S&P Capital IQ

CONTENTS

Heritage Insurance Holdings, Inc. NYSE:HRTG

FQ2 2015 Earnings Call Transcripts

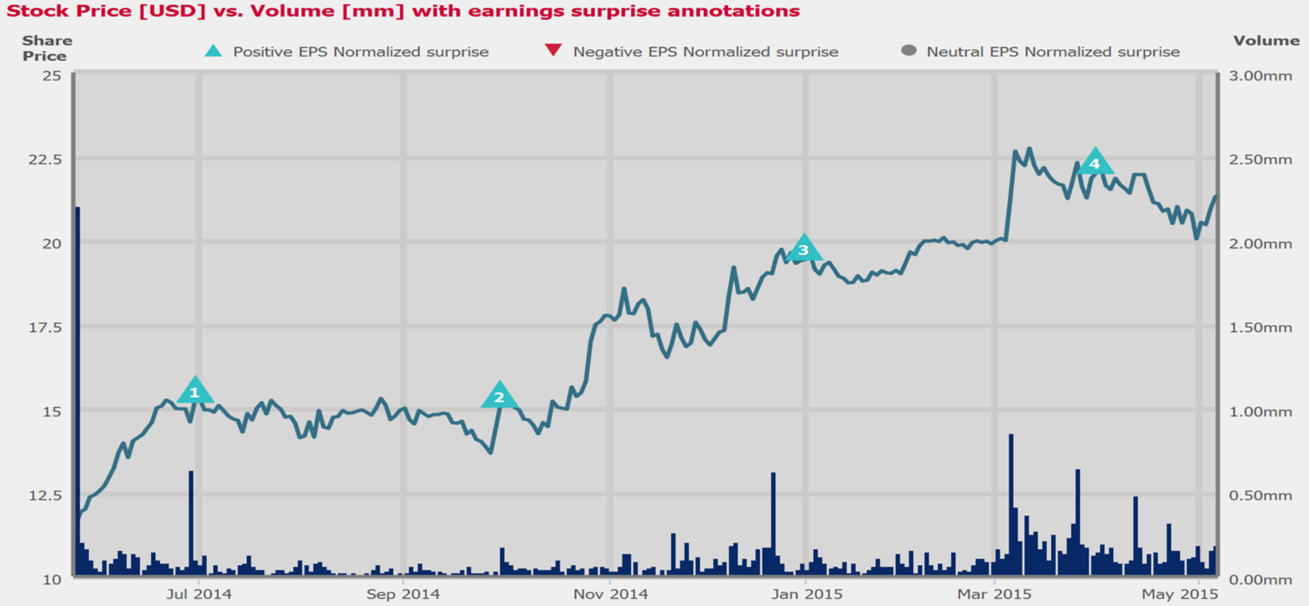
Thursday, August 06, 2015 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2015-			-FQ3 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.82	0.84	▲2.44	0.50	2.99	3.20
Revenue (mm)	103.83	99.09	▼(4.57 %)	96.61	407.98	447.68

Currency: USD

Consensus as of Aug-06-2015 4:10 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2014	0.32	0.39	▲1 21.88 %
FQ3 2014	0.27	0.33	▲2 22.22 %
FQ4 2014	0.43	0.66	▲3 53.49 %
FQ1 2015	0.78	1.00	▲4 28.21 %

Call Participants

EXECUTIVES

Bruce Lucas
Chairman of the Board & CEO

Stephen L. Rohde
Advisory

ANALYSTS

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

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John Bakewell Barnidge
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Matthew John Carletti
JMP Securities LLC, Research Division

Matya Rothenberg
SunTrust Robinson Humphrey, Inc., Research Division

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings Second Quarter 2015 Financial Results Conference Call. My name is Alison, and I will be the operator today. [Operator Instructions] As a reminder, this event is being recorded.

