Doma First Quarter 2023 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 Doma's First Quarter Financial Results Earnings 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 First Quarter 2023 Earnings Conference Call. Earlier today, Doma issued a press release announcing its first quarter 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 but 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 premium and fees, adjusted gross profit, adjusted EBITDA and the other measures described in our earnings release. Our GAAP results and a description of our non-GAAP measures with a full reconciliation to GAAP can be found in the first quarter 2023 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. In the first quarter of 2023 and as part of a comprehensive review of our business, we made significant progress towards solidifying a more scalable and mission-driven go-forward strategy while also driving progress towards reaching adjusted EBITDA profitability. We have strengthened our focus on deploying our instant underwriting technology, which we believe is our core value proposition and what will enable us to deliver a profound impact on the housing affordability pressures that face nearly every American homeowner.

There are 2 themes that I'm going to be focused on today: first, we will discuss the significant progress we've made in finalizing our go-forward strategies to more efficiently and profitably deploy our proven instant underwriting technology with the end goal of making homeownership more affordable; second, I will provide an update on our efforts to get to profitability before turning the call over to our CFO, Mike Smith, who will discuss our financial results in more detail.

While the last several years have brought with them a number of challenges to the housing and mortgage markets, Doma's critical mission has remained focused on making the home-buying process better, faster and more affordable. In support of that mission, the benefits we've proven for mortgage originators using our technology are significant. And in today's market, there is now an even more important stakeholder for us to help alleviate pressure for homeowners themselves.

Just the last few quarters, the home affordability challenge for everyday Americans has gone from bad to severe. The National Association of Homebuilders estimates that roughly 73% of all

U.S. households cannot afford the current median-priced new home. According to the Federal Reserve Bank's most recent February 2023 data, the median American household would now have to spend 40% of their income to afford the median-priced house.

For reference, U.S. households are considered cost-burdened when they spend over 30% of income on housing costs, leaving less room for them to purchase necessary items. To make matters worse, homeownership is actually 18% less affordable than just a year ago and 5% less affordable than the peak of the 2008 housing bubble. Unfortunately, the title industry has been contributing to this challenge with title closing and settlement costs, which according to Fannie Mae, are estimated to make up about 1% of the purchase price in a typical home purchase transaction, averaging upwards of $2,400 per home. In finalizing our go-forward strategy, it became clear that making home-buying more affordable needed to be front and center.

As discussed on prior earnings calls, we have been actively seeking ways to more efficiently and more profitably deploy our proven and patented instant underwriting technology as we believe this is our core value proposition and the key to modernizing the greater than $29 billion title insurance market while driving down the significant cost of homeownership. The advances we have established via our instant underwriting technology show that it is the only proven at-scale tool of its kind.

Our patented decision engine's multicomponent machine learning models have successfully underwritten over 85,000 loans for many of the largest national mortgage originators in the country since it launched in 2017. These lenders have seen that 80% of orders they sent to our technology received instant approval. Our world-class team of machine learning experts have achieved this outcome by training our models on over 20 years risk data through hundreds of thousands of past title policies.

In summary, the technology is able to eliminate the bulk of the title search, exam and curative process, reduce time to close by up to 5 days and enable significantly lower fulfillment costs for mortgage originators, all while exhibiting similar claims rates as the traditional title process.

Over the past several months, we have conducted a comprehensive review of our business to evaluate the optimal organizational structure for us to successfully deliver on our mission and to maximize shareholder value. We have identified and are now finalizing a singular transformative core strategy for the business where we would better harness the power and benefits of our instant underwriting technology via the efficient and profitable distribution of our core technology by external partners. With respect to that new strategy, we have made solid progress towards finalizing potential partnerships with some of the largest players in the national mortgage origination market to bring down refinance specific costs for end consumers associated with title and closing.

Expanding our partnership distribution channel remains one of our top priorities. While we are unable to provide further specific details today, we are excited about the profitable and impactful opportunity at hand. As we strengthen our focus on our underwriting technology business, we are taking a hard look at everything in the business that is noncore.

Regarding our local division, we previously communicated that we have been moving aggressively to close on profitable branches to refocus our efforts on more profitable opportunities, leading to the closure of an additional 13% of our total branch footprint during the first quarter. As part of our go-forward strategy and refined focus on the distribution of our underwriting technology, our local leadership team also finalized and implemented a strategic plan in the first quarter to ensure that the local division will accelerate the company's path to profitability for the remainder of the year.

