S&P Global
Market Intelligence

Universal Insurance Holdings, Inc. NYSE:UVE

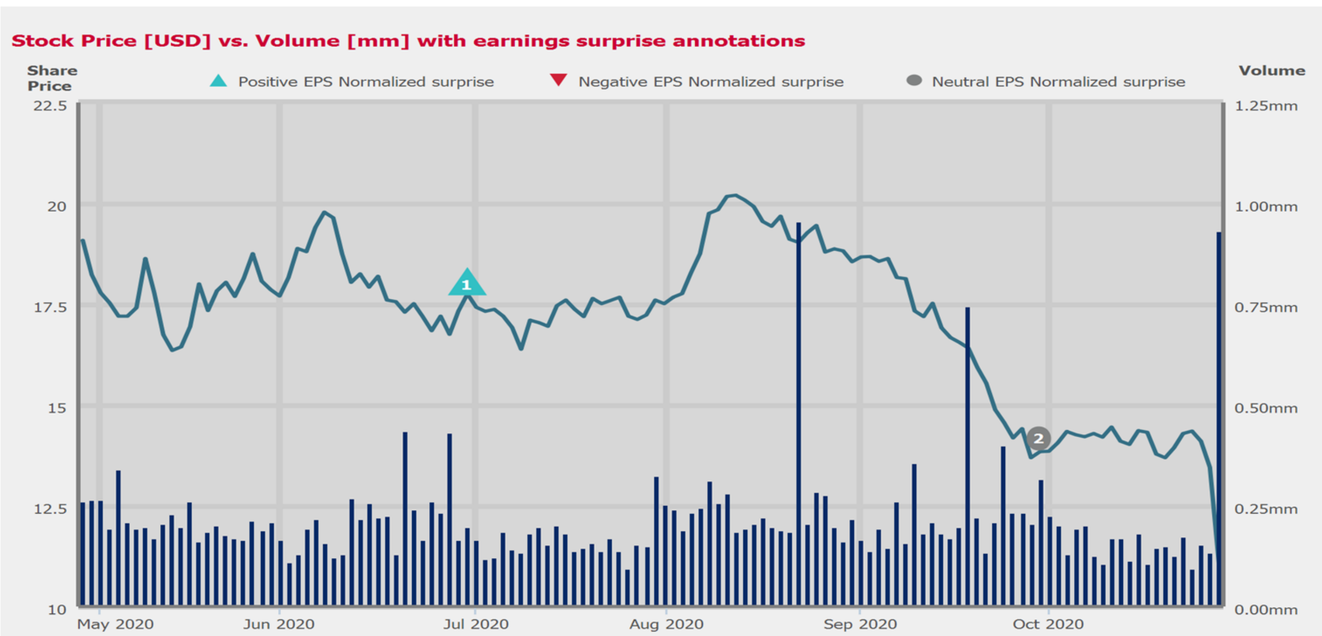
FQ3 2020 Earnings Call Transcripts

Wednesday, October 28, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2020-			-FQ4 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.10	(1.43)	NM	0.39	0.30	NA
Revenue (mm)	253.58	311.66	▲22.91	263.10	1062.75	NA

Currency: USD
Consensus as of Oct-28-2020 3:21 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	NA	NA	NA
FQ2 2020	0.50	0.52	▲4.00 %
FQ3 2020	0.10	(1.43)	NM

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Call Participants

EXECUTIVES

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Jon William Springer
President, Chief Risk Officer & Director

Rob Luther
Vice President of Corporate Development, Strategy & Investor Relations

Stephen Joseph Donaghy
CEO & Director

ANALYSTS

Thomas Henry Shimp
Piper Sandler & Co., Research Division

William Harry Broomall
Dowling & Partners Securities, LLC

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the UVE Third Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Rob Luther, Vice President of Corporate Strategy and Investor Relations.

Rob Luther
Vice President of Corporate Development, Strategy & Investor Relations

Thank you and good morning, everyone. Welcome to our discussion on our third quarter 2020 earnings results, which we reported yesterday.

