Doma Fourth Quarter 2022 Earnings Transcript

C O R P O R A T E P A R T I C I P A N T S

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C O N F E R E N C E C A L L P A R T I C I P A N T S

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P R E S E N T A T I O N

Operator
Good day and thank you for standing by. Welcome to the Doma Fourth Quarter and Full Year 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Matt Thunander, Investor Relations for Doma. Please go ahead.

Matt Thunander, Head of Investor Relations, Doma
Thank you, operator. Good afternoon, everyone, and thank you for joining Doma's fourth quarter and full year 2022 earnings conference call.

Earlier today, Doma issued a press release announcing its fourth quarter and year-end results, which is also available at investor.doma.com. Leading today's discussion will be Doma's Founder and Chief Executive Officer, Max Simkoff; and Chief Financial Officer, Mike Smith. Following management's prepared remarks, we will open up the call to questions.

Before we begin, I would like to remind you that our discussion will contain predictions, expectations, forward-looking statements and other information about our business that is based on management's current expectations as of the date of the presentation. Forward-looking statements include, that are not limited to Doma's expectations or predictions of financial and business performance, market conditions, competitive position and industry outlook. Forward-looking statements are subject to risks, uncertainties and other factors that could cause our actual results to differ materially from historical results and/or from our forecast, including those set forth in Doma's most recently filed annual report on Form 10-K and subsequent filings with the SEC. For more information, please refer to the risks, uncertainties and other factors discussed in Doma's most recently filed annual report on Form 10-K and other SEC filings.

All cautionary statements that we make during this call are applicable to any forward-looking statements we make wherever they appear. You should carefully consider the risks and uncertainties and other factors discussed in Doma's SEC filings. Do not place undue reliance on forward-looking statements as Doma is under no obligation and expressly disclaims any responsibility for updating, altering or otherwise revising any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Additionally, during this conference call, we will also refer to non-GAAP financial measures, including retained premiums and fees, adjusted gross profit, adjusted EBITDA and the other measures described in our earnings release. Our GAAP results and description of our non-GAAP financial measures with a full reconciliation to GAAP can be found in the fourth quarter 2022 earnings release, which has been furnished to the SEC and is available on our investor website.

And with that, I'll turn the call over to Max Simkoff, CEO of Doma.

Max Simkoff, Chief Executive Officer, Doma
Thank you, Matt. Good afternoon, everyone, and thank you for joining us today.

As we exit a volatile and challenging year for the U.S. housing market, I'm proud of the way our team adapted and managed our business through these unprecedented conditions. Against the backdrop of a continually dynamic mortgage landscape, we delivered year-end results within our revised annual adjusted EBITDA range that was provided on our Q3 call in November.

Our financial performance in the fourth quarter of 2022 reflects the positive impact of the significant cost-saving measures we implemented throughout the year to align Doma with the increasingly challenging housing market conditions, which we expect will continue for the foreseeable future. We took swift action last year to protect both our bottom line and the execution of our industry transforming vision and we are now seeing the benefits of those decisions. We are entering 2023 with a much leaner team, a tighter focus on how we can deliver our transformative technology to an antiquated industry and confidence that we will reach adjusted EBITDA profitability this year.

Today, we will cover 2 main themes. Number one, achieving adjusted EBITDA profitability remains our top priority, and our Q4 results demonstrate that we are on track to reach a level of sustainable profitability in 2023. And number two, against the backdrop of an unparalleled decline in housing affordability, affecting nearly every American homeowner, we are carefully finalizing better ways to more efficiently and more profitably deploy our proven and patented underwriting technology to ensure we still realize our bold vision of delivering faster and much more affordable solutions to modernize the approximately $26 billion title insurance market. I'll now provide some additional detail on these 2 themes. And after that, I'll turn the call over to our CFO, Mike Smith, who will elaborate on our fourth quarter results.

With respect to our primary focus on achieving adjusted EBITDA profitability, we made critical progress in Q4 towards our goal of financial self-sustainability. Our Q4 adjusted EBITDA improved $14 million dollars versus Q3 as we delivered full year 2022 adjusted EBITDA of negative $135 million dollars, within our revised range of negative $135 million dollars to $140 million dollars. For the full year, retained premiums and fees were $179 million dollars and our adjusted gross profit was $47 million dollars. Our Q4 adjusted EBITDA improvement was a direct result of a series of cost-saving actions that we executed throughout 2022, as well as our team's strong focus on delivering operational efficiencies. We expect this trend of improving margins to continue as our adjusted EBITDA loss narrowed significantly in the first half of 2023.

