S&P Global
Market Intelligence

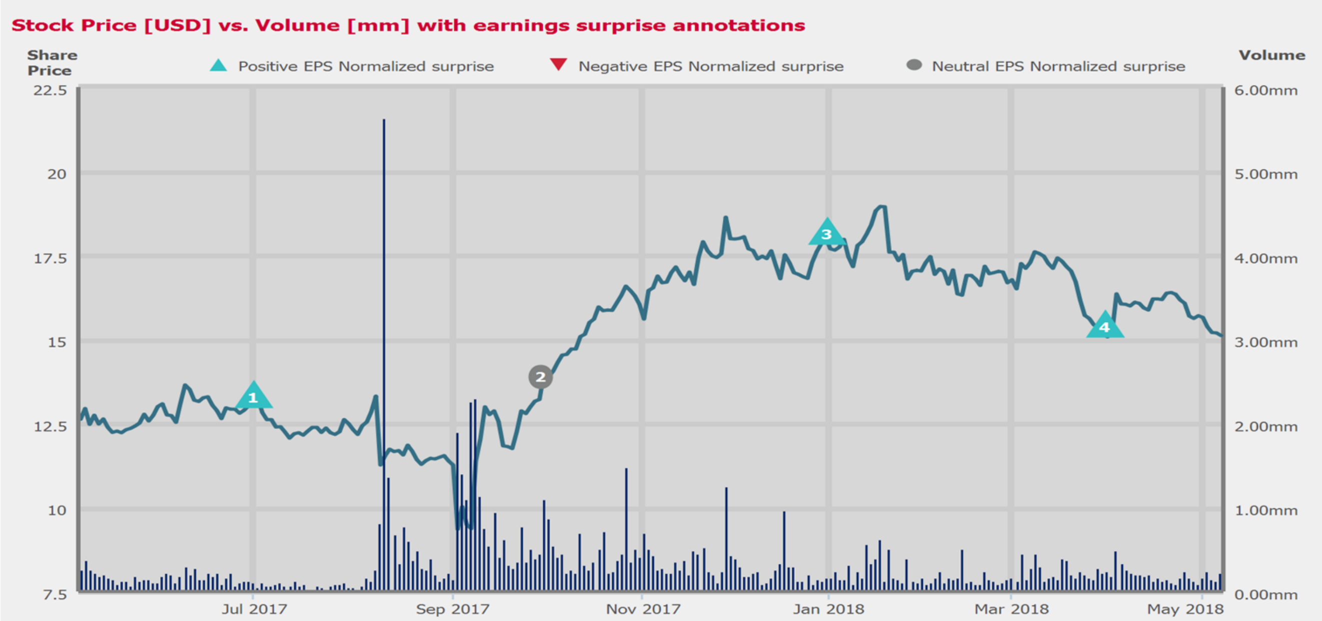
Heritage Insurance Holdings, Inc.
NYSE:HRTG
FQ2 2018 Earnings Call Transcripts

Friday, August 03, 2018 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.48	(28.36 %)	0.60	2.59	2.83
Revenue (mm)	114.13	117.97	3.36	119.11	464.61	495.28

Currency: USD
Consensus as of Aug-03-2018 1:21 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.21	0.23	1 9.52 %
FQ3 2017	(0.09)	(0.06)	NM
FQ4 2017	0.39	1.23	2 215.38 %
FQ1 2018	0.42	0.56	3 33.33 %

Table of Contents

Call Participants 3
Presentation 4
Question and Answer 7

Call Participants

EXECUTIVES

Bruce Thomas Lucas
Chairman & CEO

Joseph Rene Peiso
Director of Investor Relations

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

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

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

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

Matthew John Carletti
JMP Securities LLC, Research Division

Presentation

Operator

Good morning and welcome to Heritage Insurance Holdings' Second Quarter 2018 Financial Results Conference Call. My name is Nicole, and I will be the operator today. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Joe Peiso. Please go ahead.

