S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc. NYSE:HRTG

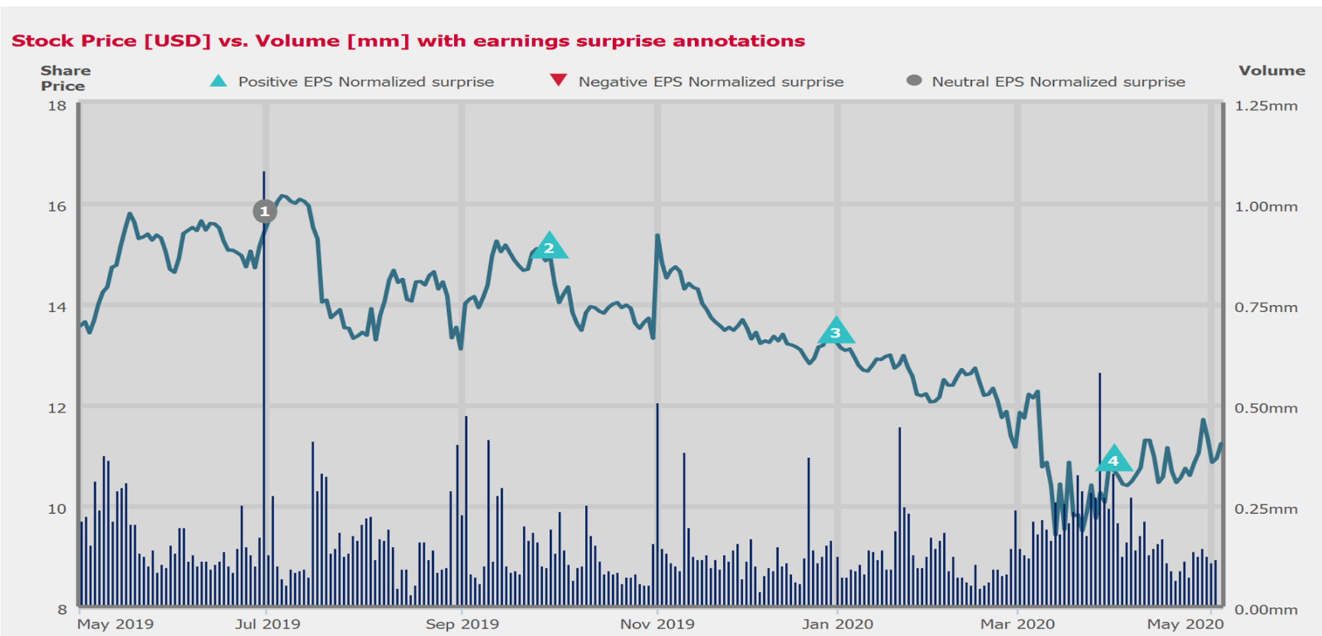
FQ1 2020 Earnings Call Transcripts

Tuesday, May 05, 2020 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-			-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.26	0.27	3.85	0.36	1.55	1.78
Revenue (mm)	127.39	132.71	4.18	131.82	536.07	569.36

Currency: USD
Consensus as of May-05-2020 12:10 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	0.00	0.00	0.00 %
FQ3 2019	0.14	0.28	100.00 %
FQ4 2019	0.37	0.42	13.51 %
FQ1 2020	0.26	0.27	3.85 %

Table of Contents

Call Participants

EXECUTIVES

Arash Soleimani
Executive Vice President

Bruce Thomas Lucas
Chairman & CEO

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Thomas Henry Shimp
Piper Sandler & Co., Research Division

William Harry Broomall
Dowling & Partners Securities, LLC

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings First Quarter 2020 Financial Results Conference Call. My name is Eiley, and I will be the operator today. [Operator Instructions] A brief question-and-answer session will follow the formal presentation. Please note, this event is being recorded.

I would now like to turn the conference over to Arash Soleimani, Executive Vice President at Heritage. Please go ahead.