I'll now provide more detail on the expense savings, which not only helped us to achieve our full year 2022 revised guidance but will also help us on our path to adjusted EBITDA profitability in 2023. With respect to the macro backdrop, we took a position early last year the industry forecasts were missing the severity of the current downturn in the market. While this stance allowed us to take more definitive expense actions earlier in the mortgage market downturn to right-size the organization, we determined late last year that in order to remain nimble, we needed to factor in an even more conservative internal forecast that would reflect the realities of 30-year fixed mortgage rate that effectively doubled from January to October. This led to further cost cutting in early December and the difficult decision to conduct an additional 40% headcount reduction, primarily impacting individuals supporting information technology, local operations and certain corporate functions.

While the actions we took in the first 9 months of 2022 delivered important cost structure and margin improvements in the back half of the year, the additional actions we took in December of 2022 are expected to generate estimated additional annualized compensation expense savings of between $85 to $90 million dollars and additional long-term facility-related expense savings all beginning in the first quarter of 2023. Additionally, and as discussed on our Q3 earnings call, we decided to pause further expansion of the Doma Intelligence platform for purchase transactions to additional local branches as part of our strategy to become profitable. We have moved aggressively to close unprofitable branches and refocus our efforts in the highest performing locations, leading to the closure of 13% of our total branch footprint during the fourth quarter.

Looking ahead to the first half of 2023, while many in our industry have started to point a potential signs of a recovery, we remain cautious and anticipate that a tepid housing market will continue to put pressure on our ability to generate retained premiums and fees. Even with expected challenges for the housing market factored into our plans this year, we remain confident in our path to profitability in 2023. We expect to recognize significant continued expense reduction as we realize the full benefit of actions implemented last year and as we continue to emphasize profitable execution in our local division and profitable deployment of our underwriting technology. Perhaps more significant than the downward pressure that negative housing market volatility put on Doma's retained premiums and fees in 2022 was the extremely challenging set of circumstances that the current market introduced for U.S. homeowners.

According to Stephens' research, 2022 saw the fastest rise in mortgage rates in U.S. history with a low of 3% in January to north of 7% in the late stage of the year. They note that the sharp rise in rates was coupled with the lingering effect of a decade worth of compounding home price growth, which materially impacted home affordability as the average monthly mortgage payment rose approximately 58% from trough to peak to the highest level on record. As skyrocketing home prices and higher interest rates made homes increasingly unaffordable, first-time homebuyers were repeatedly shut out of the market with the share of first-time homebuyers in 2022 dropping to 26%, down from 34% last year and officially the lowest level ever recorded.

To make matters worse, the home buying process became increasingly less diverse as the share of Caucasian and Latino homebuyers increased this year, while the share of African-American and Asian homebuyers decreased to their lowest level on record. Nearly everyone in the broader mortgage ecosystem from lenders to realtors to the GSEs and the Federal Housing Finance Agency agree that the focus of innovation in housing should combine faster and more efficient solutions for homeowners with cost structures that improve housing affordability for consumers. This brings me to our second key theme of today's call.

We are in the process of finalizing improved strategies for more efficiently deploying our proven underwriting technology to ensure we achieve our vision of transforming the $26 billion dollar title insurance market with better, faster and more affordable solutions. Our instant machine learning-based underwriting is our original core value driver and the most powerful asset we have. It has delivered immense value to many of the largest, most well-known mortgage originators in the country and its unique functionality is protected by several patents.

We are in the final stages of identifying more efficient and profitable ways to make this technology more widely available with an emphasis on successfully deploying our technology through new distribution channels. We are engaging in exciting new partnership discussions with mortgage originators and the broader lending ecosystems in addition to real estate agents, a route we believe will enable us to drive the most innovation while meeting our most important goal of saving homeowners' money.

As our initial move in this direction, in late 2022, we launched our proven instant underwriting solution with our independent title agent partners who utilize Doma underwriting for title insurance, an initiative we will continue to invest in going forward. Our independent agents have worked with us for a long time and have been waiting patiently to enjoy the benefits of our machine learning-based solution. As we have already demonstrated, this technology is more efficient and cost-effective and will provide direct benefits to these independent agents and the lenders and borrowers they serve.

I want to reiterate that our main focus this year is achieving adjusted EBITDA profitability, while driving even larger adoption of our instant underwriting technology in a way that will help materially alleviate the housing affordability challenge for most U.S. homeowners. We are focused on remaining nimble and aggressive in achieving our goals. We are well positioned to drive value in 2023 and beyond as the only company in our industry with a unique combination of instant underwriting technology and a nationally scaled underwriting platform, enabling us to provide homeowners with better, faster and more cost-effective solutions to offset the unprecedented affordability challenges they are facing.

