S&P Capital IQ

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Heritage Insurance Holdings, Inc. NYSE:HRTG

FQ1 2017 Earnings Call Transcripts

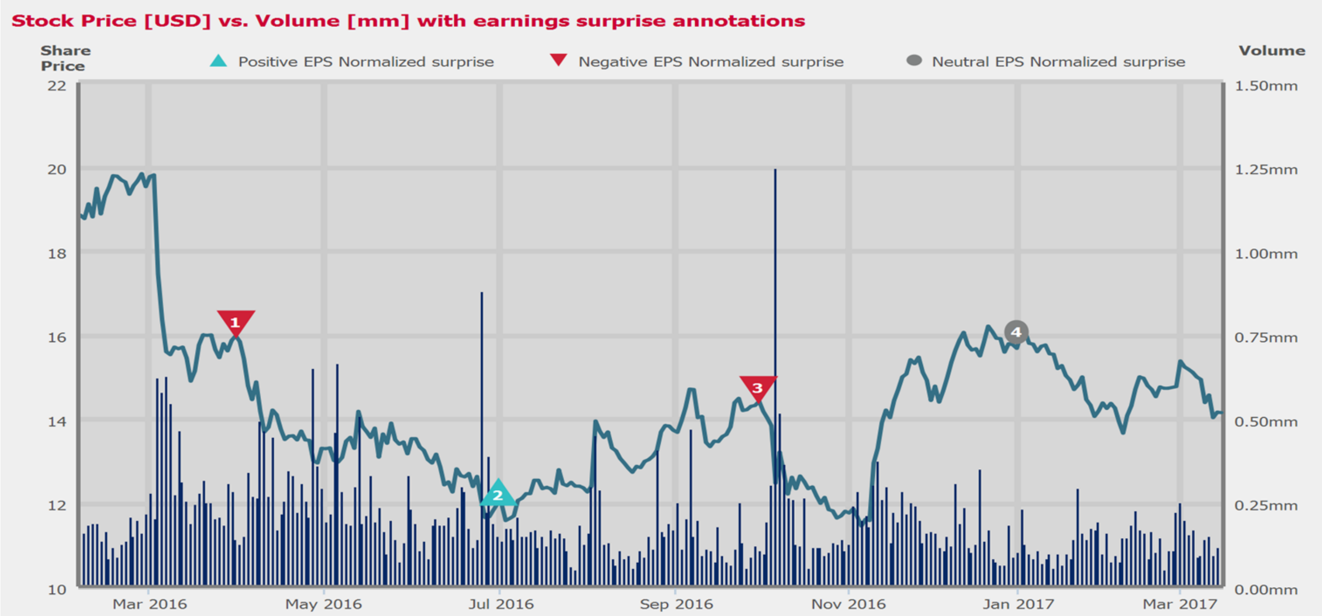
Thursday, May 04, 2017 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.18	0.21	16.67	0.30	1.27	1.95
Revenue (mm)	103.46	99.29	(4.04 %)	104.72	417.07	427.01

Currency: USD

Consensus as of Apr-23-2017 11:40 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	0.45	0.24	(46.67 %)
FQ2 2016	0.55	0.62	12.73 %
FQ3 2016	0.38	0.37	(2.63 %)
FQ4 2016	(0.22)	(0.09)	NM

Call Participants

EXECUTIVES

Bruce Lucas
Chairman of the Board & CEO

Melanie Skijus

Steven Martindale
Chief Financial Officer

ANALYSTS

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

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

Matthew John Carletti
JMP Securities LLC, Research Division

Presentation

Operator

Good morning, everyone, and welcome to Heritage Insurance Holdings First Quarter 2017 Financial Results Conference Call. My name is William, and I will be the operator today. [Operator Instructions] Please note that this event is being recorded.

And I would now like to turn the conference over to Melanie Skijus. Please go ahead.

Melanie Skijus

Good morning. The first quarter earnings release can be found in the Investor section of heritagepci.com. The earnings call will be archived and available for replay. Today's call may contain forward-looking statements. These statements, which speak only as of today and which we undertake no obligation to update, represent our current judgment and are subject to risks, assumptions and uncertainties. For a description of the 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 and other filings made with the SEC.

With us on the call today are Bruce Lucas, Chairman and CEO; Steve Martindale, Chief Financial Officer; and Steve Rohde, financial consultant to the company.

I will now turn the call over to Bruce.

Bruce Lucas
Chairman of the Board & CEO

Thank you, Melanie. I would like to welcome all of you to our first quarter 2017 earnings call.

Before we begin the call, I'd like to thank all of our employees for their dedication to our company. The first quarter was a great start to the year, and we experienced significant improvements in several key metrics. Claims and loss ratios continued to trend favorably, and year-over-year, our loss ratio improved 13.9 points. We previously provided some loss ratio guidance for the first quarter, and I'm pleased to report that we substantially beat our projections and ended the quarter with a 30.2% loss ratio.