This brings me to the second key theme of today's call. I'd like to provide a brief update on our focus on getting to adjusted EBITDA profitability by the end of this year. We are still making steady progress toward achieving adjusted EBITDA profitability as quickly and as efficiently as possible, exemplified by the cost-cutting measures we enacted in the second half of 2022, the most recent round of which we expect to be fully visible in our quarterly numbers starting in Q2 of this year. We also believe that our refined strategy will bolster our profitability efforts. Additionally, the business will continue to benefit from the healthy stability provided by our underwriting division as we remain dedicated to the continued success of the underwriter and as we continue rolling out our instant underwriting technology for our independent agents.

Despite persistent macro pressures, we do feel adjusted EBITDA profitability is still attainable by the end of 2023. That being said, we remain cautiously optimistic regarding this time line as we understand the importance of preserving the ability for our new transformative strategy to take shape. Given our revised plans and that we believe our market share is less than 2% of the overall title insurance market today, we foresee a long runway of opportunity ahead of us to grow our business.

In closing, Doma's narrowed focus on a core strategy to provide better, faster and more affordable homeownership for the majority of Americans has given us a renewed energy to continue executing even amidst the set of challenging market conditions. To ensure success in our mission, we will continue to reevaluate and reduce attention to anything noncore to this mission, and we remain focused on achieving adjusted EBITDA profitability by the end of this year.

As we are putting the finishing touches on our new strategy, we expect we'll be able to provide more specific and detailed information within a few months. We look forward to updating you on our progress throughout the year. I will now pass the call over to our CFO, Mike Smith, to provide you with further details on our recent financial performance. Mike?

Mike Smith, Chief Financial Officer, Doma
Thank you, Max, and good afternoon, everyone. Today, I will be providing an overview of Doma's first quarter financial results. Please refer to our earnings release filed earlier today for full details of the quarter. Unless otherwise specified, all the comparisons cited in my remarks are quarter-over-quarter or sequential comparisons to the fourth quarter of last year.

Consistent with prior seasonal patterns, the fourth and first quarters tend to reflect lower activity compared to the second and third quarters, which typically show more strength. In line with our expectations, we had seen some seasonal softness coupled with challenging macro conditions that impacted our Q1 results. Additionally, elevated mortgage rates continue to impact refinance and purchase volumes for 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 second quarter of 2023 and will improve to 5.5% by the end of the year. These still elevated rates will likely continue to put pressure on refinance and purchase order volumes industry-wide for the foreseeable future.

That said, in Q1, we did see an encouraging strengthening of both our open order pipeline as well as our conversion rates from open to closed orders, which we expect to create tailwinds for both our closed order and RP&F numbers in the second quarter and into the third quarter. Our primary measure of unit economics is adjusted gross profit, which was $4 million in the first quarter of 2023, which compares to $14 million in the fourth quarter of 2022. Adjusted gross profit as a percentage of RPF was 18% in the first quarter compared to 40% in the fourth quarter of last year.

Adjusted EBITDA, our main profitability measure, was a negative $22 million compared to negative $15 million in Q4 2022. As Max mentioned, our first quarter adjusted gross profit and adjusted EBITDA did benefit from the expense actions we took to rightsize our cost structure in the second half of 2022. However, the decline in these measures was largely due to the fact that the full impact of the employment actions we initiated in the fourth quarter of 2022 will not be completely realized until the second quarter of 2023.

Additionally, we had a number of onetime employee benefit-related reductions and a favorable reserve development in Q4, which did not repeat in Q1. Combined with some seasonal softness and continued challenging macro pressures, this led to a decline in adjusted EBITDA compared to Q4 of 2022. In terms of our top line performance in the first quarter, we reported revenue on a GAAP basis of $74 million, down 23% quarter-over-quarter. As a reminder, GAAP revenue includes the portion of third-party agent premiums that Doma does not retain. So we focus on Doma's retained premiums and fees, or RP&F, as an important metric, which includes -- 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, RP&F was $25 million in the first quarter, down 29% quarter-over-quarter, driven by a 60% decline in refinance closed orders and a 25% decline in purchase closed orders, both directionally expected as mortgage rates remained high in Q1, along with seasonal softness. In the first quarter, purchase closed orders made up 61% of our direct residential volume and 85% of our direct residential retained premiums and fees, which compared to 46% and 78% in the fourth quarter of 2022, respectively.

As mentioned previously, while we saw significant impacts to Q1 closed orders and RP&F due to both expected seasonality effects and volatile mortgage rate activity, in late Q4 and early Q1, we have seen strong week-over-week improvements in open order momentum in the past 6 to 8 weeks as we head into the spring selling season, which we believe will deliver tailwinds on close orders and RP&F across our direct business in the second and third quarters of this year. We expect these tailwinds to benefit adjusted EBITDA at the same time that we realize the benefits of the cost-cutting actions that we took in late 2022. As Max mentioned, we remain highly focused on achieving our goal of becoming adjusted EBITDA profitable this year.