On the call with me today is Steve Donaghy, Chief Executive Officer; Jon Springer, President and Chief Risk Officer; and Frank Wilcox, Chief Financial Officer.

Before we begin, please note today's discussion may contain forward-looking statements and non-GAAP financial measures. Forward-looking statements involve assumptions, risks and uncertainties that could cause actual results to differ materially from those statements. For more information, please see the press release and UVE's SEC filings, all of which are available on the Investors section of our website at universalinsuranceholdings.com, and on the SEC's website. A reconciliation of non-GAAP financial measures to comparable GAAP measures is included in the quarterly press release.

With that, Steve, I'll turn it over to you.

Stephen Joseph Donaghy
CEO & Director

Thank you, Rob, and good morning, everyone. Thank you for joining us today. We continued to see headwinds in the third quarter as we dealt with elevated industry-wide weather events year-to-date, particularly in coastal states. Our catastrophe response teams have directly engaged with our insureds to ensure they receive the attention they deserve.

As previously announced, we were affected by full retention events from Hurricanes Isaias and Sally in addition to other PCS events year-to-date. As the statute of limitations for Hurricane Irma approach its ending, we experienced increased prior year companion claims, as the window closed. This increase in claims led us to increase our reserves in years prior to 2020. We feel good to have Hurricane Irma behind us, the ability to strengthen reserves appropriately and proud of our employees for their contributions during these unprecedented times.

Our vertically integrated suite of capabilities continues to differentiate us in our home state. Our primary rate increases continue to flow through our book, as evident by our strong direct premiums written growth of 19.4% in the quarter. We continue to selectively write new business, are quickly approaching $1.5 billion in premiums in force, and are optimistic about our prospects in the future.

So with that, let me now turn it over to Frank to walk through our financial results. Frank?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Thank you, Steve, and good morning, everyone. As a reminder, discussions today on adjusted operating income and adjusted EPS are on a non-GAAP basis, and exclude effects from unrealized and realized gains and losses on investments and extraordinary reinstatement premiums and related commissions. Adjusted operating income also excludes interest expense.

EPS for the quarter was a loss of $0.10 on a GAAP basis and a loss of $1.43 on a non-GAAP adjusted EPS basis. Year-to-date, GAAP EPS was $1.14 and negative $0.08 on a non-GAAP adjusted EPS basis. Despite elevated activity year-to-date, we produced an annualized year-to-date return on average equity of 10% with a book value per share that remained relatively flat since the end of 2019 at $15.15.

As to underwriting, direct premiums written were up 19.4% for the quarter, led by strong direct premium growth of 18.8% in states outside of Florida and 19.6% in Florida. The quarter's growth benefited from organic new business growth and primary rate increases continuing to flow through the book.

On the expense side, the combined ratio increased 36.9 points for the quarter to 134.7%. The increase was primarily driven by previously announced increased weather events in addition to prior year's reserve development and the continuation of accruing incremental reserves for current accident year loss cost. In addition, higher reinsurance cost affected the base of the ratio. These increases were partially offset by a benefit from our claims adjusting business and a reduction in the expense ratio.

Turning to services, total services revenue increased 14.9% to $17.1 million for the quarter, driven by commission revenue earned on ceded premiums and an increase in policy fees. On our investment portfolio, net investment income decreased 40.1% to $4.6 million for the quarter, primarily due to lower yields on cash and fixed income investments during 2020 when compared to 2019.

Realized gains for the quarter were $53.8 million and resulted from taking advantage of increased market prices on our available-for-sale debt investment portfolio. We took the opportunity to monetize the increase in fair value of our investment portfolio as a means to enhance surplus for UPCIC. This facilitates our growth strategy in a hardening primary rate market while strengthening reserves.

Cash and cash equivalents increased 122.5% to $405.1 million when compared to the end of 2019 as a result of the actions taken to realize investment gains leading to higher investment cash flows. As a result of the sales and reinvestment, future portfolio investment income will reflect current market rates.