Joseph Rene Peiso
Director of Investor Relations

Good morning. We invite you to visit the Investors section of our website, heritagepci.com, where the current quarter 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. These statements, 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.

Also, during the course of today's call, our Chairman and CFO will be discussing one or more non-GAAP financial measures defined in this quarter's earnings press release, along with the SEC-required disclosures, including reconciliations to the most compatible GAAP measures.

With us on our call today are Bruce Lucas, our Chairman and CEO; and Kirk Lusk, our Chief Financial Officer. I will now turn the call over to Bruce.

Bruce Thomas Lucas
Chairman & CEO

Thank you, Joe. I would like to welcome all of you to our Second Quarter 2018 Earnings Call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company.

The second quarter was marked by unmodeled severe weather events across our portfolio with losses in excess of $14 million. These additional losses were the primary driver of our reduced earnings this quarter. Additionally, we strengthened loss reserves by $12.6 million, primarily related to litigated claims in light of the Federated National and Homeowners Choice decisions regarding attorney fee multipliers. We take a conservative view of loss reserves and are typically one of the first companies to react to adverse changes in the Florida claims environment. Absent severe weather losses and a onetime increase in reserves, we were on track for a very solid quarter, well ahead of expectations.

I have several positive developments to report. 2.5 years ago, we decided to derisk from the Tri-County region, given the growing water fraud crisis in that area. Our TIV has considerably decreased over the time, and the Tri-County personal lines represents only 6% of consolidated total insured value. Heritage is well diversified and only has approximately 1/3 of our total consolidated TIV in the Florida market.

As we have moved away from the Tri-County, the number of newly reported claims and losses has steadily declined. Current claim and lawsuit inventories are at 3-year lows, and the percentage of these claims and lawsuits related to the Tri-County are at all-time lows. As our Tri-County policy is enforced or reduced, our open claim and litigation inventory will continue to trend lower and reduce reserve volatility. We believe that we have worked through a lot of the claims tail related to Tri-County claims that began in early 2015, and we believe that our loss ratios will continue to improve.

We had another strong sales quarter. During the quarter, 47% of new business policies were originated outside of Florida. Our footprint continues to expand away from Florida, which should help to reduce claims volatility and reinsurance pricing. Policy sales continue to grow at record numbers and increased 54% year-over-year. The increase in sales correlates to an increase in premiums in force, which jumped 66% year-over-year to $930.5 million. We also plan to implement 2 new strategic relationships this year, which we believe will meaningfully increase revenue.

Finally, our Contractors Alliance Network is now operational in the Southeast and Northeast and will be operational in Hawaii this year. CAN will now be able to respond to catastrophe events in all 3 geographic zones and reduce our retain losses.

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

Kirk Howard Lusk
Chief Financial Officer

Thank you, Bruce. Good morning. Net income for the quarter was $2.4 million and was down from $6.6 million reported during the second quarter of 2017. The main driver of the variance and also the deviations from expectations are due to weather losses and reserve strengthening. Due to the significant impact that these items had on the quarter, I would like to address them first.

The net loss ratio was 59.3% for the second quarter of 2018 compared to 50.9% for the second quarter of 2017. The impact of the weather-related losses and reserves strengthening impacted the net loss ratio for the quarter by 14.8 points. The loss ratio was partially mitigated by profitability arising from the utilization of our vertically integrated affiliate, Contractors Alliance Network. We have a geographically diversified portfolio that yields many advantages. However, with that diversification, we will occasionally be hit by severe isolated storms.

With respect to reserves strengthening, we have continued to evaluate our reserves to ensure that they are adequate and appropriate. One area that we have continued to focus on and to evaluate on an ongoing basis is litigated claims in the State of Florida and, in particular, the Tri-County area. Although we believe that we have the fewest litigated claims amongst our peer group, we felt that it was necessary to increase our reserves due to the judicial environment in the state.