I will now pass the call over to our CFO, Mike Smith, to provide you with further details on our recent financial performance and an update on our outlook. Mike?

Mike Smith, Chief Financial Officer, Doma
Thank you, Max, and good afternoon, everyone. As Max mentioned, we are pleased to have ended the year within our revised full year adjusted EBITDA range. I'll start by providing a brief overview of Doma's fourth quarter results and then we'll be happy to take your questions. Please refer to our earnings release filed earlier today for full details of the quarter. Unless otherwise specified, all of the comparisons cited in my remarks are quarter-over-quarter or sequential comparisons to the third quarter.

I'll begin with the significant expense reduction initiatives we implemented in the second half of 2022. These actions were beneficial to our fourth quarter results, but their primary benefit will be to our adjusted gross profit and our adjusted EBITDA in Q1 and Q2 of 2023. Additionally, all of the expense reductions we implemented in 2022 will continue to assist us on our path to adjusted EBITDA profitability in 2023.

Our primary measure of unit economics is adjusted gross profit, which was $14 million in the fourth quarter of 2022, up 20%. Adjusted gross profit as a percentage of RPF increased to 40% in 4Q 2022 compared to 27% last quarter. For the full year, adjusted gross profit was $47 million compared to $114 million in 2021. Adjusted gross profit as a percentage of RPF was 26% in 2022 compared to 44% in 2021.

Adjusted EBITDA, our main profitability measure improved $14 million in the fourth quarter to negative $16 million compared to negative $30 million in Q3. Our quarter-over-quarter improvement in adjusted gross profit and adjusted EBITDA were driven by the expense actions we took to right-size our cost structure in addition to one-time employee benefit-related reductions and favorable reserve development.

In addition, we recorded charges in the fourth quarter that do not directly impact adjusted EBITDA, but were necessary in the current operating environment. These charges included $23 million of software impairments, $7 million of lease impairments and $5 million of contract acceleration costs associated with our workforce reductions and vendor management initiatives. Looking forward, we will continue to prioritize our investments in areas that we believe will drive the most long-term value for all of our stakeholders and prioritize our investments with a focus on profitability and cash generation over growth as we navigate the current environment. Let me emphasize, cash preservation remains one of our top priorities.

In terms of our top line performance in the fourth quarter, we reported revenue on a GAAP basis of $96 million, down 11% quarter-over-quarter. As a reminder, GAAP revenue includes the portion of third-party agent premiums that Doma does not retain. So, we focused on Doma's retained premiums and fees or RPF, as an important metric, which excludes the premium retained by third-party agents. We believe this is a much better representation of Doma's underlying top line performance.

With this in mind, RPF was $35 million in the fourth quarter, down 17% quarter-over-quarter, driven by a 36% decline in the refinance closed orders and a 26% decline in purchase closed orders, both directionally expected as the 30-year fixed rate averaged 6.7% in Q4. In the fourth quarter, purchase closed orders made up 46% of our direct residential volume and 78% of our direct residential retained premiums and fees. For the full year, RPF was $179 million compared to $260 million in 2021.

As we've mentioned before, mortgage rates have significantly impacted refinance volumes for both Doma and other industry participants. The latest MBA mortgage finance forecast is projecting that the 30-year fixed mortgage rate will remain above 6% in the first quarter of 2023, improving to 5% towards the end of the year. We anticipate that these still elevated rates will continue to put pressure on refinance and purchase order volumes for the foreseeable future.

One other item of note. During the fourth quarter, we recognized a goodwill impairment charge on our distribution segment of $32 million. The triggering events for this non-cash accounting charge included the sustained decline in Doma's stock price, coupled with the current housing and macroeconomic landscape and our initiative to focus resources on our instant underwriting capabilities. We do not believe that this goodwill impairment charge will impact future profitability or cash generation potential, but rather as a reflection of the current economic conditions, our depressed stock price and our strategic focus.

While we are on track to achieve adjusted EBITDA profitability in 2023, given the volatility in the market in the near term and factors Max and I just discussed, we are not providing 2023 financial guidance on this call. We are closely monitoring evolving market conditions and we are committed to managing the business prudently, while also aggressively marching towards the goals Max outlined today.

I'll now pass the call back to Max for closing remarks before we open the call to questions.