In regards to capital deployment, during the third quarter, the company repurchased approximately 534,000 shares at an aggregate cost of $9.9 million. Year-to-date, the company repurchased 1.4 million shares at an aggregate cost of $26.5 million. On July 6, 2020, the Board of Directors declared a quarterly cash dividend of $0.16 per share of common stock, which was paid on August 7, 2020, to shareholders of record as of the close of business on July 31, 2020.

As mentioned in our release yesterday, we are updating our full year guidance to reflect increased top line revenue, offset by elevated third quarter loss and loss adjustment expense. We now expect a GAAP EPS range of $1.80 to $2.10 and a non-GAAP adjusted EPS range of $0.55 to $0.85, assuming no extraordinary weather events in the fourth quarter of 2020 and no realized or unrealized gains for the fourth quarter. This would yield a return on average equity derived from GAAP measures of between 11.1% and 14.1% for the full year.

Let me now turn it over to Jon to walk through some additional specifics.

Jon William Springer
President, Chief Risk Officer & Director

Thank you, Frank, and good morning, everyone. We continue to make significant progress in resolving the remaining open claims on prior year catastrophe events. And as Steve noted, we reached the statute of limitations milestone for Hurricane Irma claims. We did see over 2,000 new Irma claims reported during the third quarter and we elected to book the Irma gross ultimate at $1.55 billion.

The modest run-up in claims filed in advance of the 3-year statute of limitation for filing new Irma claims that expired in the second week of September was expected, but we were surprised and disappointed to see quite a number of non-cat Irma companion claims filed simultaneously. This phenomenon contributed to a portion of our third quarter prior year adverse development. We will continue to monitor the effects of these late reported Irma and Irma-related claims going forward. But we are extremely pleased with the diligence of our claims adjusting staff.

As of 9/30, Hurricane Michael had a little over 100 claims open, as we start to approach the end on this storm. We did elect to book the Michael gross ultimate at $386 million. This change does not impact our net loss position.

In regards to third quarter 2020 weather events, as noted in our September 23 press release, and again in our release last night, we did experience losses from 2 specific hurricane events during the third quarter, Hurricanes Isaias and Sally. Each of these events was booked at 9/30, expecting a full retention loss under its respective reinsurance program. For Hurricane Isaias, that was $15 million pretax under our other states program, and for Hurricane Sally, that was $43 million pretax under our all states program. Together, these 2 events resulted in a total net impact of approximately $58 million pretax, approximately $44 million after-tax.

With that, I'll turn it back to Rob.

Rob Luther
Vice President of Corporate Development, Strategy & Investor Relations
Thanks, Jon. I'd like to ask the operator to now open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Tom Shimp from Piper Sandler.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Just hoping to get more color on the companion claims, the non-cat claims. Can you give me an example of what type of claims those are, and just why that caught you guys by surprise? Just any more color on that would be greatly appreciated.

Jon William Springer
President, Chief Risk Officer & Director

Yes, thanks, Tom. Thanks for the question. A companion claim, as we're describing it, is a claim that's filed simultaneous with a catastrophe claim. So typically, with the help of a public adjuster and/or an attorney, what we'll see is, we'll see a Hurricane Irma catastrophe claim come in, and again at the same time, a non-cat claim for the same property. And really, the goal of the policyholder or the public adjuster or attorney is try to make every effort that their client has the opportunity to get paid on one or the other or both of those claims.

It wasn’t -- the concept is not new at all. In fact, we've had over 10,000 of these type of claims filed since Irma first made landfall over 3 years ago. What was unexpected, and maybe a little disappointing, was that we did see a rather significant number filed again in the third quarter of 2020, as we saw that late push of a little over 2,000 cat claims come in. So obviously, when these claims come in, they're non-cat, they typically fall into an older accident year. So it would require us to bolster our reserves for those particular years.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay. So I just want to make sure I understand this correctly. It sounds like from a perspective of the 3-year statute of limitations has passed now, that claim count for that really shouldn’t go up. And it's not really a classification issue that had the potential to develop further?