Of the prior period development taken during the second quarter, about 90% was due to litigated claims. We have taken and continue to take actions that we believe will mitigate the future detrimental impact that litigated claims have upon the company. Those actions include the reserve strengthening in the quarter as well as our hiring of 16 attorneys to bring all litigated claims in-house. In addition, we took actions in 2016 to reduce our exposure to the Tri-County area, which typically comprises approximately 80% of the litigated claims. We will continue to evaluate our exposures and reserve position and to take the steps necessary to limit the impact on future periods.

Operating income was $8.2 million for the quarter, which was down from $13.1 million as of the second quarter of 2017.

Looking at the top line, gross premiums written are $264 million, which is an increase of 66% or $105 million from the second quarter of 2017. $89 million of the increase was from NBIC and $15 million was from the Legacy Heritage portfolio. Gross premiums earned were $231 million, which was up $79 million year-over-year. Net premiums earned increased from $90 million at 2Q 2017 to $111 million at the second quarter 2018, which is a year-over-year increase of 23%.

Ceded premiums increased from $62 million to $120 million, reflecting the addition of the catastrophe reinsurance programs for NBIC and the various quota-share programs on its portion of the business. Correspondingly, the consolidated ceded premium ratio, as majored against gross premiums earned, increased to 51.9% from 40.6% in 2Q 2017 and from 41% from year-end 2017. Excluding NBIC, the ceded premium ratio was 37% and down from the prior year of 41%. This reduction in ceded premium reflects the reinsurance synergies related to portfolio diversification and exposure management.

The net expense ratio decreased year-over-year from 41.8% at 2Q 2017 to 39.4% at the second quarter 2018. Ceding commissions of $18 million were offset against acquisition costs and operating expenses in proportion to the expenses associated with the production of business. Our combined ratio for the quarter as a percentage of net premiums earned was 98.7%, which is up from the 92.7% as of Q2 2017. The increase reflects the losses as previously discussed.

Moving to the balance sheet. Shareholders' equity at June 30, 2018, increased to $386 million from $380 million at the end of 2017. The change predominantly reflects the year-to-date net income, offset by the tax-affected change in net unrealized investments, dividends to shareholders and repurchase of a portion of the convertible notes. Book value per share is $14.98 per diluted share, up from $14.67 per share at year-end. Total invested assets increased $22 million for the quarter, mostly driven by the receipt of reinsurance recoverables related to Hurricane Irma claims.
Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from John Barnidge of Sandler O'Neill.

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

I dialed in like a minute late, so I apologize if you already said this. But what were cats and reserve development independent of one another? I know in the press release, it said $14 million. But could you break that out, cats and then development? And then geographically, where were your cats located?

Bruce Thomas Lucas
Chairman & CEO

Yes. The cat portion was about $14 million and primarily related to hail events and development up in the Northeast on winter storms. The development -- not really development. It's really reserve strengthening, as we view it. Just kind of looking at what the litigation environment looks like in Florida, we want to be ahead of that. We added about $12.6 million in additional reserves.

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

Okay. And then with Narragansett being added on, there's more scale that's obviously going to be a crane over time. But your expense ratio, sequentially, actually bumped up almost 7 points or right around there on a net basis. Can you talk about maybe what you're seeing there on a gross basis? It was up 4 points.

Kirk Howard Lusk
Chief Financial Officer

Yes. There's 3 items in particular I'd like to address there. One is there was a onetime personnel-related charges of about $3 million in the quarter. There's about $1.5 million worth of expenses associated with volume and bringing personnel, and you'll see that written premium's up associated with that. And then the other, it really has to do with the -- some of these that the personnel were bringing in to handle litigated claims, boosting the claims operation and the integration aspects with NBIC. So that's about $2 million right there.

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

Okay. On non-other operating expenses, we hadn't seen that in a while, and it showed up $542,000 in the quarter. What was that about?

Kirk Howard Lusk
Chief Financial Officer

Yes. That's the debt on the extinguishment of some convertible debts.

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

Okay. Last question and I'll requeue. With shares trading where they are, I know in the previous quarters, you have been pretty active buyers of your own stock, but weren't this quarter that I at least saw. Can you talk about that maybe?