One last item to note for the first quarter of 2023 is that we did not incur any goodwill impairment charges. With that, thank you for joining us on the call 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. I'm incredibly proud of how we've navigated such a volatile period, not only the housing market but in the overall economy. We held firm in our goals of providing better, faster and more affordable solutions. We made significant strides in finalizing our new company strategy positioning Doma for long-term success and ensuring we play a pivotal role in mitigating the severe home affordability concerns being experienced nationwide. 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
(Operator Instructions) Please standby while we compile the Q&A roster. Our first question comes from the line of Tom White from D.A. Davidson & Company. Please go ahead.

Wyatt J. Swanson D.A. Davidson & Co., Research Division - Research Associate
This is Wyatt Swanson on for Tom. Thanks for taking our questions. Realized you guys paused the rollout of Doma Intelligence to the local channel late last year, but for those markets that have been deployed and live for a while, is there any early data or kind of maybe cohort analysis you could share about the branches or the markets where it got rolled out earliest? And whether you're seeing any kind of change in the market share in that area, maybe a change in the trajectory of closed orders that would signify that the technology is really resonating and getting attention?

Max Simkoff, Chief Executive Officer, Doma
Sure. Hey Wyatt, this is Max. So I would -- I think I'll kind of refer back to some things we probably also touched on in the last call. In the locations that did get deployed on the technology throughout last year, as we saw those locations process more and more orders using the technology, we saw very positive signs that indeed it was working and producing the desired outcomes. That said, we made a conscious effort, as you mentioned, last quarter, to put that

deployment on pause because, frankly, our primary focus in our local division is contributing as much to accelerating our path to adjusted EBITDA profitability as possible.

I think the other thing I'd point out, which I mentioned in some of the remarks, the initial remarks earlier today is we've now seen this technology deployed at national scale across, quite frankly, what are the largest mortgage originators in the country. We not only know that it works. We know that it works incredibly well to speed up the process and also introduce much needed efficiencies that we think can be better harnessed to bring down the cost to the end consumer. So as I mentioned, with regards to the singular new strategy that we're focusing on, that's really where our focus is going to be, making sure we get that proven technology deployed on a broader scale with some partners in the broader mortgage ecosystem and ensuring that the efficiencies we've proven can show up in the form of ultimately lower cost to the end customer.

Wyatt J. Swanson D.A. Davidson & Co., Research Division - Research Associate
Great. Thank you very much.

Operator
(Operator Instructions) Thank you. All right. Our next question comes from the line of Michael Ward from Citi. Your line is now open.

Michael Augustus Ward Citigroup Inc. Exchange Research - Research Analyst
Hey guys, thank you. I guess maybe just high level. Sort of wondering what has changed with respect to the EBITDA guide. It sounded like maybe you're a little bit more cautious than previously. So wondering if you can expand on that.

Max Simkoff, Chief Executive Officer, Doma
Sure. Why don't I give a quick kind of general comment, and then Mike can probably comment on some of the specifics that we think you'd see from last quarter to this quarter and where we think those are going to net out throughout the balance of the year. I used the term cautiously optimistic because I want to stress that regardless of macro conditions, and this is the way that we've learned to operate our business over the last couple of years, we still intend and see a path to get to adjusted EBITDA profitability by the end of this year.

So -- and in fact, we've got multiple levers we could pull to get there. The phrase I've used around cautious optimism just means that we are very, very focused on making sure that we launch our new singular strategy successfully. We've seen this housing affordability issue really become front and center in such a quick period of time. And we think we're uniquely advantaged to drive the success of our business by solving that problem. And we just want to make sure that we balance some flexibility that we may need to launch that program successfully with management's confidence that we have several levers we can pull to ensure that we get to adjusted EBITDA profitability by the end of the year.

Mike, do you want to just comment on some of the specific kind of movement from Q4 of last year to Q1 of this year and how that gives us further confidence that we're on track for our plans?

Mike Smith, Chief Financial Officer, Doma
Sure, Max. Yes, Michael, I think one of the things that we might point out here, too, is that if you look back at Q4, we pointed this out at the time that we had several onetime items that we pointed out that favorably impacted Q4. And then if you look at Q1 here, obviously not quite the performance that we had expected, but there was only really one item that really surprised us. We didn't know from like a top line basis that revenue is typically soft in the first quarter.

We also didn't have the repeat of those Q1 benefits that benefited the fourth quarter. We did have a decent-sized large claims provision that did impact us in Q1. That was somewhat unexpected. And then also our conversion rates were not what we had hoped that they would be in the first quarter. So there were a couple of things that did surprise us, but otherwise, we did expect the first quarter to be somewhat not quite as good as the fourth quarter.