Max Simkoff, Chief Executive Officer, Doma
Thanks, Mike. 2022 was incredibly challenging, and I'm proud of how we successfully navigated a period of transition amongst the worst housing market in years. I want to acknowledge and thank the team for their hard work and continued commitment to our bold vision. We remain optimistic about the long-term opportunities for Doma and are focused on driving shareholder value, while delivering on our vision of making the experience buying, selling or owning a home better, faster and more affordable. We look forward to updating everyone with our priorities and progress on our next earnings call.

Operator, we’re ready for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. At this time, we will conduct the question-and-answer session. (Operator Instructions) Our first question comes from the line of Matt Carletti of JMP. Your line is now open.

Matthew John Carletti JMP Securities LLC, Research Division - MD & Equity Research Analyst
Thanks, good afternoon. Max, I was hoping I could get you to peel back the onion a little bit on order activity kind of as the quarter progressed. And particularly, I'm thinking about that several weeks or so period where rates kind of backed up from, they hit 7% and came back down towards 6%. Did you see any material change in order activity when that happened? I'm just trying to get a feel for kind of the elasticity and what might be on the sidelines?

Max Simkoff, Chief Executive Officer, Doma
Yes, sure, hey, Matt, and great to hear your voice. Look, I think it generally follows suit that when you see the 30-year fixed rate moving as significantly as it does in any one direction, you're going to see a response in terms of open orders. Without commenting specifically on what it was within the quarter, I think it generally follows that again, if you're going to see a movement of 50 to 100 basis points and increase in the 30-year fixed rate, regardless of what time of year it's going to be, you're going to see an impact to open orders. That said, Q4 traditionally is also you're going to have some seasonality in there. So, even if I did look at the intra-quarter movement, it'd probably be hard to tease out what was seasonal versus what was rate affecting, but that's generally a case.

And I guess what I'd reiterate here in terms of how we manage our business is, we've started this year similarly to the way when we started last year, where we formed our own more conservative take on where we think the market is likely to be for some time. I think that approach like last year is probably more conservative than kind of the typical industry benchmarks. And we think it's going to be more appropriate to manage the business according to that more conservative outlook until we see that things have steadied a bit more in terms of the rate volatility front.

Matthew John Carletti JMP Securities LLC, Research Division - MD & Equity Research Analyst
That makes sense. And then a couple of numbers questions real quick. Customer acquisition costs fell nicely in the quarter, both not just in dollars, but as a percentage of retained premiums and fees. I know that's kind of part of what you're working towards. But is that a -- is there any kind of one-timer in there kind of help in that number? Or is that kind of what we could expect to see in terms of at least on a premium relativity, kind of where that number is coming in now?

Max Simkoff, Chief Executive Officer, Doma
I don't -- I'll let Mike comment on the specifics. The high level is, I don't think that was one-time. I think you're just seeing the results of some of the cost actions we took earlier in the year and also just us focusing on being much more lean in how we manage the performance of the business. But Mike, do you want to provide any comments?

Mike Smith, Chief Financial Officer, Doma
Yes, I'd echo that, Max. I mean, really, if you think about the personnel and other expense reduction actions that we took prior during the year, we said in some of our prior earnings releases that those would take some time to be fully manifest. And I think you're seeing that during the fourth quarter in those customer acquisition costs.

Matthew John Carletti JMP Securities LLC, Research Division - MD & Equity Research Analyst
And then one last one, if I could. Is there any ballparking you put around, you mentioned kind of the additional facility savings, order of magnitude sort of number? And also if there's any -- if we should expect whether it's Q1 or Q2, any kind of one-time lease exit cost and the rough order of magnitude that might be?

Mike Smith, Chief Financial Officer, Doma
Yes. So, if we think about like Q4 and Q1, Q4 did have some one-time items. We had some one-time employee benefit items and some reserve-related items that impacted favorably the fourth quarter. In total, those were approximately $9 million. We're not forecasting those to repeat in the second quarter, but that's roughly the magnitude that they were in the fourth quarter. And also., I guess you're also asking about the lease impairment as well, maybe?

Matthew John Carletti JMP Securities LLC, Research Division - MD & Equity Research Analyst
Yes.

Mike Smith, Chief Financial Officer, Doma
Yeah. So, on the lease impairment, basically, we had roughly $13 million dollars of lease impairment charge and contract acceleration charges that hit during the fourth quarter. And those -- we don't expect those to be repeated into the first quarter of '23.

Matthew John Carletti JMP Securities LLC, Research Division - MD & Equity Research Analyst
Perfect. Thank you very much.

Operator
(Operator Instructions) We seem not to have any further questions. So, we will say thank you for your participation in today's conference. This does conclude the program. You may now disconnect.