The matters discussed on this call that are forward-looking statements are based on current management expectations involving risks and uncertainties that may result in these expectations not being realized. Actual events, outcomes and results may differ materially from what is expressed or forecasted in forward-looking statements made on this call, due to numerous risks and uncertainties, included, but not limited to, the risks and uncertainties described in this conference call, the press release issued yesterday and other filings made by the company with the Securities and Exchange Commission from time to time. Forward-looking statements made during this presentation speak only as of the date on which they are made, and Heritage Insurance Holdings specifically disclaims any obligation to update or revise any forward-looking statements to reflect new information, future events or circumstances or otherwise.

Now at this time, I would like to turn the conference over to Mr. Bruce Lucas, Chairman and Chief Executive Officer of Heritage Insurance Holdings. Please go ahead, sir.

Bruce Lucas
Chairman of the Board & CEO

Thank you, and good morning to everyone joining us for the call. This is Bruce Lucas, Chairman and CEO of Heritage Insurance, and with me is Steve Rohde, our CFO. I would like to welcome all of you to our second quarter earnings call. Before we begin the discussion of our quarter, I would like to take a moment to thank all of our employees for their commitment to our company.

We had another great quarter, in which we earned net operating income of $25.4 million. We have a strong business plan, and our quarterly earnings results reflect our ability to execute on that plan and once again, outperform expectations. From a financial perspective, the quarter was solid. Our gross premiums written were strong. Our voluntary personal lines premium in force grew by 67% [ph] year-over-year, and our voluntary commercial residential production outpaced our expectations.

While we continue to assume policies from Citizens, our opt-out rates have been much higher when compared to historical takeouts, and we believe that future takeouts from Citizens will be more challenging and smaller in scale. Citizens recently filed for a rate increase, which will likely make more policies eligible under our underwriting guidelines. But it is too early to determine the impact this proposed rate increase will have on our policy selection process.

Regardless of dynamics within Citizens, we continue to have tremendous success in growing the company, as evidenced by a 37% increase in gross premiums written as compared to the second quarter of 2014; a 114% increase in net premiums earned as compared to the second quarter of 2014; a 30% increase in policy count compared to the second quarter of 2014; net income of $25.4 million, which is an increase of 166% compared to the second quarter of 2014. Our combined ratio was 71.1% for the quarter. Shareholders' equity increased 41% compared to the second quarter of 2014, and our return on average equity was 33.9% for the quarter.

In closing, I would like to talk about the acquisition that we announced earlier this week that I'm particularly excited about. BRC Restoration Specialists, a full-service general contractor with operations throughout Florida, is our third M&A transaction and helps to fill a vital niche for our company. BRC is a large-scale contractor that currently services several property and casualty insurers in Florida and understands our business. BRC will enable us to perform all facets of repair, including those related to fire, mold and roofing, and they will bolster our water mitigation division by adding additional personnel and resources. The acquisition will provide better customer service by allowing our in-house contractor to work directly with the insurer to repair their home with professionalism and expediency. This will help

Heritage control claim expenditures by performing the repair and reconstruction work at the appropriate price without having to pay the profit margin charged by outside vendors.

We send millions of dollars through Contractors' Alliance Network every year, and we will be able to service these claims immediately. As part of the transaction, we are reorganizing Contractors' Alliance Network to include the first notice of loss, water mitigation and construction services, so that all of these professionals can better work together.

Additionally, BRC's resources will be particularly helpful after a hurricane, as the company can immediately respond to catastrophe claims, which should help to better serve our policyholders and control claim expenditures. The company has named John Crist as the President of Contractors' Alliance Network to lead this exciting and innovative component of the company. And I believe that John's experience and leadership will prove invaluable in the years to come.

Now for more on the financial results, I will turn the call over to Steve Rohde, our Chief Financial Officer. Steve?

Stephen L. Rohde
Advisory

Thank you, Bruce, and good morning. Gross premiums written for the second quarter were $135.6 million, up 37% year-over-year, resulting from $134.8 million of direct premiums written and $0.8 million of assumed premiums written.

There are a few factors that impacted premiums written for the quarter. First, the opt-out rate for our personal residential assumptions from Citizens in April and May were higher than we have historically seen. The higher opt-out rates we've experienced recently began in February and appeared more reflective of the current environment. This translated into an 80% opt-out rate in the second quarter compared to an average of approximately 46% in 2014.