The Tri-County continues to lead Florida in assignment of benefits and other abusive claims practices. We implemented new underwriting initiatives a year ago, and we are beginning to see the positive results of those actions. Notably, our Tri-County claims dropped substantially in the quarter, resulting in a 30% reduction in Tri-County claims year-over-year. This trend is very encouraging and helps to improve our underwriting profit while decreasing costly AOB claims.

We have also initiated 2 rate increases that are targeted toward the Tri-County. Initial results have been quite encouraging. Although we have had a slight decrease in retention in the Tri-County, average premium per policy in those counties is increasing, and claims are down considerably. These results are helping to improve our loss ratio while making the company a more attractive risk for reinsurers.

On that topic, I'd like to point out that the company is nearly finished with the 2017 reinsurance treaty. We will not comment on the final terms until the placement is finished, but we are expecting additional reinsurance savings beginning on June 1.

On the production side, our voluntary production continues to grow. Voluntary policies written in the first quarter set a new record for the company. We continued to grow new business in Florida, and production in the Carolinas and Georgia is ramping higher. All in all, we are off to a great start in 2017.

Some notable highlights for the first quarter are as follows: Gross premiums earned increased 2% for the first quarter 2017 as compared to the first quarter of 2016; our loss ratio improved 13.9 points in the first quarter 2017 as compared to the first quarter 2016; net income of $6 million for the quarter; book value per share increased 6% to $12.67 when compared to the first quarter 2016; shareholders' equity was

$361 million at March 31, 2017; capital returned to stockholders via a dividend of $0.06 a share; and we repurchased 361,211 shares for a total of $4.5 million during the quarter.

I will now turn the call over to Steve to provide more detail on our financials.

Steven Martindale
Chief Financial Officer

Thank you, Bruce. Good morning. Gross premiums written for the first quarter of 2017 were $142.2 million, down 3% compared to a year ago. Direct premiums written for the quarter were $142.3 million, up 4.2% compared to the first quarter of 2016. Assumed premiums written for the quarter were minus $54,000 compared to $9.1 million a year ago. Approximately 13% of gross premiums were written outside of Florida, with 10% coming from Hawaii and 3% from the Carolinas and Georgia.

For the quarter, we wrote approximately 24% of our direct new business premiums in the Carolinas and Georgia and approximately 2% in Hawaii. Our total policy count at March 31, 2017, was approximately 321,200, our personal lines policy count was approximately 316,500 and our commercial residential count was 3,555. Personal lines policy counts by state were approximately 233,000 in Florida; 73,300 in Hawaii; and 10,200 in the Carolinas and Georgia. All commercial residential policies were written in Florida.

Gross premiums earned for the first quarter were $154.6 million compared to $151.9 million a year ago. First quarter 2017 gross premiums earned included a full quarter of Zephyr business, which was approximately $12.8 million higher than a year ago. The first quarter 2016 gross premiums earned included only 10 days of Zephyr business as the acquisition closed on March 21, 2016. Offsetting this increase was a reduction in gross premiums earned resulting from pricing and underwriting actions we've taken, primarily in the Tri-County area.

Our ceded premium ratio, as measured against gross premiums earned, was 40.3% for the first quarter of 2017 compared to 30% for the first quarter of 2016. Approximately 2.5 percentage points of the increase was due to a change in our business mix to include more commercial residential business and wind-only personal residential business, each of which has a higher catastrophe reinsurance cost. The ceded premium ratio for the first quarter of 2016 was 5.8 percentage points lower due to the benefits of assuming policies from Citizens during the fourth quarter of 2015 and the first quarter of 2016. The first quarter of 2017 ceded premium ratio was approximately 2 percentage points higher due to the decline in our gross premiums earned noted previously.

Our loss ratio, as measured against gross premiums earned, was 30.2% for the first quarter of 2017 compared to 44.1% for the first quarter of 2016. The loss ratio for weather claims for the first quarter of 2017 improved by 4.4 points compared to a year ago. In addition, claims reported in the Tri-County region were down 30% for the quarter compared to the first quarter of 2016.

Our operating expense, which excludes interest expense as a percentage of gross premiums earned, was 26.4% for the first quarter of 2017 compared to 21.4% for the first quarter of 2016. We recorded no benefit to the expense ratio in the first quarter of 2017 related to the assumption of policies from Citizens, where there are no acquisition expenses associated with the premium, compared to a 2.3% benefit to the expense ratio a year ago. In addition, the first quarter 2017 expense ratio included 1.6 points for the amortization of intangible assets associated with the purchase of Zephyr.

