S&P Global
Market Intelligence

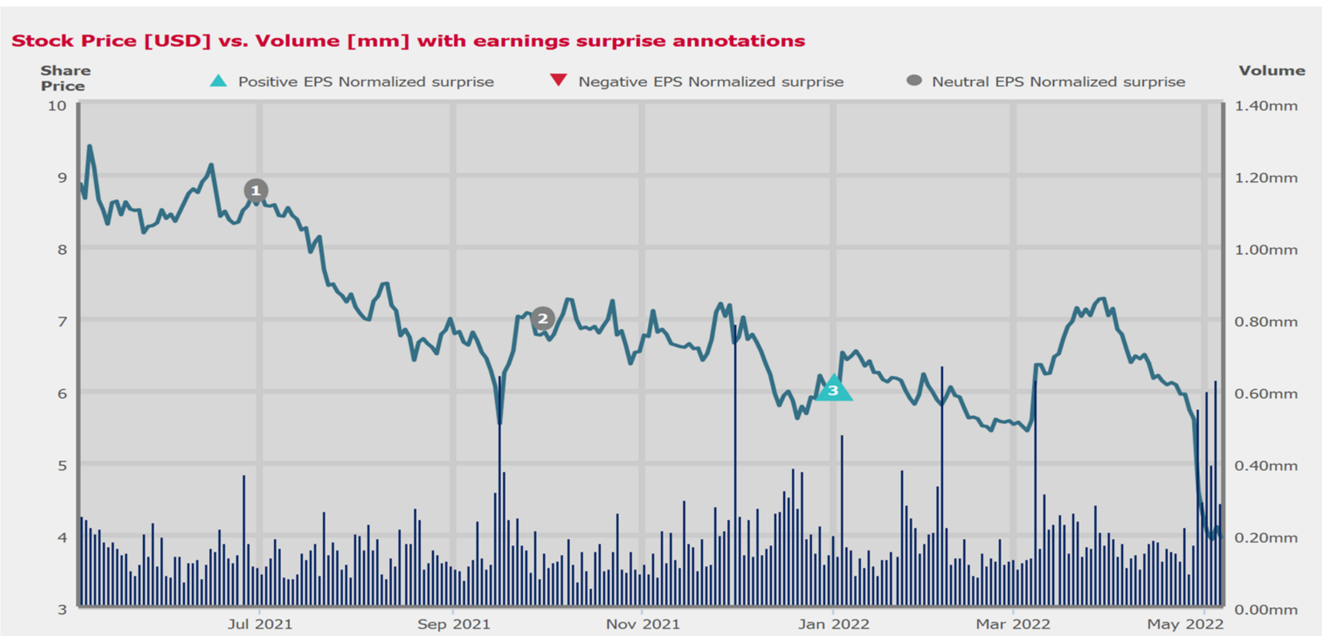
Heritage Insurance Holdings, Inc. NYSE:HRTG
FQ1 2022 Earnings Call Transcripts

Friday, May 06, 2022 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.22	NA	NA	0.21	0.75	NA
Revenue (mm)	153.80	158.61	▲3.13	160.44	656.27	NA

Currency: USD
Consensus as of May-04-2022 7:16 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	(0.04)	(0.12)	NM
FQ3 2021	(0.27)	(0.59)	NM
FQ4 2021	0.16	0.41	▲156.25 %
FQ1 2022	0.22	NA	NA

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Call Participants

EXECUTIVES

Ernesto Jose Garateix
CEO & Director

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

Marla Susan Backer
Sidoti & Company, LLC

Matthew John Carletti
JMP Securities LLC, Research Division

Nicolas Iacoviello
Dowling & Partners Securities, LLC

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good morning. and welcome to the Heritage Insurance Holdings First Quarter 2022 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Kirk Lusk, Chief Financial Officer. Please go ahead.

Kirk Howard Lusk
Chief Financial Officer

Good morning, and thank you 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 upon management's current expectations and subject to uncertainty and changes in circumstances. In our earnings press release and 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 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, earnings release and other SEC filings.