Jon William Springer
President, Chief Risk Officer & Director

No, that's right. Yes, you're correct. Our goal really with everything we've done here in the third quarter, Tom, is to try to get Irma cat claims and Irma-related non-cat claims in the rearview mirror. With what we've booked here from a gross cat perspective, as well as what we've done to bolster the older year reserves related to some of these companion claims, we're really hoping to put Irma behind us.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

All right, great. That's very helpful. And then if we could talk about just capital strategies, you guys are holding onto more cash, you're still buying back some shares, and the company is reporting strong growth. So how's the comfort level trending around capital adequacy? I know you guys took the gains on some of the investment portfolio, but if organic growth opportunities continue to present themselves, could management envision other avenues to support the growth, taking advantage of low rates, raising some capital. Is that a possibility?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Good morning, Tom. This is Frank Wilcox, I appreciate the question. Just a reminder about our business model and how we accumulate and deploy capital. In addition to the opportunity to accumulate capital at the insurance entity levels, with our vertically integrated structure, we also have the capacity to accumulate capital outside. That capital, of course, is used to return value to shareholders in the form of dividends, share buybacks, and from time to time, if needed, to support growth at UPCIC. Right now, we're okay with capital. If the need be to look elsewhere, certainly, that capital raise would be to support growth.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay, great. And then net investment income, it was a bit lower than I expected. I understand yields are coming down and holding onto cash more so -- but can we just discuss the decelerating net investment income and if this is a good run rate we should assume going forward?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Yes, well, the decrease in the interest rates had an impact first on our cash equivalents and our short-term investments, as those reprice regularly. The book of fixed income, long-term fixed income, securities as they matured, or as they were paid down before maturity, we're repricing into a lower interest rate market. So those are contributing factors. Going forward, I think you need to keep in mind the fact that we monetize the unrealized gains, and those unrealized gains basically represented future collection of interest income. So we accelerated the collection of that interest income, and now, as we replace our investment portfolio, the majority has been replaced. And the composition of the portfolio is very similar to what we had in the past, which is very conservative in nature. And of course, that served us in the past. But as we continue to deploy the available cash, we're expecting a yield of somewhere between 130 to 160 basis points depending on the adviser that we're working on.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay. And then I just wanted to touch on just a high-level question here. Obviously, the Florida insurers in general are struggling right now. Can you just discuss what you're seeing in the operating environment, the potential, any opportunity to take further rate increases and how the regulator would respond to that? And just in general, what are your thoughts on the ability to get enough rate to stabilize margins for the Florida peers?

Stephen Joseph Donaghy
CEO & Director

Hey, Tom, it's Steve. Thanks for the question. The Florida market, as we've commented briefly, it's hardened. We see a lot of competitors that are pulling out of specific areas around the state. Our philosophical approach to rating has never been to rate to competition, but to rate to adequacy. So we now find ourselves writing around the state in areas that traditionally, we did not; traditionally, in areas where friends of ours, agents of ours that we knew well, could not write because we were double or as much as triple the premium of some of our competitors.

So as that has changed, our ability to organically write and underwrite our own policies is considerable, and we like the growth. I think our reinsurance partners will like the growth because it is outside of tri-county. And as we continue to balance our portfolio, we feel as though that is a considerable opportunity for us going forward.

Mechanics in the state, as we continue to aggressively handle our claims, we are experimenting and continue to use products we've used for 2 or 3 years. Many insurers are more welcoming of our ability to adjust or adjudicate a claim remotely, rather than having to send them in. Many of our field staff we have tested for the virus regularly to prevent the spread. And we notified our insureds that will be coming that we've done that and -- but if they’ve had any exposure, please let us know so we can do our best to adjudicate that claim remotely. Again, that's somewhat unique to Universal and not all third-parties, adjusters, in the state have demonstrated an ability to comply to our requirements. So we feel good about what we've built in the past to execute now.