A second contributing factor was our choice not to do a June takeout due to the economics of how the FHCF premium is calculated. As a result of these first 2 factors, personal residential policies assumed in the second quarter were approximately 3,400 policies.

Also playing a role was our commercial business, where we chose not to select any commercial policies during the second quarter, while receiving notification from Citizens that we had some midterm cancellation of policies assumed during the first quarter 2015 and the fourth quarter of 2014. This resulted in $2.3 million of unearned premium being returned and accounted for in our financials as negative premiums written in the second quarter.

Finally, our nonrenewal activity and commercial takeout policies during the quarter was higher than normal due to the exposure management that we did as well as competitive pressures in the commercial marketplace. The market has softened since we selected our commercial policies in the fourth quarter of 2014 and the first quarter of 2015. As a result, we identified portions of that business that were no longer attractive at rates being offered by our competitors to our long-term profitability goals. It is important to remember that these policies provided significant profits for us the past 3 quarters, and we expect that the policies that we are retaining will continue to contribute to profits going forward.

Our personal residential policy count increased during the quarter to 219,200 policies, an increase of approximately 2,000 policies from March 31 of 2015. Our voluntary personal lines policies increased by almost 4,900 policies during the quarter.

During the quarter, we completed the first anniversary of our Sunshine State Insurance Company policy acquisition. One year later, we have retained approximately 82.4% of the policies we acquired, ahead of expectations.

Our total premiums in force at June 30, 2015, were $510.2 million, an increase of 61% over June 30, 2014, and a 4% reduction from March 31, 2015, as a result of the exposure management that took place in commercial lines and a modest second quarter Citizen takeouts. This in-force premium result in $127.1

million of gross premiums earned compared to $64.1 million for the second quarter of 2014. The increase in gross premiums earned was a significant contributor to our growth in net income when compared to the previous year.

Additionally, our results were again favorably impacted by significant lower reinsurance cost as measured against gross premiums earned. As a reminder, our reinsurance treaties renew on June 1 and run through May 31. Ceded premiums earned in April and May relate to the reinsurance treaty that was put in place the previous June. Our ceded premium ratio was 25.4% for the second quarter of 2015 compared to 30.9% for the second quarter of 2014. The reasons for the decrease in the first 2 months of the quarter were twofold: first, last year's favorable reinsurance market conditions and the lower cost of reinsurance associated with the issuance of $200 million of catastrophe bonds by Citrus Re as well as the improved geographic spread of risk resulting from the SSIC policy acquisition; second, our fourth quarter of 2014 and first quarter of 2015 Citizens takeout activity had a positive impact on the ceded premium ratio. These takeouts increased gross premiums earned for April and May without a corresponding increase in ceded premiums. The ceded premium ratio for the month of June of 2015 was approximately 34.9% compared to 33.5% for June of 2014 following renewal of the reinsurance program.

On June 1, 2015, we renewed our reinsurance program, which now provides $1.8 billion of coverage for a cost of approximately $177 million. Included in this cost is reinstatement premium protection, which will provide approximately $440 million of reinstatement coverage. A total of $477.5 million of coverage was provided through catastrophe bonds; approximately $690 million through the Florida Hurricane Catastrophe Fund; $566 million through private reinsurance; and a $35 million retention shared by our insurance subsidiary, HPCIC, and Osprey, our captive reinsurance company. Our retention is split $15 million to HPCIC and $20 million to Osprey. In addition to its $20 million retention at the bottom of that program, Osprey has a $5 million retention alongside the FHCF to fill a small gap between the 2 CAT bonds we placed alongside the FHCF. The cost of the program, as measured against in-force premium at June 30, is 34.7%. This year's program costs were in line with expectations, considering the inclusion of the commercial residential book of business, which did not exist last June. And on a risk-adjusted basis, the costs were modestly down from last year.

Our loss ratio as measured against gross premiums earned was 26.7% for the quarter compared to 30% for the second quarter of 2014 due to the continued benefit of our commercial residential business, as this line of business historically for the industry has had a very low non-catastrophe loss ratio. Our experience to date has been excellent. Through 3 quarters, our reported loss ratio for commercial residential is in the low single digits.