Our comments today will also include non-GAAP financial measures. The reconciliation of and other information regarding these measures can be found in our press release.

With me on the call today is Ernie Garateix, our Chief Executive Officer. I will now turn the call over to Ernie.

Ernesto Jose Garateix
CEO & Director

Thank you. Kirk and I would like to thank everyone for joining the call today. I would like to thank our Heritage employees for their dedication to the company as well as our policyholders. I also would like to thank our valued reinsurance partners for their commitment to our program.

On this call, we will begin with an overview of our performance for the quarter ending March 31, 2022, provide updates on key financial performance metrics and then open the call for Q&A.

The first quarter of 2022 marked another quarter impacted by severe weather losses. These higher weather losses resulted in a net loss of $30.7 million or $1.15 per diluted share. Despite the substantial increase in net current accident year weather losses during the quarter, we remain encouraged by the rate and form changes implemented throughout the book of business over the last 18 months.

These changes, coupled with additional geographic diversification and more restrictive underwriting for new and renewal business will continue to positively impact our portfolio. These changes are highlighted by the improvement in our attritional loss ratio for new business quarter-over-quarter. The initiatives to tighten underwriting and increase rates have improved our average premium per policy by 10.7% from the first quarter of 2021.

The impact of existing rate increases has not worked its way through our entire book of business. Therefore, this amount does not include rate changes on policies which have not yet renewed. For perspective, our 2022 voluntary homeowners renewals for all states are averaging a 21% rate increase over the prior year with our existing rate changes. We will continue to seek rate changes commensurate with our cost of doing business.

Rate changes are implemented at policy renewal and are earned throughout 1-year policy period. We are committed to proactively and appropriately raising rates to offset higher loss costs and taking underwriting actions to improve our profitability throughout the year.

We look forward to finalizing our cat XOL reinsurance program, which should be completed by the end of this month. We used our SPV, Citrus Re, again this year for a portion of our cat XOL program specific to the Northeast. We were pleased with the pricing of this $100 million reinsurance cat bond as we continue to successfully access the capital markets as part of our risk transfer program.

This concludes my remarks. Let me now turn things over to Kirk Lusk for a review of the key metrics and numbers.

Kirk Howard Lusk
Chief Financial Officer

Thank you, Ernie. Good morning. In-force premiums grew by 4.7% during the quarter to $1.2 billion primarily due to rate increases while policies in-force for the same time frame were down 5.5%. We believe the rate and underwriting changes being implemented will have an impact later this year as volatility of loss costs are reduced and produced meaningful improvements in the bottom line.

We recognize that litigated claims environment has made the Florida market very difficult, and we're taking rating and underwriting actions that we believe will position the company well in the future. This could dampen our future growth in the Florida market. Efforts to shift business from Florida has resulted in a 19.1% reduction in personal lines policies in-force in the state.

As a result of the continued execution of our diversification strategy, 74% of our TIV was outside of Florida, up from 69% as of the first quarter of 2021. We think it is important that the TIV increase outside of Florida was distributed among nearly each state, which we conduct business, which improves our overall diversification of risk.

The ceded premium ratio was 46.8% in the first quarter, down 60 basis points from 47.4% in the first quarter of 2021. The decrease primarily stems from gross premiums earned growth outpacing ceded premiums growth.

The first quarter weather losses were up substantially to $63.8 million. Current accident year weather losses include $45 million of net current accident quarter cat losses while we are up from $15.4 million in the prior year quarter. This year-over-year increase also includes $18.8 million of weather losses, up from $16.1 million in the prior year quarter.

First quarter 2022 weather losses are primarily attributed to events in Florida, particularly severe storms in mid-January and mid-March. Our preannouncement of weather losses last week reflects our commitment to transparency with our shareholders as well as an appropriate approach to estimating losses. Our net loss ratio of 91.6% ended the quarter 22.8 points higher from the prior period due to the higher weather losses outlined.