Our combined ratio as a percentage of gross premiums earned was 96.9% for the first quarter of 2017 compared to 95.5% for the first quarter of 2016. For the quarter, our improved loss ratio offset most of the increases in the ceded premium and expense ratios as compared to a year ago.

Net income for the first quarter of 2017 was $6 million compared to $7.4 million for the first quarter of 2016. In addition to the changes noted previously in our ceded premium and loss expense ratios, interest and the amortization of issuance costs totaling $2.2 million associated with our senior notes issued in December of 2016 accounted for the change in net income for the quarter compared to a year ago.

On the balance sheet side, stockholders' equity stood at $360.8 million at March 31, 2017, compared to $358 million at December 31, 2016. We repurchased shares of our common stock totaling $4.5 million during the quarter, and declared dividends of $1.8 million. Invested assets stood at $605.8 million in March 31, of which $572.9 million was invested in fixed maturity securities with an average credit quality of AA and an average duration of 3.5 years. Our cash position was $104.7 million, and our total assets stood at $955 million at March 31.

With that, Bruce and I are available to take your questions.

Question and Answer

Operator

[Operator Instructions] And it looks like our first questioner today will be Matthew Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

A couple quick questions. First one, just on the claims side. Bruce, I appreciate your comments and glad to hear that you're seeing claims in Tri-County slow down quite a bit. But I was hoping you could help me kind of triangulate a few numbers and just understand what's going on. So claims are down, we see your reserves down about 6% sequentially. But at least in the public data, it looks like, not just for you, but for everybody, lawsuits remain at pretty elevated levels each month and the new lawsuits coming in. So are you closing kind of the older claims at a pretty good clip and it's outpacing kind of the new lawsuits that come in? Because I'd imagine those are bigger claims than non-attorney represented claims. Could you just help me through kind of the moving pieces there?

Bruce Lucas
Chairman of the Board & CEO

Sure. Yes, I mean, reserves are down slightly but the number of open claims is down at a much higher percentage. One thing that we've been doing is closing out claims faster fourth quarter and first quarter, moving out some old inventory. So our opens are down much more than any reduction in reserves. And as I look at reserves, I mean, just kind of comparing it to some of the other Florida publicly traded companies, I don't think anybody has more loss reserves than us, at least as of last quarter. So we have, I think -- our best estimate on reserves is, I would say, on the conservative end. And you could definitely see that just by comparing our loss reserves to the other publicly traded peer group. And with respect to the number of open lawsuits out there, it really hasn't been accelerating, I wouldn't say. It's been kind of steady. We've had months where it's really dropped down and some months where it went up. But I would say overall, I think we're trending lower. The number of open lawsuits that we have right now really isn't that much different than where it was about a year ago. We have right now about 8 in-house attorneys, so we're handling a lot of these lawsuits ourselves to keep LAE low. I do see the trend is shifting in our direction quite favorably. Anytime you can see a reduction in Tri-County claims year-over-year, like we've had, while still having a pretty high retention on the policies, that's impressive. And I could tell you just from fourth quarter to first quarter, the number of Tri-County claims was down about 20%, right? So we're definitely trending in a very favorable direction here.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, great. That's helpful. And then one quick numbers question, if I could, just on the expense ratio. It popped up a few points in the quarter as, I think -- is that -- are we at a reasonable kind of run rate going forward? Or are there anything in the either policy acquisition costs or general expenses in the quarter that deserves calling out that might be more one time?

Steven Martindale
Chief Financial Officer

This is Steve. Right, we had the amortization of some of the acquisition costs from Zephyr, which will come down about 1.2 points going forward. So we completed the amortization of our VOBA.

Operator

And our next questioner today will be Mark Hughes with SunTrust.

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

Bruce, I wonder if you could comment on any broader initiatives in Florida. Anything in the legislature, anything out of the OIR that might lead to some progress on the AOB issues?

Bruce Lucas
Chairman of the Board & CEO

Yes. I don't think you're going to see anything out of the legislature. Obviously, the House passed their version of AOB reform. There's just too many trial attorneys in the Senate. I just don't see why they're going to end the fraud. There's just no way that's going to happen. I mean, that's how a lot of these guys are making the money. I've been saying it for over a year now, it's not really an AOB issue as much as it is a trial attorney issue. So I don't really envision any legislative support here as session is winding down. I don't even think they're going to hear the bill that the House passed at all. And The Wall Street Journal's been commenting on this quite a bit lately, so there's some really good articles out there on the topic. I do have a lot of optimism that the Office of Insurance Regulation is going to take a more active role in helping consumers to fight this AOB fraud issue. I don't speak for them. I'm not going to say with certainty that something will or won't happen. However, I can tell you that they really have 2 choices, and this is common knowledge. Choice one, let's just run up insurance rates on homeowners in perpetuity, and all the innocent actors who have done nothing wrong are going to pay the bill for people who are cheating the system. Or option two, you can start to put some, let's just say, some additional language in the policies that will help to go a long way to curbing the fraud abuse. And I think that the OIR and Commissioner Altmaier, they're really looking at all the options right now to try to help consumers. And the best way to help them is to take action to prevent the fraud from taking place, and that keeps rates low on everybody. And so I am quite optimistic that we could see some real reform coming down the pipe.