Bruce Thomas Lucas
Chairman & CEO

Yes. We were not terribly active in buying back the stock during the quarter because we retired $10 million of the convertible bonds that were outstanding. We look at the convertible bond as -- an unfortunate feature of the bond, when you're in the money on the option, as your share price goes up, there's a short interest that grows against the share price that caps you. So you actually get better long-term value retiring the coupon, getting rid of that principal amount and having the short covered. And so we did allocate $10 million. And rather than put it into a share repurchase, we did it in the form of a bond repurchase.

Operator

Our next question comes from Mark Hughes of SunTrust.

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

The -- of those expense items, the $1.5 million related to the new premium, I presume that sticks around if you continue to grow the top line. Is that fair?

Kirk Howard Lusk
Chief Financial Officer

Yes.

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

And then the $2 million for the -- I guess the new legal staff, that sticks around as well. Is that correct?

Kirk Howard Lusk
Chief Financial Officer

Yes. A portion of that will, yes. There's a portion of it that will not, but the good portion of that will, yes.

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

Okay. And then could you talk about your reinsurance program? What do you anticipate in terms of cost on the new program? And how did it come together compared to what you had targeted with the NBIC acquisition?

Bruce Thomas Lucas
Chairman & CEO

Do you have those numbers? The cost came in -- first of all, the synergies came in, in line with our expectations. It was about $15 million of reinsurance synergies that were realized on the 2018 program. We weren't really sure how to put in the cost going into 2018 for reinsurance. There was a lot of speculation that rates would go up 20%, 30%. Some people said flat. We actually came in risk-adjusted for 2018 at about a 0.4% decrease in cost. So we did pretty well, and the diversification in our program helped that out tremendously. If you're looking for a net spend, I'm sure we can get you that dollar amount.

Kirk Howard Lusk
Chief Financial Officer

Yes. And again, it's reflective of the -- when you look at the ratios, dropping from 41% ceded down to 37%, that really is indicative of the savings we're seeing. If you were to back out the net and gross quota shares from NBIC, which have a tendency to distort that ceding commission, it's going to be right around the 37.5%, 37% range, so therefore, it's going to be in line with that. So that gives you an idea of what the savings on that reinsurance program is for the synergies.

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

I guess, I'm thinking in terms of dollar spend annually or sort of on a quarterly basis. Your reinsurance cost is $120 million roughly in the last couple of quarters. Is that going to change much on a go-forward basis?

Kirk Howard Lusk
Chief Financial Officer

Yes. It'll drop a little bit over where it was previously.

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

Maybe $115 million?

Kirk Howard Lusk
Chief Financial Officer

It's unwholesome. I can get you the number.

Bruce Thomas Lucas
Chairman & CEO

Hold on a second while he scrolls to that page.

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

Okay. And then I think you've said $15 million of the increase in gross premiums written was in the legacy Heritage portfolio. Could you talk about your voluntary production trends?

Bruce Thomas Lucas
Chairman & CEO

Yes. So we are seeing increased production across the Heritage portfolio. We are -- launched in the Southeast, we're in Georgia, Alabama, North and South Carolina and Florida. Production increases have been pretty steady across-the-board. We are hitting record new business volumes in Florida, and that new business, by the way, is outside of the Tri-County. And that's the key with us. I mean, we really look at where the AOB problem is, where it's going, and that analysis actually started before we even founded the company. We were one of the first companies to predict there would be an issue. It certainly blew up a lot more than us and others thought it would. But once we saw that increase in 2015 in AOB, AOB losses, et cetera, coming out of the Tri-County, we reacted immediately. We shut down production 2.5 years ago. We've been hitting that book of business with some pretty significant rate increase. We've been doing some selective nonrenewals. We've been dropping our TIVs in force there. And that has an overall impact on your top line premium because those are the highest premium per policies in our portfolio. But despite that, we've been growing outside of the Tri-County in record numbers, offsetting a lot of that attrition that we've been getting. So it's worked well from a top line number for us. We're getting a nice hedge in production elsewhere, good diversification for us. But most importantly, Mark, it has helped us to get way ahead of the Tri-County fraud tail. And every company in Florida, whether they're going to tell you this or not, they have a big tail, and they're booked related to Tri-County claims and adverse development. Our approach to it is a lot different. We looked at it and said stop the problem now 2.5 years ago, don't write any more business, leave that book off and let's get ahead of this issue. So we're sitting here today with a open inventory of claims in the Tri-County that are at 3-year lows, when the problem first started. We are at an open inventory and lawsuits that are down 60% year-over-year and are also at 3-year lows. And then the percentage of open claims that we have in Tri-County are at record lows, which tells me that we are much closer to resolving the tail of these claims that come through than other carriers in Florida. And so to be able to grow the top line the way we've done it and reduce the claims that we see there has been -- I think, is incredibly positive for the company.