We believe the social inflation affecting Florida claims is driven largely by litigated claims practices, which drives up the loss costs associated with each weather event. The Florida legislation has taken up some actions to address this issue via Senate Bill 76, and we are interested in seeing the outcome of the special session later this month.

Our net expense ratio decreased by 90 basis points to 37.9% driven by our continued drive to manage G&A expenses. Policy acquisition costs are relatively flat as a percentage of net earned premiums.

The net combined ratio for the quarter of 2022 was 129.5%, which is up from 107.7% in the prior year period, reflecting a higher net loss ratio partially offset by a lower net expense ratio.

Total capital returned to shareholders during the first quarter of 2022 was $6.7 million, reflecting a $0.06 per share regular quarterly dividend and repurchase of shares. During the quarter, we repurchased 721,118 shares at an average price of $6.93 per share, totaling approximately $5 million.

Many of our markets, and especially Florida, are challenged by social and economic inflation, continued litigation and increasingly severe weather. We have taken considerable actions to mitigate their effects and improve our underwriting results, including taking rate, increasing our inflation guard factor, tightening underwriting standards and managing exposures. Our actions have improved our portfolio while claims inflation and litigation associated with continued severe weathers continue to dampen the impact of those improvements.

As such, you can expect the management to accelerate our initiatives. The management team has focused on improving margins and returns to shareholders. We are committed to taking rate where it is needed, tightening our underwriting standards even further, while remaining compliant with state regulatory requirements and changing our products, coverage and exposures, all in an effort to accelerate the changes we believe are necessary until we achieve our target returns. We will consider all options to realize the value of our entities, and we will also take the actions necessary to improve margins.

That concludes our prepared remarks. Operator, we are ready to begin the question-and-answer portion of the call.

Question and Answer

Operator

[Operator Instructions] Our first question is from Marla Backer with Sidoti.

Marla Susan Backer
Sidoti & Company, LLC

So stepping back and looking at some of the initiatives that you have done and accomplished over the past several quarters, do you see any areas perhaps where some of the diversity that you hope to inject into the underwriting book might not have lived up to your expectations? Are there any areas in addition to Florida, where you think perhaps you should pull back now as well?

Ernesto Jose Garateix
CEO & Director

Marla, that's a good question. So we continue to look at the book, and we're pleased with the actions that we're taking, but I think to understand that some of those actions, whether they're nonrenewals, increasing rates, take 12 to 18 months to flow through the book. So we are -- on a monthly and quarterly basis, are constantly looking at those actions and seeing where it's appropriate to take. But to understand the full effect of those, it does take 12 to 18 months. So we continue to look, and there's areas outside of Florida that we are constantly looking at, but we're overall pleased with the direction in which we're heading on with the underwriting performance.

Kirk Howard Lusk
Chief Financial Officer

Yes. In addition to that, I'd say we're also much more surgical. So for example, we will look at each individual state and our distribution within that state by county, between coastal and inland and adjust the portfolio where we aren't seeing the returns we want to. So it's not a carte blanche, I think, view of the different diversification because it's much more surgical than that.

Marla Susan Backer
Sidoti & Company, LLC

And then once you take a decision to either, as you say, surgically shift a little bit, tweak the portfolio, is it still the same 12-month process before you see that shift actually happen?

Ernesto Jose Garateix
CEO & Director

Yes. It will take a bit of time to roll through the book because you do have to give a nonrenewal notice, right? Or for example, in some areas where we've terminated agents, that takes some time for those policies to roll off. So those things, unfortunately, do not happen overnight. It takes a little bit of time on that. You've got to get proper notice if it's a nonrenewal and some of the rates that we take on a renewal basis. So by the time you get those approved, it does take a bit of time.

Marla Susan Backer
Sidoti & Company, LLC

Okay. And then last question for me is can you give us a little bit more color on some of the partnerships that you formed in that where you see those -- that part of the business going?

Ernesto Jose Garateix
CEO & Director

Yes. So we do have some large partnerships with Liberty Mutual, GEICO, Safeco and Nat Gen. And we're constantly in communication with them regarding the business that we're looking to target. They have been very cooperative, very good about looking at those pieces. And obviously, in a true partnership, there are times where we have to pull back in certain areas and they understand, but then we refocus in other areas where it's more profitable for us. And they have been very good partners with respect to that.