Arash Soleimani
Executive Vice President

Good morning, and thanks for joining us today. We invite you to visit the Investors section of our website, investors.heritagepci.com, where the earnings release and our earnings call will be archived. These materials are available for replay or review at your convenience.

Today's call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. In our earnings press release and in our SEC filings, we detail material risks that may cause our future results to differ from our expectations. Our statements are as of today, and we have no obligation to update any forward-looking statements we may make. For a description of the forward-looking statements and risks that could cause our results to differ materially from those described in the forward-looking statements, please refer to our annual report on Form 10-K, earnings release and other SEC filings.

With us on the call today are Bruce Lucas, our Chairman and Chief Executive Officer; and Kirk Lusk, our Chief Financial Officer.

I will now turn the call over to Bruce.

Bruce Thomas Lucas
Chairman & CEO

Thank you, Arash. I would like to welcome all of you to our first quarter 2020 earnings call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company. I'd also like to thank all health care workers and other essential personnel for their service during these unprecedented times. The company has had tremendous momentum over the past year. The core components of the company continued to improve, and this improvement accelerated again in the first quarter.

Book value per share is up 9% year-over-year and at a 12% compound annual growth rate since year-end. Top line revenue continues to trend higher and gross premiums written increased 8.9% year-over-year, both new business production and gross premiums written had a new record for the company in the first quarter. Our higher growth rate outside Florida reflects our continued shift to more stable and diversified markets and further solidifies our standing as a premier superregional insurer. At the end of the first quarter, approximately 30% of our consolidated TIV was in Florida, with only 6% of consolidated TIV in the volatile Tri-County region, and I'm unaware of any peer carrier that has this market advantage.

Heritage continues to be unique among peers as evidenced by reporting our seventh consecutive quarter of favorable prior year reserve development. During that same period, our peers have more often reported adverse reserve development. We believe our diversification, solid underwriting and prudent reserving process will continue to drive outperformance.

While COVID-19 remains an issue for the macro economy, the homeowners insurance sector, our core focus, continues to be highly resilient. Our products are essentially a must-have for all homeowners, renters and landlords regardless of economic conditions. We did not see a drop-off in sales in March, and new business sales in April set a new monthly record for the company. There is no guarantee that these trends continue, particularly in an uncertain and volatile macroeconomic environment, but we have weathered the storm incredibly well so far. We do not write business interruption insurance, and we don't have material exposure to other economically sensitive lines of insurance. Given our confidence in the resilience of our business through economic cycles, we took advantage of stock market conditions and aggressively repurchased our shares in the first quarter. We repurchased 766,900 shares at an average price of $10.41, 35.4% below first quarter book value of $16.11. We have every intention of continuing our share repurchase program as long as our share price does not reflect fair value.

I will now turn the call over to Kirk to provide more details on our financials.

Kirk Howard Lusk
Chief Financial Officer

Thank you, Bruce. Good morning. I'd like to echo Bruce's thank you to health care workers, essential personnel, and especially to our employees. All facets of the company are performing well. During this challenging time, our employees have delivered, and we greatly appreciate their flexibility in working remotely and to their dedication to maintaining the high service levels our customers and distribution partners expect. I am very proud of how our employees have stepped up and dealt with the situation.

Net income for the quarter was $7.6 million or $0.27 per diluted share, up from $7 million or $0.24 per diluted share reported during the first quarter of 2019. Of the $0.03 improvement year-over-year, $0.02 was due to increased earnings and $0.01 was due to lower share count. During the first quarter of 2020, we continued our buyback program and repurchased over 766,000 shares at an average price of $10.41, which is 35% below first quarter 2020 book value per share.

Gross premiums written for the quarter were $229.1 million, up $18.8 million or 8.9% year-over-year. At quarter end, we had $958.1 million of gross premiums in-force. Gross premiums earned were up 2.7% year-over-year, reflecting overall gross premiums written growth over the last 12 months. The ceded premium ratio was 46.3% in the first quarter, down 5.7 points year-over-year reflecting an overall reduction to our quota share reinsurance coverage and reinsurance synergies, partially offset by additional XOL coverage.