During the quarter, we increased IBNR by $5.2 million to $39.5 million. IBNR represented approximately 56% of our total loss reserves at June 30, a level consistent with previous quarters and accounted for 4.1 points of the loss ratio.

Our expense ratio as a percentage of gross earned premiums was 19% for the quarter, the same as the second quarter of 2014. The final amortization of the Sunshine State policy acquisition cost of $550,000 occurred in the second quarter, which represented 0.4 points of the expense ratio. Our expense ratios for the second quarters of both 2015 and 2014 were favorably impacted by assumed earned premium from the Citizens takeouts, in which there were no acquisition expenses. This improved the Q2 expense ratios for 2015 and 2014 by approximately 3.7 points and 4.2 points, respectively. Our combined ratio as a percentage of gross premiums earned was 71.1% for the quarter compared to 79.9% for the second quarter of 2014.

We are very pleased with these results. Despite some challenges on the revenue side, it was another excellent quarter for us, especially considering each component of our combined ratio. Reinsurance, losses and expenses were in line or better than our expectations. We believe these underlying base of profitable business, representing $510 million of in-force premium, positions us well for the coming quarters.

On the balance sheet side, stockholders' equity increased to $312.1 million compared to $255.1 million at December 31, 2014. Statutory surplus in our insurance company subsidiary at June 30 was $200.3 million, an increase of $6.2 million for the quarter. Our invested assets at June 30 were $438 million, with approximately $398 million invested in bonds with an average credit quality of A and a duration of 4.1.

Our cash position was $132 million, and our total assets were $854 million at June 30. Overall, we had an excellent quarter, one we are very proud of.
With that, Bruce and I are now available to take your questions. Thank you.

Question and Answer

Operator

[Operator Instructions] And our first question comes from John Barnidge from Sandler O'Neill.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

I had a quick question. Now that we're in the later innings of the Citizens takeouts, how should we think about geographic expansion for the company? Because that seems to be the next leg for growth.

Bruce Lucas
Chairman of the Board & CEO

John, this is Bruce. I don't know that we're in the later innings of the takeouts at Citizens or not. All we can say is that lately, the opt-out rates have been higher than normal. I don't know if that's a trend that's going to continue or not. We did not do a takeout in June because we wanted to manage our reinsurance cost. Likewise, we do not have one planned for August, again, because we're just watching our true-up mechanism under our reinsurance program. We still think that there are good opportunities at Citizens. We are getting good production out of the takeout process.

We have been focused on going multistate now for about a year. We did our due diligence and filed in 4 states recently. That is something that we believe is more of a 2016 story by the time we get licensed and get our systems up and running in those new states. We are looking at filing in a few more additional states, and we are looking at some M&A opportunities that are outside of Florida. We do think it'll be a growing portion of our business, especially as we progress into 2016.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

And a follow-up to that and one other question, if I may. You mentioned M&A, how large a transaction could you -- do you anticipate that you could currently handle with your current capital?

Bruce Lucas
Chairman of the Board & CEO

I would say at the top end, current capital-wise, we could do a transaction that is $125 million to $150 million-ish. That would be a rough ballpark estimate.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

That's great. And then, your recent acquisition just further integrates the vertical integration that you guys have. Over time, how much savings do you think that could be on a loss ratio basis? I mean, how much do you feel like you're paying out in profit to contractors versus the cost on an annual basis?

Stephen L. Rohde
Advisory

John, this is Steve. Our CAN operations has been improving our loss ratio by about 1.5 points on our loss ratio. We anticipate the BRC acquisition, that'll push it above the 2% savings on our loss ratio. And if we can leverage BRC more, it'll obviously improve it more. And that's just on the savings side. We also have the opportunity to reduce what we call the loss ratio creep, that by getting there quicker, that the scope of loss stays smaller. And the more penetration we can get our people in quicker and avoiding the public adjusters and the lawyers and such, reduces the overall size of severity. As an example, right now, when our people get in with CAN on the water losses, the average loss is about $6,000. And when someone else comes in first, the average loss is about $12,000. So that's savings in addition to the 1.5 to maybe up to 2.5 points with the integration of BRC.