Operator

The next question is from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

I'm sorry. I hope you can hear me now. I wanted to hone in on the just the cat losses to start with. They were unusually large by your standards as well as really anybody else in the industry. So was there anything that would lead us to suggest that this was just a particular concentration of an area? Or maybe you could talk about how you define your cat losses, maybe you're having a different definition than the standard industry, anything that would give us some insight into why Heritages cat losses were an anomaly in the quarter versus the peers?

Kirk Howard Lusk
Chief Financial Officer

Yes, correct. Okay. So first of all, there are 6 PCS events that we categorize into that, PCS 2211, 2212, 2218, 19, 20 and 21. The largest one of those is 2212. When you look at the states that, that impacted, it was Alabama, Georgia, Florida and North Carolina predominantly. The bulk of those losses are in Florida.

And also, when you look at, I think, our reserving practices, we do have -- like when you look at our reserving practices over the -- since third quarter of 2018, we've had favorable development up until this quarter. This quarter, we did have a slight unfavorable development of like $2.4 million. But prior to that, we've had until -- from third quarter 2018 until now, have had favorable development to the tune of about $30 million. So we think our reserving is prudent and accurate. So I can't speak for anybody else's losses or their reserving, but that's how we look at it.

Paul Newsome
Piper Sandler & Co., Research Division

Your reserving certainly has been a relative strength versus your peers. Could you -- that was going to be my second question, whether you had reserve development or not. Could you maybe focus on that given it's an unusual development for you?

Kirk Howard Lusk
Chief Financial Officer

Yes. We did have the $2.4 million worth of development and again, first quarter in a long time. There was really nothing in particular about that as far as where it was coming from. It was just like a myriad of things. There's a couple of the storms, Elsa, Fred and Ida, which are all retained for us. They are not into our cat layer. So those did deteriorate slightly and so therefore, those are fully retained.

Paul Newsome
Piper Sandler & Co., Research Division

That makes sense. A different topic, could you talk a little bit about -- and you don't have to be precise, but the profitability of the Florida book versus the non-Florida book, is it -- was it that much different than the rest of the book this quarter or not? Just additional details would be great.

Kirk Howard Lusk
Chief Financial Officer

Yes. Well, with the weather losses, obviously, the Florida book did not perform well. When we look at going forward, because of the rate increases that we are taking in the Florida market and also due to the tightening of the underwriting standards, we have -- we are looking at that as seeing quarter-over-quarter improvement in that. But again, it's the weather that is driving it, obviously, this quarter.

Paul Newsome
Piper Sandler & Co., Research Division

Right. So the big topic of the -- well, really the last year or so has been underlying claims inflation versus rate. If we could look back a year ago and then look at sort of the next 12 months rolling, where do you think you stood from a rate versus claims inflation perspective? It would seem if you sort of add up the year on a rolling basis that you might have lost some traction. But is that fair to say that or not? Maybe you could just think about how -- let us know how you think about that.

Kirk Howard Lusk
Chief Financial Officer

Okay. Well, I think we look at claims inflation probably running around 12% overall. And that's kind of how we look at the portfolio. That's what we look at building into our pricing. And I think it's consistent with what we've seen over the past year.

And so from that standpoint, I think we're building that in appropriate. We have increased our inflation guard factors throughout our geography to also contemplate that. So that would be over and on top of the rate increases that we're getting. So I do think that there's probably the -- I think we've got the inflation currently pegged although that, as everyone knows, can move up and down, and it has some volatility to it. It's -- I think the social inflation and probably the weather that are the ones that are probably even a little bit more difficult to predict.

Operator

[Operator Instructions]

The next question is from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

I just want to go back to trying to better understand the cat/weather losses in the quarter. Just to get -- some of your peers that have similar kind of footprint, your guys' numbers magnitude of what they've reported. Can you define for us what is the cat for Heritage and what is weather for Heritage? Because it seems that the weather bucket is the majority of it and the cat's bucket isn't necessarily so sizable.