If that didn’t answer any specific area of your question, just let me know and I'll be happy to address it.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

No, I think that hits it, but it brings up another question. As you guys try to move away from Tricounty, I've been hearing some discussion that some of the issues that are in Tricounty moving to other counties throughout the state. Is that something you guys have been seeing too? How has that been trending in your guys' thoughts?

Stephen Joseph Donaghy
CEO & Director

Yes, we track that on a regular basis, as you can imagine, Tom. And the infrastructure that we've built to deal with Tricounty, should we experience that, we feel that we are strategically positioned to combat whatever comes at us in any other markets. Again, that being said, our rate adequacy is the key to our ability to operate around the state effectively and efficiently. So our lawyers are ready, our specialists in claims are ready. But thus far, we have not seen the increase in premium result in increase in litigation or PAs, etc., around other markets in the state. They're there, we know they're there, we know who they are, and I'd like to think they know who we are, and that we have the right tools to combat and compete, should they decide to pursue frivolous claims.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay, great. And then just lastly, I was hoping we can revisit the impacts from COVID. We're a lot farther into the pandemic now. Are you guys seeing any beneficial impacts, be it direct distribution or possibly less non-attritional losses, as homeowners work from home?

Stephen Joseph Donaghy
CEO & Director

Tom, that's an interesting question, we get it regularly. We've not seen any peaks or valleys in claim development, claim requests. We have had people ask for relief due to the pandemic, but our policies specifically do not cover that. So we review the claims and it's maybe 3 digits that we received in the last 9 months, so it's not a huge amount. But we've not paid out, at this point, on any due to the policy language that we fortunately have across the board and -- yes.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Are you seeing any impact from -- a beneficial impact from just homeowners being at home, or is it just too early to tell [indiscernible]?

Stephen Joseph Donaghy
CEO & Director

Well, I will tell you, Tom, the beneficial impact from my office that I see are the tremendous associates that we've recruited to Universal in the past, and our ability to respond, attend and operate as efficiently as possible in these times. The technology that we've embraced for years within the Claims Department has served us really well, and the ability for a consumer to take their phone and take pictures of the claims that they submitted and help us get them to what they desire to get repaired.

I have been pleased with the construction business. We don’t participate in that, but it does seem as though consumers are able to find people to work on their homes and get back to normal, and prevent further damage from affecting a claim, and that's been beneficial.

So I think across the board, our associates are doing a great job. Clearly, third-party construction firms continue to assist our insureds and get people back to where they were. And I think our ability to use technology for -- within claims has been really good, and some of that is proprietary. We have our own claims app that we developed in-house and people can track their claims on their phone, if they'd like, and that serves us quite well.

Operator

Our next comes from the line of Bill Broomall from Dowling & Partners.

William Harry Broomall
Dowling & Partners Securities, LLC

If I could just start -- in the past, you’ve talked about your direct loss pick and how you view that. Has there been any change on that front?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

No…

Jon William Springer
President, Chief Risk Officer & Director

No, we -- I'm sorry. Go ahead, Frank, you go first.

Frank Crawford Wilcox
CFO & Principal Accounting Officer

I was simply going to say that it hasn't changed from what we previously announced.

William Harry Broomall
Dowling & Partners Securities, LLC

Perfect. Can you just help me reconcile the direct to net adverse development? Just trying to understand. I think Michael will be a piece of it, Irma would be a piece, but is there anything else? I'm just trying to get from the 136 down to the 31 -- or the 30, sorry.

Jon William Springer
President, Chief Risk Officer & Director

No, you're right. Irma and Michael would be the largest contributors to that.

William Harry Broomall
Dowling & Partners Securities, LLC

Okay. Got it. On the cash component on your balance sheet, I was just wondering how much of that cash is at the holding company?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Well, that's disclosure that we do annually through our 10-K. There are financial statements at the end. It's not a number that we publish in the interim, Bill, but last year, the amount was between $80 million and $90 million.