2020 Q1 net premiums earned were up 14.9%, reflecting higher gross premiums earned and lower ceded premiums just mentioned. The net loss ratio was down 250 basis points to 54.1% for the first quarter of 2020 compared to 56.6% for the first quarter of 2019. The improvement reflects lower attritional and weather net loss ratios and better prior year favorable reserve development, partially offset by lower income from vertically integrated operations. The net expense ratio was 41.1%, up only 40 basis points year-over-year, reflecting a modestly higher G&A ratio.

The net combined ratio for the first quarter of 2020 was 95.2%, which is down from 97.3% in the prior year period. The decrease reflects a decrease in the net loss ratio, partially offset by the increase in the net expense ratio. Interest expense is down slightly, reflecting a decrease in LIBOR rates relative to last year.

Our fixed income investment portfolio has performed well this quarter and benefited by about $2 million of unrealized gains. We believe our conservative investment philosophy provides our portfolio with resilience during volatile economic times.

Shareholders' equity was $449.3 million at the end of the first quarter of 2020. Book value per share increased to $16.11, up 9% year-over-year. Of the $50 million of stock buyback authorized by our Board, in August of 2018, over $25 million remains available. As of March 31, the company had over $20 million of cash in nonregulated companies and also has $40 million available under its revolver.

We are pleased with the results of the first quarter and even more pleased with how the company is positioned for 2020. We are positioned for solid organic growth, rates are continuing to favorably impact the P&L, and our reserve position is strong.
Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question today comes from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Bruce, I was hoping you could give us an update on some of the ex-Florida growth and, in particular, if any color you can give generally on some of the partnerships, which seem to be evolving? And also, you mentioned in the press release going into California on an E&S basis and hopefully -- I'm hoping you could give us some color there in terms of the thought process behind it and the opportunity that you're seeing.

Bruce Thomas Lucas
Chairman & CEO

Absolutely. So ex-Florida is completely leading our growth factor right now. I mean we're out producing outside of Florida by a margin of over 2:1. So that's been the focus of the company, has been underwriting the non-Florida states, and we're licensed in 16 states now. So the focus has really been in the other 15, very, very happy with what we're seeing. The ramp-up in production that we've been building over the past year just keeps getting better and better. I mentioned a couple of quarters ago, I didn't really see anything on the horizon that would stop that growth rate. And so far, the numbers bore that out. We actually started the second quarter with a record month, and a lot of that production was ex-Florida. And didn't just break the monthly record, shattered it. So we're in a good position outside of Florida.

With respect to partnerships, yes, we have national partnerships with some pretty notable auto carriers, but it's our policy and out of respect to them that we don't disclose details about the extent of the business that we're doing together. But I can tell you that those relationships have picked up a lot of steam in the past 6 to 9 months, and we're incredibly happy with them.

With respect to California, this was an opportunity that we've been looking at now for well over a year. It's a very dislocated market in California. There are a lot of areas that simply cannot find coverage. Our philosophy in California is to use surplus lines paper and not go in with an admitted product because of all the rules that are being instituted in California. This gives us some underwriting flexibility. It gives us form and rate flexibility. We are limiting our concentrations in any specific area to X million in TIV per grid. We just launched it. It's picking up a lot of steam now. We've only written a couple of hundred thousand dollars in premium out there, but we're definitely seeing an increase in production quotes. And we think it's a good arbitrage opportunity for us because the rates certainly makes sense along with some of the reinsurance synergies.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then my only other question was just, I know, it's a little early yet, and you're in the midst of discussions, but any thoughts surrounding this year's reinsurance renewal in terms of how you're looking at it?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean it's a fair question. And you're right, we are in the middle of negotiations, so I can't get too far into the weeds, Matt, but I can tell you that the placement has gone really well. We've been in firm order now for about a week and just rounding out the placement. We're pretty comfortable with where we are on a risk-adjusted basis. We've seen the vast majority of our reinsurance partners, actually, increased lines and capacity from other carriers and deploy them on our program, which has really helped us on the placement. We do think it will get done here in the next week or so. And as soon as it's done, we'll put out a press release outlining the terms.