Bruce Lucas
Chairman of the Board & CEO

Yes, I think -- and this is Bruce. I think that the addition of BRC is going to be meaningful. And we're adding about 50 to 60 people that are essentially an arm of our claims department. These individuals currently service Florida-based property and casualty insurance companies now. So they really understand the business. They understand policy forms. They know the importance of getting out to the scene quickly. They're license bonded. They can do all aspects of the repair work. We're sending millions of dollars a year through our Contractors' Alliance Network, and we're able to harvest all of those profits that we are currently ceding out to third parties. And additionally, having another 50 to 60 people in the field helping us to work with policy holders at the time of loss to capture that work should improve the penetration ratio that we're getting on our claims, which again, will help to lower our gross loss ratio. So this is a home run for us in the AOP [ph] side. On the catastrophe side, this is a hedge that I really don't think anyone else in the business has, maybe Peoples Trust to a certain extent. But we're able to now dispatch our of professionals out into the field immediately to tarp roofs, to do repair work, et cetera. That keeps the dollar in the door. It is a good hedge on our reinsurance retention. And it should help to control our catastrophe losses, which would be a positive message for our reinsurance pricing on our program going forward.

Operator

The next question comes from Mark Hughes from SunTrust.

Matya Rothenberg
SunTrust Robinson Humphrey, Inc., Research Division

This is actually Matya on for Mark. You mentioned your -- you mentioned that you're not doing a takeout in July or August. Can you just discuss how the takeout prospects are shaping up for the fall?

Stephen L. Rohde
Advisory

We actually are doing one in July. It's in process right now. The opt-out process is in its last 2 weeks. We had selected 18,000 policies in July, and at this point, there's 8,000 policies remaining that have not yet opted out, so we still have 2 weeks to go on that. And we've done a proof for a September takeout for up to 40,000 policies, and we've just gone through our selection process on that. We do anticipate selecting close to 40,000 policies. But again, we don't know [ph] what the opt-out rate is going to be on those.

Bruce Lucas
Chairman of the Board & CEO

And part of the reason that we're not really sure what the opt out-rate's going to be going forward is we've done smaller-scale takeouts with smaller population sizes. And so we don't know if that's just a reflection of the policies that we happen to take or if it's more endemic of higher opt-out rates into the future.

Matya Rothenberg
SunTrust Robinson Humphrey, Inc., Research Division

And then, could you just give a little more detail on competition in commercial?

Bruce Lucas
Chairman of the Board & CEO

Yes. So commercial residential like -- just like the personal line side, I mean, the rates have been a little soft here in Florida. What we have really seen more than anything are the excess and surplus line carriers coming into the state and trying to take really high TIV policies now. We had some of that business from our Citizens assumption. I don't think we have a lot of that business now, which is fine with us. And there's a lot of additional reinsurance costs that are associated with those policies. But the E&S carriers came in and were looking for large premiums, large TIV, because their spread of risk throughout the U.S.

is radically different than our ours, which is more Florida-centric. So they were able to take some of the large TIV structures at a lower premium than we were willing to go to.

So we had to make a decision: Do we want to keep that business at a -- really, at a combined ratio that did not make sense to us? Or do we want to let that business go, therefore, we don't have to buy the reinsurance on it and focus really more on the core aspects of the commercial residential program, which are incredibly profitable for us? So E&S really is working on the higher TIV policies, is what we've noticed. And I think that's been the lion's share of the premium that we let go in that division.

Stephen L. Rohde
Advisory

To add some to that, the policies that came up for renewal that we did not renew had an average premium of about $70,000. And the ones that we did renew had an average premium of about $32,000. And then I mentioned we had some midterm cancellations, and this again, were policies that were taken by E&S carriers midterm. And those were the really large ones that had an average premium of $173,000. So we're going back -- what's remaining is kind of the -- what our bread and butter would've been and what is more in line with what our voluntary policies are.