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

And then a final question, what do you see in terms of potential rate increases, both in Florida and the NBIC footprint?

Bruce Thomas Lucas
Chairman & CEO

NBIC rates are pretty stable. I think we have a rate increase coming through roughly a couple of percent. Maybe North Carolina goes up upper single-digit kind of range. At Heritage kind of Legacy portfolio in Florida, we applied for and received 14%, and those are in place and being renewed with pretty sticky retention rates. That's the one good thing I can say about the Florida market is that you are able to get rate here, and that does help counteract some of the volatility you're going to see in claims in future quarters.

Kirk Howard Lusk
Chief Financial Officer

Yes. I think you can look at the ceding commissions being about $115 million.

Operator

Our next question comes from Matt Carletti of JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Bruce, I just wanted to follow up on a comment you made in your opening remarks. I think I heard you right that you mentioned some point coming up 2 new strategic relationships that will significantly increase revenue. And while I know you can't tell too much, can you give us a little bit of color on what the nature of those might be, where they might be located, kind of the magnitude of volume that's associated with them? And -- or did I just not hear you right?

Bruce Thomas Lucas
Chairman & CEO

No, you heard me right. We do have 2 new strategic relationships. We will announce them as soon as we buy in the first policy. I can tell you that one of the relationships is, let's say, a top 1 or 2 auto writer in the United States, and the other one is probably top 5. And so I don't want to get too far ahead, and I want to make sure that any comments we make are approved by our partners before I make them. But the upside potential on these, it's massive. It's bigger than anything else we have in our portfolio. So we're really looking forward to these new partnerships that are launching this year. And we've already got training in place and launch dates kind of set, and it looks like they're going to launch here in the third quarter. These are going to be big drivers of growth for us for future years.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. It was -- given kind of how you described those, it would be right to think of these as national or multistate sort of relationships. Or would they be more [indiscernible] -- multi...

Bruce Thomas Lucas
Chairman & CEO

Yes. Multistate relationships for sure. And there's a third one we're close too as well, but that one hasn't been inked yet.

Operator

Our next question comes from the Arash Soleimani of KBW.

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

Just wanted to continue on Mark's question on the rate increases. So I know you have the 14% in Florida. But to the extent that you're getting more renewals outside of Tri-County, is the effective rate increase coming in actually below 14% since -- I'm assuming the higher rates increases are in Tri-County?