Matthew John Carletti
JMP Securities LLC, Research Division

Congrats on nice start to the year.

Bruce Thomas Lucas
Chairman & CEO

Thanks, Matt.

Operator

[Operator Instructions] Our next question will come from Tom Shimp with Piper Sandler.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Just staying on reinsurance, just had a quick question. There's a lot of talk about rising reinsurance prices in Florida, but is it fair to say that you guys should be less exposed due to where you write in Florida as compared to your peers?

Bruce Thomas Lucas
Chairman & CEO

Absolutely. And yes, it is a hard market this year and rates are moving up. I think everybody knows that, and it was the same kind of last year as well. Where we are differentiated is really 3 areas. First and foremost, only 30%, in fact, just under 30% of our TIV is in Florida. 70% is in 15 other states. That helps us a lot. We also have approximately 6% of our TIV in Tri-County. There isn't a public company in our sector that can boast these types of numbers. So when reinsurers look at the risk profile of all of the Florida cedents, ours really does stand out because it's the most diversified program. It's the less -- lowest concentration in Florida and absolutely the lowest concentration in Tri-County, and that is a very volatile topic of discussion for them when it comes to pricing. I'd say the third thing that really helps us out a lot is that our ceded losses are just a lot lower than our peer group.

Our business plan has been to balance Southeast area with inland growth versus coastal to have a bit of a hedge against the coastal exposures that we have in Florida. And so that really applies to the Gulf Coast and the Southeast Coast in the Carolinas and Georgia. And as a result, if you look at events like Hurricane Michael, we have one of the lowest ceded losses of anybody in the state. It's just into the first layer of reinsurance. So this is not a huge loss. And on Hurricane Florence, our -- I think our loss there is roughly $30 million with IBNR. And that's not even in the first layer of reinsurance. So lower ceded losses, better diversification and lower Tri-County risk is definitely working in our favor. And we see it in terms of the increased capacity that we're getting out of our reinsurance partners. And we do think, once again, this year, we're going to fare better than the rest of the market.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay. Great. And then for Hurricane Irma, are you guys seeing any ramp-up in the amount of claims filed as we get closer to the 3-year anniversary?

Bruce Thomas Lucas
Chairman & CEO

No. If that claims -- claims, in general, across our footprint are down.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay. And then shifting to COVID-19. Is there anything you're seeing in the -- on the impact on the legal environment in Florida, as such that it's possible that the lawyers are shifting their focus away from homeowners insurance?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean that's a good question. I mean there's going to be a lot of COVID-related lawsuits that come out of Florida without a question. And it's really going to be a lot of business interruption policies is what we think is most at risk. Hard to say if that's going to cause a shift in the next 6 to 9 months or so or 12 months into those areas versus just doing regular property claims. But it's something that I think you're going to see a lot of -- no, we're pretty confident that we just don't have exposures here. We don't write BI as a stand-alone policy. So we know it's not a covered peril with us, and we're not concerned about it.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

Okay. Great. And then my last question, just on the favorable development, it was quite strong in the first quarter. Can you provide more color there and what accident years had the development? And what factors were driving that?

Kirk Howard Lusk
Chief Financial Officer

Yes. That was predominantly 2018 and 2019 was where the favorable development occurred. We did have a little bit of adverse in '17. But again, '18 and '19 were so strong. And that's when we did kind of like the reserve review study, was in '18 and kind of looked at our reserves there. But that's really the bulk of it is those 2 years. And when we look at it, there is a little bit in the Northeast portfolio, probably about 1/4 of that development is in the Northeast and the rest of it is actually in the Southeast portfolio.