Operator

Our next question comes from Matt Carletti from JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Just want to ask a question following up on some of the discussion about your in-house claims litigation -- or, I'm sorry, claims management. And just given, in late July, I believe there's a lot of rain, particularly in your guys' part of Florida. I'm just curious what you guys have seen. Has there been in uptick in claims? And if so, have you been able to address it mostly with your in-house claims adjusters? And how do you feel about the result there?

Stephen L. Rohde
Advisory

Yes, our loss ratio has ticked up a bit. We really saw a little bit in June as well as July, weather-related still, a lot of water claims as well as a lot of roof losses. And our penetration, we -- about 35% of our claims are being handled by our in-house people. We would like that to be higher. It's still a challenge, particularly down in south Florida, and if we get the penetration because of the culture of the PAs [ph] and the lawyers and so forth. But again, our loss ratio has not gotten out of hand. It's just spiked up a bit.

Bruce Lucas
Chairman of the Board & CEO

Yes, and we do always see that -- yes, we always see that in the summer months. It's the same every single year. It's May, June and July are the wettest months in Florida, so you always see an uptick in loss ratios for those 3 months. That's because it's the rainy season down here. We also get a lot of claims that are reported in that are flood-related, which we don't cover. And so you have to kind of ferret through those claims as well as and make sure that while total claims coming in may be higher in those 3 months, a lot of those claims won't be covered simply because we don't cover the flood peril.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, so would you say that seasonally-adjusted -- or say, look year-over-year as opposed to sequentially, it's maybe more normal?

Stephen L. Rohde
Advisory

Yes, I think so. And on -- probably a couple of points higher than what we had earlier in the year. So again, it's not significantly higher.

Operator

Our next question comes from Arash Soleimani from KBW.

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

Had a couple of questions. I just wanted to confirm. So in-force premiums this quarter were $510 million. So it looks like they declined sequentially from last quarter. Is that correct?

Stephen L. Rohde
Advisory

Yes. Last quarter, we had -- end of 1Q we were at $533 million. Now we're $510 million, and the drop was all in commercial. Personal lines is basically the same at $423 million.

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

And so the -- and that drop within commercial, was that all within the assumed commercial book?

Stephen L. Rohde
Advisory

Yes. The voluntary actually increased by $7 million, so sales were again strong in the second quarter for commercial voluntary. Commercial voluntary is sold -- we started in the third -- fourth quarter of 2014, it was $6 million. First quarter, $6 million, and then the second quarter, $7 million. So it's continued its strong pace, but it was all in -- the exposure management took place in the commercial takeout business, again, due to the softening in the prices and us just not willing to go down to meet the prices that the E&S carriers were offering.

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

Okay. And I guess, the other question is in terms of your shelf registration, is that -- is there anything to read into that in terms of needing capital for growth into the other states? Or I mean, it seemed like you mentioned you can do something over $100 million in terms of M&A without raising capital. So I just wanted to just get a sense of how necessary the -- a capital raise would actually be to fund your growth?

Bruce Lucas
Chairman of the Board & CEO

Yes, I think that's a great question. This is Bruce. And I've already had several inquiries this morning about it. And I think there's maybe some perception out there that we're about to do an equity offering. Let me just tell you, that is not the case. The shelf registration filing is just a corporate housekeeping filing that we put in place. We have no intention of raising any securities pursuant to that registration statement anytime soon. We do not need to raise equity at this point in time. That's just something that we had to get in place following our 1-year IPO anniversary. So I really wouldn't read anything into that at this point in time. It's just cleaning up, some general housekeeping that we have to do in getting that registration in place.

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

Fine. Should we still think of commercial residential as becoming a growing part of your overall premiums? Or is that something that is unlikely in the near term because of some of the Citizens challenges? Or what's the right way to think of the mix of business?