Bruce Thomas Lucas
Chairman & CEO

No. We spread it across-the-board. Actually, the Tri-County rate increases were fairly consistent with the rest of the state. So you got to remember, we've been extremely proactive over the last 2.5 years and increasing rates in Tri-County because we predicted that the AOB problem would worsen. A lot of people kept their rates low and continue to buy in policies and, to this day, are still doing that, if you can believe it. So the fact that we've raised rates so much down there over the past couple of years means that the rate gap on this last filing was sort of in line with the rest of the portfolio. That's a good trend. We like that sign. The only thing that we don't like is the litigation environment. And if you look at some of the decisions against some of our peer carriers where you can go to court on a $19,000 roof claim and end up paying costs and attorney fees of $700,000 or $800,000 to the plaintiff counsel, there is something incredibly upside down with what's going on in the legal environment in Florida. We view that as the #1 risk factor in the Florida market, end of story. What investors, in my opinion, should be looking at more than any other metric, number of open lawsuits and number of open lawsuits in Tri-County and then just number of open claims in Tri-County. Those 3 steps will tell you whether that company is going to outperform or underperform for the next 5 years. And our strategy is to get ahead of these things, to resolve these lawsuits, resolve these claims quickly. Problems don't age well, and our actuaries will tell you that as well. And when you see a sudden change in the legal environment like we saw recently on those 2 decisions that came through, you have to make adjustments to your portfolio and get ahead of that. And that's what we did. It's painful. It sucks to have a quarter where you're coming in way below what your own internal guidance was. Had it just been the increase in reserves primarily related to 2Q, that would be one thing if -- the miss wouldn't be that great. But when you couple it with some cat losses, I mean, that's just a one-two punch that, unfortunately, hurt our earnings a lot. But yet, I'm not going to sandbag the reserve analysis to try to get a better quarterly number. I'm just going to do what I can to get ahead of the problem, so that -- work through the tail and moving forward. And I think that's the best long-term play. It's a lot better than putting up lawsuits with almost no reserves and acting like the problem doesn't exist.

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

And can you remind me when the 14% went into effect? And then looking ahead, do you anticipate taking another sizable rate increase? And if so, do you expect the regulators to be onboard with that as well?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean, the -- my hat's off to the floor to regulators. They're doing an incredible job. They're doing everything they can to help companies. They're aware of the problem. I mean, there's limitations to what they can and can't do. I think they're a little overly criticized, in my opinion. But the one thing that they've been good at, they have not taken a hostile approach to require rate increases, and they've been focusing on insurance company solvency. So our rate increases on the voluntary side, roughly 14%. That effective date was August 1. And then we had roughly a 14% rate increase on the takeout business, and that effective date was 5/15 of this year. So that's already well in place right now. And I can't tell you about future rate because we haven't done the actuarial analysis yet.

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

Okay. And then just some questions on gross Irma losses. Can you remind us what the original gross loss was and where it stands today?

Bruce Thomas Lucas
Chairman & CEO

Yes. I think we put a number up without any claim experience. We just took an average of AIR and RMS, and that was somewhere in the upper $500 million. And today, it's between $700 million and $800 million.

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

Okay. And do you have the number of claims to date and how many of those are paid versus unpaid?

Bruce Thomas Lucas
Chairman & CEO

Yes. Our open claim count is somewhere in the neighborhood of maybe a couple of thousand claims. It's pretty much closed, and that's probably on a top line number of 34,000, 35,000 claims. And we do not count reopens as a separate claim, where a lot of companies do. So if you had 10,000 reopens, for example hypothetical, we'd actually have 45,000 claims related to Irma, but we only report it as one claim even if it reopens. So if you want to go look at it kind of apples-to-apples with how a lot of other players do in the market, I'd say we've closed 98% of our claims, something like that.

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

Okay. I know you're still seeing a lot of claims coming in. And if so, are most of those -- do most of those have attorney involvement at first notice of loss?

Bruce Thomas Lucas
Chairman & CEO

Yes. We're still seeing some new claims come in, and that tail trickles off over time. Right now, the attorneys are out trying everything in their power to mine claims. They're going door to door. They're advertising everywhere. It's quite the racket. So yes, new claims are coming in. You do get reopens and you -- what we have seen is that a lot of the new and reopen claims that are coming in are related to Tri-County. And I look at a stat, it's a few months tail. So I don't have an updated number for you. But talk 3, 4 month ago, I looked at all claims reported and what percentage by county was represented by a PA or an attorney and Dade and Broward were like 35% to 40% of all claims were reported by a public adjuster or an attorney, and the rest of the state was like 5%. So it tells you where the problem is. You're seeing the same fraud on reinsurance-related recoveries that the Florida market's been seeing on, water-related claims. But the numbers continue to trickle down. That's a good thing. And the fact that we started de-risking 2.5 years ago in the Tri-County means tail problem on this won't be as big as a lot of other players.