Bruce Thomas Lucas
Chairman & CEO

And I'd like to note as well, Tom, and I'm glad you raised that. We are known for being very conservative on our IBNR picks. And you see it 7 consecutive favorable quarters in a row. There isn't anyone in Florida that can say anything remotely close to that. We are more conservative. We maybe have overshot it a little bit. If you look at 7 straight quarters of favorable, that would probably bear that out. But despite the favorability in our development, we are still booked well above the midpoint of our range. And it's important for investors to understand that we still have a lot of conservative loss picks in our IBNR numbers right now and, at least, looking at the trends today, we're pretty optimistic on where we stand in terms of reserve development going forward.

Thomas Henry Shimp
Piper Sandler & Co., Research Division

All right. Great. Congrats on the strong first quarter.

Bruce Thomas Lucas
Chairman & CEO

Thank you, Tom.

Operator

Our next question comes from Bill Broomall with Dowling & Partners.

William Harry Broomall
Dowling & Partners Securities, LLC

Just to follow-up on that last question on development. Was the favorable development, was that for cash or non-cash?

Bruce Thomas Lucas
Chairman & CEO

Well, it's our attritional losses, and that would include some of the mini-caps that we've had, I'm sure that there was some of that baked in there, too, whether it's a hail event or a tornado event or winter storm event. So you say cat is pretty broad, but this would be just normal attritional losses.

William Harry Broomall
Dowling & Partners Securities, LLC

Perfect. Okay. And then going back to Matt's question on California. Just so to get a little more understanding. Are you growing in certain parts of the state? And how does your reinsurance work with providing protection, because there's a different risk profile of California versus some other states that you're in?

Bruce Thomas Lucas
Chairman & CEO

Yes. Really good question, Bill. And we are growing everywhere in California. There is not one particular area of concentration for us. We're writing business in Southern California and urban areas that have 0 wildfire exposure. We're writing up some policies in the [woobie], the interface that we see out there between wildlife and urban areas. It's really a good spread of premium. We've done a few high-value policies that are in Los Angeles, that are really not fire-exposed at all. It's just a hodgepodge. There is no one particular area that we're looking at. First and foremost for us is just limiting our concentration in any one geographic area. And so we're using a pretty thorough daily underwriting metric as we look at new business applications coming in to make sure that we avoid concentration of risk in any particular pocket. That was the problem that plagued a lot of the California writers in 2017 and '18.

With respect to reinsurance, we have had very robust discussions with our reinsurers in advance of launching the product. We have reinsurance in place, both per risk, facultative, XOL. It's a fully reinsured portfolio. And there are some retentions associated with California, just like there are with hurricane retentions on the East Coast. But the retentions are pretty modest. And given the spread of risk, it's unlikely at this point in time that we would go anywhere near a full retention event. We just don't have the exposures, and we don't have the concentration risk.

William Harry Broomall
Dowling & Partners Securities, LLC

Got it. And how has the reception been with the agents in California? Are they looking for more paper?

Bruce Thomas Lucas
Chairman & CEO

Yes. It's been strong out there, Bill, because you've got a lot of the primary writers that just are not open for new business throughout the state. And what we have found when we were doing our due diligence, and we probably talked to couple of hundred agents. There are areas that are not wildfire exposed at all that have capacity problems. And the reason for that is there are plenty of primary carriers out in California that are just derisking concentration loads everywhere. And so that makes it pretty tough for the agents to place the capacity, and that's why the fair plan out there is growing so robustly. That exposure is going into the fair plan, but that's a kind of a water down policy. It doesn't really cover everything. The commission structure is not favorable to the agents. They do not want to put their clients in the fair plan. So markets such as Heritage coming in on an E&S basis. I'd note that PURE and some others are out there as well, writing on an E&S basis. So the response from the agents has been incredibly strong and growing. And the request for appointments are, frankly, more than we can handle at this time. We want to do this in a measured way, where we roll out our select agents in the sequence and start to build our footprint in the California market. But I'm pretty happy with the response that we've gotten thus far.