Bruce Lucas

Chairman of the Board & CEO

It's still growing every month. In fact, it's internally outpacing our models. And we're doing pretty well in the voluntary side, and we're doing over -- roughly $2 million a month in new business. And we've been a little conservative on the underwriting front up until recently, because we really wanted to watch the reinsurance cost going into wind season. It's still a growing component of our company. We've got the -- in my opinion, and I'm pretty sure this is accurate -- we have got the deepest commercial residential department in the state of Florida. So we have the resources there. We've got the operating system built out, good relationship with the agents. We're getting great premium. The loss ratios there are just phenomenal. So it's a growing part of the company, and it will continue to be a growing part of the company.

Stephen L. Rohde
Advisory

There's about 1,000 policies that not -- have not yet come up for renewal on the takeout policy, so there might be some continued pressure on that. But what's remaining has an average premium of $30,000. So again, it wouldn't have the large towers that was attractive to the E&S market, so we should see a better renewal rate on that. I did some calculating that, adjusting for the exposure management side of it, the renewal rate has been running about 75% on the takeout business. Again, when you factored out some of these policies that we basically knew we were going to lose, our model had anticipated about an 80% renewal rate. So again, now that the large policies are gone, I would anticipate it would be close to that 80% renewal on the takeout business. And then as Bruce mentioned, we're adding close to $2 million a quarter on the voluntary side.

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

Okay. So should we -- for the third quarter, does it look like in-force premiums, should we expect them to be up in the third quarter? Or could that be pressured again sequentially?

Stephen L. Rohde
Advisory

There aren't as many renewals in the takeout business in the third quarter for Citizens. But in July, there -- we did have some additional premium go off. So I would suggest it'll be kind of flat. I don't think it'll be definitely up or down.

Bruce Lucas
Chairman of the Board & CEO

I think the big movement that we've had on the commercial residential took place really in the second quarter, and we had to make the call. On these huge TIV structures, obviously, there's some risk on those. You got to buy facultative reinsurance, put risk reinsurance and then regular excessive loss reinsurance on them. And you look at that risk profile and say, "As long as you're making a certain profit margin, you're very comfortable with that line of business." And some of the E&S quotes were just simply too low for us.

And we had to make the call, either we retain that business and buy the reinsurance on it and going forward, it's really not a great policy to have; or we simply let that go and let the E&S players take it. And that's decision we made. Most of those big towers are now through our portfolio, so we think that the -- that was kind of the big erosion event, so to speak, that took place. Going forward, it's more the garden-style commercial residential structures that we have. And that's like -- Steve mentioned earlier, that's our bread and butter.

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

Okay, can you remind me what was the in-force premium for commercial residential, 1Q versus 2Q?

Stephen L. Rohde

Advisory

Okay. 1Q was $110 million, and 2Q is $87.3 million.

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

Okay, and then on the reinsurance side, so you said the $177 million, that includes the RPP, right?

Stephen L. Rohde
Advisory

Yes, it does.

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

It doesn't? Okay.

Stephen L. Rohde
Advisory

Yes, it does.

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

And you mentioned 34.7% as the ceded premium ratio. So is that something that -- do you guys also cede for federal flood?

Bruce Lucas
Chairman of the Board & CEO

No. We don't offer any flood coverage whatsoever.

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

So that 34.7% should be basically the run rate for this year. But if you guys are able to get some growth in, I mean, would it be fair to expect the 34.7% to decline over the next few quarters?

Stephen L. Rohde
Advisory

Yes. That would be our desire, certainly.

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

Okay. And just to make sure I'm clear, the retention; did you say the total retention is $35 million? And how much of that is from Osprey? And how much of that is from the statutory subsidiary?

Stephen L. Rohde
Advisory

Yes, $15 million is from our statutory insurance subsidiary and $20 million from Osprey, our captive.

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

And was the decision to increase the overall retention from last year, was that -- I guess, what drove that decision? I mean, I know part of it is just that you're bigger. But was there anything else that drove the...

Stephen L. Rohde

Advisory

That's the reason. Our surplus now is $200 million, up substantially from what it was last year as well as our capital position at the holding company.

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

Okay. So that's just a function of the size. So the 1 in 100 PML, would that be roughly then the $35 million?

