability to hold these securities to maturity. We view reinvestment as an opportunity for improvement in investment income with rising rates a positive for Fortegra's investment portfolio in the long run. Fortegra's capital and liquidity remained strong, with \$325 million of stockholders' equity, strong cash flow from operations and a debt capacity of nearly \$200 million, all of which put the business in a solid position 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 Invesque shares. Pretax income for the quarter was \$9.1 million compared to \$8.4 million in the prior year, driven by the performance of our shipping investments. Our shipping investments contributed \$13.8 million of pretax income as both dry bulk and tanker charter rates remain at robust levels.

As Michael mentioned, we expect to recognize a gain of \$21 million on the sale of our three dry bulk vessels, only \$7 million of which impacted the second quarter, with the remaining \$14 million expected in the third quarter. Given elevated charter rates and strong demand for shipping assets, we believe the fair value of our remaining two vessels is in excess of our second quarter net book value of \$34.5 million.

In the past two years, our mortgage business benefited from several tailwinds, including higher refinance volumes, supported by both low rates and rising home prices as well as the growing servicing book. These tailwinds drove significant returns on our investment in this business, which as of June 30, 2022, had grown to \$58 million.

Rising mortgage rates and declining affordability has impacted originations across the industry. As a result, we have seen our mortgage origination volumes decline 17% from the prior year and margins compress to pre-COVID levels. While we believe our mortgage servicing portfolio will offset some of the impact on originations as rates rise, we expect to continue to face headwinds in volumes and margins for at least the remainder of this year.

Turning to Page 11. We highlight Tiptree's sum 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 \$744 million or \$19.85 per diluted Tiptree share. As you

can see, including our remaining assets, we believe Tiptree sum of the parts value to be \$26.12 per diluted share.

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

Michael Barnes

Thanks, Sandra.

We were pleased with the performance of our subsidiaries' operations through the first half of the year. Fortegra continues to post record premiums, adjusted net income and return on equity. Market conditions remain favorable and the pipeline for new business is as strong as it has ever been. As we look forward, we see significant opportunities to create value with our investment in Fortegra. Within the shipping sector, charter rates remain at above average levels, which through the sale of our dry bulk vessels and continued ownership of our tankers provides us the opportunity to drive near-term returns, and we remain focused on deploying capital with the objective of long-term shareholder value appreciation.

Sandra Bell

Thank you, everyone, for joining us for our second quarter 2022 conference call. As always, we are available to take your calls and questions. Please feel free to reach out to me or Scott at any time. Thank you again.