William Harry Broomall
Dowling & Partners Securities, LLC

Got it. Perfect. And then just switching back to Florida. We've heard from a macro level, for others, it could be a challenging renewal just maybe given some changes in capacity. How do you think about positioning Heritage given what could possibly happen for others in the market? Is there an opportunity to grow? Is there an opportunity to -- maybe, to take books of business? Just any thoughts that you might have.

Bruce Thomas Lucas
Chairman & CEO

Yes. Bill, I mean, we're positioned a lot differently than the Florida writers, the traditional Florida writers, simply because of the lack of Florida and Tri-County concentration. And so ours is a radically different program from the other carriers. That helps us a lot. But I hear your point. And it kind of comes down to things that I've been saying over the past year that I believe that there are some companies that will write for insolvency. Certainly, I wouldn't name them, but I think everybody in this business knows who they are. And if rates go up in a pretty meaningful way with respect to their program this year, I really question how some of these carriers can even pay for it. And we already saw 2 companies go out of business, one in the fourth quarter, one in the first quarter in Florida, and those reinsurers did not get paid their installment premiums. There's real credit risk on some of these guys and the reinsurers know it, they're going to surcharge them. And that makes their market even that more difficult. So while I do think that there are some underlying issues in Florida with respect to getting your tower place and getting at the right price, I can tell you that because of our size, scale, diversification, lower ceded losses and strong relationships that we're going to get our program placed without a problem, and firm order is filling up pretty nicely right now. So we feel like we're in a really good spot.

But we will look at some of these companies to answer your question that do find themselves in an insolvency situation. But it's got to be a really, really strong fit for us, and it's got to be policies that make sense for us. We've done an excellent job, kind of, cleaning up the Florida portfolio, while everybody else kind of just wrote business as usual. We're not looking to reload and undo all the hard work that we've put in for the past 4 years. But if there is a good strategic opportunity in the policy premium, location makes sense, then we'll certainly take a look at it.

William Harry Broomall
Dowling & Partners Securities, LLC

Does the recent change to your credit agreement help facilitate that?

Bruce Thomas Lucas
Chairman & CEO

Yes. It helps us to use those funds for both M&A opportunities and in Osprey, which is our captive reinsurer.

William Harry Broomall
Dowling & Partners Securities, LLC

Got it. So you can use the credit facility for Osprey?

Bruce Thomas Lucas
Chairman & CEO

Yes.

William Harry Broomall
Dowling & Partners Securities, LLC

Okay. And one last one, and then I am done is any change -- you talked about Michael and Florence, but did you mention Irma and any change in your ultimate pick?

Bruce Thomas Lucas
Chairman & CEO

No, Irma has really not changed at all. I mean, we're still getting some new claims in, and your incurs go up a little. But all in all, it's been pretty stable.

Operator

Our next question comes from Mark Hughes with SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

I'm sorry, I missed the early part of the call, but the California business, is there any appreciable fraud in the state?

Bruce Thomas Lucas
Chairman & CEO

Yes. There are some pockets that are known for water fraud, similar to what you see in Tri-County. We just don't underwrite those pockets.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then what did you say about the impact on ceded premium ratio and acquisition costs on the margin as you grow in California?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean, the agent commission out there is pretty standard. It's 15%, 15%, which is what we're essentially paying in every state except Florida. It's a pretty low acquisition cost for us. It's a lot cheaper than buying business or buying a going concern. And we're -- we have the benefit mark of pricing out the premium where we know that we're making a good expected margin on these policies. So that's the real benefit of E&S. We can move our rate up and down depending on the risk and profile and the underwriting characteristics of the home.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And did you say you get a better combined ratio return in California or more in line with your book of business?

Bruce Thomas Lucas
Chairman & CEO

Definitely better.

Operator

This concludes our question-and-answer session. I would like to turn the call back over to Bruce Lucas for any closing remarks.

Bruce Thomas Lucas
Chairman & CEO

I'd like to thank, everyone, for participating in our first quarter conference call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.