Bruce Lucas
Chairman of the Board & CEO

No. $35 million was the total retention that we have on the program, when you look at both HPCICs, primarily retention and then the lower-level risk that is shared with Osprey, our captive insurer.

Stephen L. Rohde
Advisory

We bought the $1.8 million and our 1 in a 100 is about a little over $1.5 billion.

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

Okay, okay. Let me just see if I have anything else. Okay, and what was the GAAP loss ratio in commercial residential, just like the calendar-year GAAP?

Stephen L. Rohde
Advisory

Counting IBNR, it'd be about 3%, 4%.

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

So that's not -- so that sounds much lower than, I guess, what you guys had anticipated in the past? Because I...

Stephen L. Rohde
Advisory

Yes.

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

I thought before the thought was that it would be in the 10% range? So is that...

Stephen L. Rohde
Advisory

Yes, it's performing extremely well. Our reported loss ratio is just -- less than 1%. And very few claims reported, nothing with any large severity. So it's performing much better than anticipated.

Bruce Lucas
Chairman of the Board & CEO

Yes, it's a great book of business. That's why we want to make sure that we're protecting the really good policies. And some of these higher-risk ones, larger TIVs, where the premium isn't there, we just don't want an appetite for that when there's plenty of business out there that meets the current underwriting criteria that we have in place right now.

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

Okay, is so that -- is 3%, I mean, the right run rate to think about on a -- like, again, a calendar-year GAAP loss ratio with IBNR? Is that...

Stephen L. Rohde
Advisory

That may be a little low, but I think 5% to 6% is not unreasonable.

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

Okay. And do the loss ratios there change once the policies renew? I mean, is there a change in coverage once the Citizens policies renew in terms of having to provide more cover that could impact that loss ratio?

Stephen L. Rohde
Advisory

Nothing significant, no.

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

Okay, and is 30% still kind of the right run rate for the personal residential policies?

Stephen L. Rohde
Advisory

Yes.

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

Okay. And from the recent acquisition, do you guys have amortization or anything that's going to hit the expense ratio?

Stephen L. Rohde
Advisory

No. They'll go to goodwill and it'll -- and the earnings will support the goodwill that we put towards this acquisition.

Operator

Our next question comes from Casey Alexander from Gilford Securities.

Casey Jay Alexander
Gilford Securities Incorporated, Research Division

Do you intend to put out an 8-K on the reinsurance program? Because sometimes, I read better than I hear.

Bruce Lucas
Chairman of the Board & CEO

I don't think so.

Stephen L. Rohde
Advisory

Yes, we weren't planning on it. It's normal course of business.

Casey Jay Alexander
Gilford Securities Incorporated, Research Division

Okay. The reinsurance program, I don't think -- did you say exactly what -- based upon the approved OIR models, your reinsurance program is good for a "1 in how many year" storm?

Stephen L. Rohde
Advisory

Approximately 115.

Casey Jay Alexander
Gilford Securities Incorporated, Research Division

1 in 115. All right.

Bruce Lucas
Chairman of the Board & CEO

[indiscernible] That really also depends on which OIR-approved model you look at, right? The result is probably lower if you look at RMS. And if you use a Florida Public model, god, it could be massively higher than that. It just -- you have to ask what model are you using? Because the models are vastly different from one another.

Stephen L. Rohde
Advisory

We use the AIR model for all our modeling and pricing work.

Bruce Lucas
Chairman of the Board & CEO

Yes, and I think a lot of companies that report, they -- why you see such a high return period, let's just say they had a 200-plus year return period. They're using the Florida Public model as a standard for putting that information out there. But when they actually buy their reinsurance, they're probably using AIR RMS, and so the results are not even close to using the Florida Public model.

Casey Jay Alexander
Gilford Securities Incorporated, Research Division

Okay. And if I understood it correctly, we should be allocating about $44 million per quarter to ceded reinsurance premiums?

Stephen L. Rohde
Advisory

Let me do the math. $177 million divided by 4, that sounds like $44 million.

Operator

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

Bruce Lucas
Chairman of the Board & CEO

I would like to thank everyone for their participation on our second quarter call.

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