Kirk Howard Lusk
Chief Financial Officer

Yes, well, the cat bucket was $44 million -- $45 million. And the other weather was the 18 7 number. So it is predominantly the cat number, and that's defined by the PCS events. So that is what we put into that bucket as PCS events.

Matthew John Carletti
JMP Securities LLC, Research Division

PCS events -- I'm sorry, PCS events are defined cats?

Kirk Howard Lusk
Chief Financial Officer

Yes.

Ernesto Jose Garateix
CEO & Director

Property catastrophes...

Kirk Howard Lusk
Chief Financial Officer

Yes, we're putting the PCS events into the cat bucket. Correct. So it's...

Matthew John Carletti
JMP Securities LLC, Research Division

So it's not any -- okay. Do you have handy like how many claim counts that came off of those events that relate to that 60 -- I'm sorry, whatever there was, $64 million of cats and weather.

Kirk Howard Lusk
Chief Financial Officer

As far as reported claims as of -- yes, 3/31, there was 876.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. All right. Okay. And then just a separate question. Could you give us the backdrop of, obviously, a lot of your peers in the market are struggling quite a bit. Can you just update us on how you view your capital position as you sit here today?

Kirk Howard Lusk
Chief Financial Officer

Yes. I think we look at our capital position as good. I think we've got Osprey that we were able to utilize also. We also have our service companies, [MTAs]. And then in addition to that, we do have our syndicate of banks. We do have a revolver available to us. So from that standpoint, we do think that we're okay from a capital position and continuing to look at that going forward. Yes. In addition to that, I would mention the fact, from a cash position, our nonregulated cash is $35 million.

Operator

The next question is from Nick Iacoviello with Dowling & Partners.

Nicolas Iacoviello
Dowling & Partners Securities, LLC

The first question, it was on holdco liquidity, but that's at $35 million, correct? And then can you -- so where was group's stat surplus as of the quarter end? And was anything downstream at this point in time?

Kirk Howard Lusk
Chief Financial Officer

Let me see here. Let me pull that up real quick. Yes. Yes, total stat surplus is 294 across the entity.

Nicolas Iacoviello
Dowling & Partners Securities, LLC

Okay. And then I guess just on the G&A expense, just looking forward, right, it was relatively in line with the year-over-year, but it was up versus the prior 3 quarters. So is there something -- perhaps can you just help me think about that going forward on an annual basis and the quarterly cadence would be helpful.

Kirk Howard Lusk
Chief Financial Officer

Yes. I think you're going to see it a little bit higher in the first quarter of each year and then drop slightly throughout the year.

So I know last year, it probably dropped -- first quarter was higher, and then it dropped a fair amount in the second quarter. I would expect it to drop some into the second through the fourth quarter, but probably not to the extent it did last year.

Nicolas Iacoviello
Dowling & Partners Securities, LLC

Great. And then I guess just on the renewals. I don't know how much you can talk about now, but I guess, [can you just disclose] the percent of the capacity has been secured at this point in time or no?

Kirk Howard Lusk
Chief Financial Officer

Are you talking about reinsurance [overall]?

Ernesto Jose Garateix
CEO & Director

The reinsurance placement? I'm sorry, you broke up there. You're referring to the reinsurance placement?

Nicolas Iacoviello
Dowling & Partners Securities, LLC

That is correct, the reinsurance placement.

Ernesto Jose Garateix
CEO & Director

Yes. So we did go out to the market early. We've met with all our large reinsurance partners. We're very pleased about what we're seeing, and we're in the process of that being placed. We're very optimistic. Again, we've got a lot of commitments, and we're in the process and expect that to be fully placed by the end of the month. And then obviously, in the announcement, we did go out early and make the cat bond placement as well.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Ernie Garateix for any closing remarks.

Ernesto Jose Garateix
CEO & Director

We thank everyone for joining the call today, and wish everyone a great weekend.

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