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

Right. Your voluntary -- I don't know whether you shared specific voluntary production numbers. If you have those available, I'd be interested to hear them. And then, do you think there's any competitive help from some of the capital discussion earlier in the year, that Demotech was wanting the people to a have more solid balance sheet? Do you think that helped your voluntary production at all?

Bruce Lucas
Chairman of the Board & CEO

Yes, I do. I -- so to answer the first part of your question, the total voluntary production in the quarter was about $17.2 million in premium. So we have definitely seen increasing production in terms of our policy count. And I think that a lot of that -- well, some of that has to do with part B of your question, which is Demotech kind of calling out some solvency issues from some of these kind of lower-capitalized companies in Florida. It spooked a lot of agents. We had a lot of agents contact us for book roll opportunities. They're worried about their errors and omission policy if somebody goes insolvent, especially as we approach wind season. And I think there's more of a flight to quality in the market right now. Why put your client with somebody who's 10% cheaper and has $15 million of surplus and $75 million of written, and they haven't had an underwriting profit in 5 years. That's a risky proposition for agents. I think what Demotech did, rightfully so, was just to call out some of these issues, highlight concerns. And I think that has helped to get through to agents so that they can start putting business with more quality companies with high levels of surplus. And I look at our surplus level now, on a consolidated basis, we're #2, and that's the last publicly available information I have is that we had the second highest consolidated surplus of any of the Florida domestics. And we definitely highlight our financial solvency, and I think agents are beginning to recognize that.

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

And on that capital topic, any thoughts on capital management, share buyback, upping dividend? How are you looking at that?

Bruce Lucas
Chairman of the Board & CEO

Yes. I mean, listen, I have been putting my money where my mouth is. And I firmly believe our share prices is just ridiculously cheap. And we are going to be active buyers at these levels. This is -- that's no secret. I've been telegraphing that for a while. Me, personally, I've bought about $700,000 worth of stock over the past year, continuing to add to my position. I bought $200,000 worth last quarter. I just view it as a good opportunity. So I view it that way personally. I think the company views it that way. And we're going to continue to use our dollars to buy back stock when the stock is, in our opinion, significantly undervalued.

Operator

[Operator Instructions] And our next questioner today is Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So I wanted to ask the -- I think you had mentioned essentially last quarter or the quarter before that you were offering discounts on homes over 40 for -- in order to cap the water losses at $10,000. I was just curious if you're seeing that have a beneficial impact on your loss ratio.

Bruce Lucas
Chairman of the Board & CEO

It's starting to trickle in. We started the water per occurrence cap at $10,000 on the HO3 takeout book, and that went effective 12/15. So as policies roll onto that new policy form and then submit a claim, you're going to see the -- that's where you're really going to see the improvement. You got to remember our numbers right now are through March 31. So to the extent that, yes, we've had policies renew on that book after 12/15 and submitted a claim, yes, it has been a helper for the loss ratio. But it's pretty minor at this point. You got to give it the full year to earn out. And we have the same exclusion on the voluntary book, and that starts for new business, 5/15 and renewal business 6/1. So there is an additional impact coming down the pipe as well, which we think will be quite beneficial. About 35% to 40% of our takeout HO3 portfolio is plus 40 years, right? So we really should see a good impact on it as we move forward.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, great. And I was wondering if you could provide an update on commercial residential. Are you seeing more competition there? Or does it look pretty steady? What does the pricing environment look there? Just any help that you can provide on that front.

Bruce Lucas
Chairman of the Board & CEO

Yes. I do think the admitted carriers are feeling a little bit of a squeeze there. We definitely were down a little bit on premium written just -- it what was all really commercial residential because voluntary is accelerating. The Department of Financial Services thought it would be a really smart decision to allow unregulated out-of-state companies to come in and take anything they want. And it violates the statute that's in place in Florida. We have a new CFO coming in. I think that he's going to be -- hopefully, going to be more concerned about protecting Florida companies and Florida jobs. And I do think that this kind trend is going to, in all likelihood, reverse itself. If not, I'm sure there'll be legal action on it. But it is creating a little bit of softness in the market, nothing devastating, but it's a little soft. But I do think that, that trend will reverse second half of the year.

Operator

[Operator Instructions] There look to be no further questions, so this will conclude the Q&A session. I would like to turn the conference back to management for any closing remarks.

Bruce Lucas
Chairman of the Board & CEO

Right. Thank you to everyone for participating in our first quarter earnings call.

Operator

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