William Harry Broomall
Dowling & Partners Securities, LLC

Got it. That would -- that's year-end 2019?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

That's correct.

William Harry Broomall
Dowling & Partners Securities, LLC

Okay. And just following up on one of Tom's comments, is there a leverage ratio that you think about writing at the sub level?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Are we talking about debt?

William Harry Broomall
Dowling & Partners Securities, LLC

Sorry, underwriting leverage -- I apologize -- premiums to surplus and how you think about what you're writing at. Is there some [tools] that you can have?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Yes, there's several measures that we monitor. We monitor gross written premiums to surplus, net written premiums to surplus, and of course, RBC ratios. And we do that in order to maintain regulatory standards, but also to support our ratings. So yes, we do constantly monitor those measures.

William Harry Broomall
Dowling & Partners Securities, LLC

And would you say where you are right now is in the -- if you think about bands, where do you think you stand right now in terms of what you like to write at from a leverage ratio?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

Well, those are annual figures, so we're looking at that in conjunction with our forecast for the rest of the year. We have had tremendous growth from opportunities in the State of Florida, and we recognize that we need surplus in order to support that growth. And we have, in the past, infused capital from the holding company down to the insurance entities, and we stand ready to do the same if necessary.

William Harry Broomall
Dowling & Partners Securities, LLC

Now did you downstream anything in Q3?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

I'm sorry, what was the question?

William Harry Broomall
Dowling & Partners Securities, LLC

In your prepared remarks, I believe, Frank, you mentioned about the surplus. And did you downstream any capital to the end of this year to support the growth?

Frank Crawford Wilcox
CFO & Principal Accounting Officer

We did. We infused $44 million from the holding company.

Stephen Joseph Donaghy
CEO & Director

And Bill, this is Steve. We still have funds at the parent. We're very comfortable with where we sit from a capital perspective. And our ratios, as we sit here today, are better than they were at the end of 2019 and Q1 so generally. So we feel good about where we're at, and as Frank talked about, the focus on capital is constant. And he's always running in and sharing where we're at and what we're doing, and what we need to do.

And fortunately, the company has been built in a manner that we can continue to do the necessary things, and thus far, have had no need to enter capital markets for additional assistance.

William Harry Broomall
Dowling & Partners Securities, LLC

Great, both those commentaries were very helpful. And I might've missed this, Jon, but what are the number of open Irma claims? I know you had 2,000 new ones, but I think at the end of Q2, you had about 450 and I was just wondering what the open claims were on Irma.

Jon William Springer
President, Chief Risk Officer & Director

Yes, open Irma claim count as of 9/30 was 418, so that number, it sounds like it went down just a little. But obviously, we made progress on the new claims that came in during the quarter.

William Harry Broomall
Dowling & Partners Securities, LLC

Yes, okay, yep, yep. And in the past, you've paid a special dividend. I was just wondering when does the Board meet to review that, or what's the process when you think about -- review the dividend?

Stephen Joseph Donaghy
CEO & Director

Yes, Bill, that's part of our ongoing capital management strategy that we employ and the Investment Committee will meet. We have a Board meeting this week. The Investment Committee met last week on some matters, and have discussed it. So we're in regular discussion. We generally like to get us through the hurricane season as possible, and currently, we sit in a position where the capital is there to deploy barring any unforeseen circumstance. So again, it's part of our ongoing strategy. We feel good about it. And the capital is there today and as we maturate through the next few weeks, we should be in a position to announce.

Operator

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Stephen Donaghy for any further remarks.

Stephen Joseph Donaghy
CEO & Director

Yes, thank you, Jonathan. In closing, I would like to thank our associates, consumers, agents and stakeholders for their continued support of Universal. And all those on the line, we wish you the best in these unprecedented times and look forward to speaking to you at the end of the year. Have a great day.

Operator
Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.