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

And in terms of the reopens, do you have any stats for what percentage of claims are reopening? Or -- and any [indiscernible] for...

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean, the problem with tracking reopens that way is that you could reopen for an administrative reason. You could reopen to drop an estimate into a claim. You could reopen to reissue a check that had expired. I mean, there's hundreds of reasons why a claim would technically reopen. We just track them as a reopen. So I don't -- I can't give you a good number right now. I'd have to actually spend a lot of time digging through the data to figure out the cause of the reopen. But we probably had a couple of thousand maybe of reopens, 1,500. That's just a guess.

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

Okay. And do you -- can you provide, by any chance, the average severity for claims closed with payment?

Bruce Thomas Lucas

Chairman & CEO

I don't have that in front of me, and we have commercial, residential. It skews the number quite a bit.

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

Okay. That's fair. In terms of -- I know you guys use the CAN network, obviously, to help generate some extra income there. Do you -- when you have the discussions with the reinsurers, do you get any pushback from them? Or is it positive feedback? Just curious how they look at that.

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean, we've got nothing but positive feedback. I mean, CAN is going in and doing repair work at a substantial discount to what an AOB would be. And if you can get out to a claim quickly and get the customer signed up into the repair program, you're going to save a lot of money. You're going to save a lot of AOBs and PAs and attorney fees and where you also see a corresponding reduction and loss adjustment expense. I guarantee you, I'd put thousand dollars on it, we have the lowest loss adjustment expense in Florida. We are under 10%. I had some -- Lloyd's syndicates come through here the other week. I asked them what they're seeing as the average LAE ratio in Florida, and it's like 25% to 30%. So CAN saves a lot of money on these cat costs.

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

And are you able to disclose in the quarter the impact that any kind of CAN -- any work that CAN performed related to Irma? To what extent it benefited the loss ratio this quarter?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean, on -- I don't -- we don't really break down those types of numbers because we do guard CAN quite a lot because it's our -- it's the one thing that we have that nobody else does. But I can tell you, the repair work on CAN, actually -- I mean, it's in a trickle mode at this point. I mean, Irma was kind of 11 months, 11 months ago now. So most of that repair work related to Irma has kind of washed through. Where we're seeing benefits today are on the -- on the repair side, is on the daily claims. And that's just something that we do systemically.

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

And in terms of the growth outside Narragansett in the legacy Heritage book, to what extent was that exposure versus rate-driven?

Bruce Thomas Lucas
Chairman & CEO

You had some rate-driven changes, but you also had -- because we didn't get rate increases like everyone else. But you got to remember, we lose a tremendous amount of top line revenue because we're not writing in the Tri-County and we continue to derisk there. We dropped 17% year-over-year in TIV in Tri-County alone. And the average premium down there is $3,000, maybe even $3,500 a policy. Whereas if you're writing a policy in Jacksonville, it's probably around $800. So the fact that our top line continues to increase despite derisking in the Tri-County is pretty impressive. And it just goes to show you how diversified the footprint is becoming, and it's accelerating in all of our new states in the southeast.

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

And what's driving that acceleration? Because I know the new partnerships you're talking about haven't gone into effect yet. So what's that main driver in 2Q, for example?

Bruce Thomas Lucas
Chairman & CEO

Well -- I mean, it takes time in new states to get your ground game in place to market to agents. I know that our new system enhancements have been really critical. It makes it easy to buy into policy, buy into policy with us in under a minute. And so the agents do love that. We rolled out Georgia, we rolled out Alabama, South Carolina. Those things were helping to drive growth. In North Carolina, we're absolutely killing it, and the beauty of North Carolina is we're not really writing a whole lot on the coast. It's inland business, and everyone said that would be impossible. But -- I mean, the ratios inland to coastal, I mean inland premium is like 5x higher in terms of volumes. So we're dialed in, our rates looks good, our system's good. We got our ground game in place. It's working very well for us, and we're gaining a lot of traction in other areas of Florida that are just far away from the Tri-County.