Michael Augustus Ward Citigroup Inc. Exchange Research - Research Analyst
Really helpful. And then maybe the expense reduction measures from 4Q expecting to sort of flow through in 2Q, I -- just sort of curious if you could address that a bit how that should work -- play out?

Mike Smith, Chief Financial Officer, Doma
Yes. That's -- Michael, that's a great question. And again, as we talked during the fourth quarter and again during the first quarter, we'll reiterate that those expense actions that we took in the fourth quarter, we'll see that full benefit fully reflected in the second quarter. Obviously, we continue to look at our cost structure and continue to find meaningful progress there. We're laser-focused on that. So you'll see that benefit coming through fully in the second quarter.

Michael Augustus Ward Citigroup Inc. Exchange Research - Research Analyst
Okay. And maybe just sort of to get your guys thoughts sort of on like the underlying trends that impact the top line. Just curious if what you guys think is driving tailwinds in order numbers and conversion rates?

Max Simkoff, Chief Executive Officer, Doma
Yes, it's a great question. And honestly, in this market, it's really difficult to say. And I'd say 2 things here. One is that, as Mike mentioned, one unexpected outcome that we saw in Q1 was that the conversion rate of orders that were open in Q4 that were then closing in Q1 were significantly lower than what we would have expected for that time of the year. And again, I wish I could give you a causal versus a correlational answer.

I'm not really sure it matters because it was an observed behavior that happened at a time when things were pretty volatile in the overall markets, right? You had a lot of volatility in both directions on 30-year fixed rate, you had bank failures. You had some odd consumer spending behavior, you had low housing inventory, so there were a lot of things going on there, and we're not really sure how those influenced those conversion rates.

On the flip side, the conversion rates seem to have more than normalized and come back to what we'd expect, and we have seen very encouraging open order momentum for really the last 6 to 8 weeks. Some of that is probably that we're getting into the spring selling season. But other than that, I'd probably attribute it to the fact that we are still in some really great markets, and we've got great people out there executing and doing what they're supposed to do to ensure that they drive the revenue that's going to help us get to adjusted EBITDA profitable on the time line that we expect.

Michael Augustus Ward Citigroup Inc. Exchange Research - Research Analyst
Great. Thank you guys.

Operator
Thank you, one moment please. Our final question comes from the line of Karol Chmiel from JMP. Your line is now open.

Karol Krzysztof Chmiel JMP Securities LLC, Research Division – Associate
I'm calling in for Matt from JMP. And one of the questions was already kind of answered and that was regarding the momentum of the open orders, and I guess the 6 -- the most recent 6 to 8 weeks of the past quarter were the drivers. But is there any additional granularity you can give us on that 6 to 8 week period? Is there anything specific to it?

Max Simkoff, Chief Executive Officer, Doma
I don't think -- I mean, again, not really other than -- again, I hate to sound repetitive, but I commend our people across the business for really -- after getting through a tough second half of last year where we did a considerable amount of expense reduction and streamlining the business and navigating some volatile mortgage rates and broader macro activity in Q1, I think they've just been executing really well. And they've been focused on delivering revenue -- leading indicators of revenue for the business that we would expect to show up in the form of a top line tailwind for Q2 and into Q3.

Karol Krzysztof Chmiel JMP Securities LLC, Research Division – Associate
All right. Fair enough. And then the next question is just -- it was kind of answered in the past. But regarding the new strategy, and what you mentioned in the beginning of the closing of the unprofitable branches. Is there a commitment to keeping the local presence for branches that are profitable?

Max Simkoff, Chief Executive Officer, Doma
Good question. So here's the way we think about it. We have our confidence that there are 2 elements of the core strategy going forward that need to be front and center right now. The first is, as I mentioned, getting our technology more efficiently deployed through some transformative partnerships in a broader mortgage ecosystem to help alleviate the challenges

with home affordability. And the second is that our underwriting business, which continues to be a stable platform that we believe can deliver profitable growth going forward continues to execute on its objectives and partner with our independent agent community. So those are the 2 kind of top of mind areas of our core strategy that we're immediately focused on.

As it relates to the local business, and this I think is consistent with what we said last quarter, its primary focus is on making sure that it contributes to the maximum amount of profits of the business to help us reach our goal of adjusted EBITDA profitability by the end of the year. And I'm extraordinarily proud of our local leadership team for not only making a tough decision to exit some unprofitable markets very quickly but also putting together and implementing a plan in the first quarter that is designed to help us accelerate our path to adjusted EBITDA profitability.

Karol Krzysztof Chmiel JMP Securities LLC, Research Division – Associate
Alright. Thank you.

Operator
Thank you, and thank you, everyone. This concludes today's conference call. Thank you for participating. You may now disconnect.