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

And in terms of the reserve strengthening, which accident years were those from?

Bruce Thomas Lucas
Chairman & CEO

A lot of those was related to 2Q, right?

Kirk Howard Lusk
Chief Financial Officer

Yes. It was 2Q. It actually was throughout, but predominantly '15, '16.

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

Okay. And in terms of the -- I apologize if you mentioned this already in the prepared remarks. But in terms of a quota share, did you make any changes to Narragansett quota share?

Kirk Howard Lusk
Chief Financial Officer

Yes. We dropped the gross quota share from about 10%, so that will have an impact on the ceding commission and also on the ceded premium.

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

Okay. And just given the cats this quarter, I mean, does that change the way you think about reinsurance? Would you want to, I guess, implement like an ad cover, anything to reduce the volatility there? Just curious how you're thinking about that.

Bruce Thomas Lucas
Chairman & CEO

Well, we do have an ad cover at Heritage, but these were -- none of them appears through the retention. And so yes, we're going to think about it. I mean, this is unusual. I think the most we've ever had in cat losses in the second quarter is, usually, we're seeing a couple of million bucks. And so you get a couple of hail events and you got a portfolio there, it's going to hit you. There's just nothing you can do about that. We have a pretty robust net gross quota-share program in place in Narragansett Bay, along with an aggregate program that's very robust, but it's not going to pick up all the losses. And remember, first quarter losses were records, and there is sliding scales and quota shares, et cetera. So -- I mean, you have really, really tough weather events in the first quarter. It responds really well to it, and it did certainly last quarter. But you're not just going to get dollar-for-dollar coverage for all these losses. And if things escalate and get a little bit worse, you're going to have to -- it goes toward your retention amount. That's the one thing you get when you have a diversified portfolio. You're more open to frequency events.

But overall, when you compare the reinsurance savings that you get by being diversified, less risk, less volatility that you typically get over time versus isolated severe conductive events, it's definitely better to be diversified than to have all your eggs in Florida, particularly in the Tri-County.

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

Exactly. And to what extent does your retention change, given the quota-share change that you made in Narragansett?

Kirk Howard Lusk
Chief Financial Officer

10.

Bruce Thomas Lucas
Chairman & CEO

10 points.

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

Okay. And can you -- and I think you had mentioned some comments in terms of additional legal fees and such. What about with the integration of NBIC? I think Kirk said that was $2 million. So is that something that will be a recurring, I guess, expense for a few quarters? Or how does the integration cost work going forward?

Kirk Howard Lusk
Chief Financial Officer

Yes. A good portion of that will continue for a period of time. And then again, some of it is actually staffing, so that will continue also.

Bruce Thomas Lucas
Chairman & CEO

We have big growth plans for NBIC. And if you're going to grow it, including new states and new partnerships, we launched some new lines that just went live recently up in the Northeast, you got to have the bodies to generate the growth, and there's a lead lag to staffing and production. If you try to get the production before you get the staffing, you're going to fall flat on your face.

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

Okay. So you're basically just putting the infrastructure in place for the future growth so that you're ready to go?

Bruce Thomas Lucas
Chairman & CEO

Yes. For the growth, yes. And we've been -- remember, we've been expanding Contractors Alliance Network up there, et cetera. So there's G&A expenses that come along with growth, but then you get the return for it in future quarters.

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

Okay. Perfect. And maybe just to comment on your M&A thoughts and any kind of change in your M&A appetite? Or what you're looking at going forward?

Bruce Thomas Lucas

Chairman & CEO

Yes. I mean, we did look at an M&A transaction. I'm under an NDA, so I can't disclose names or anything like that. We walked away from it. We were just not -- we just didn't feel comfortable with the purchase price versus what we saw. And the sellers, on their part, weren't comfortable with where our purchase price came in. So the 2 parties just couldn't align on that. It happens all the time. I probably looked at 20 or 30 different M&A opportunities. We've done 2. And so we're going to be pretty selective. We got a model. The model works. We're going to stick to it. And if something comes along in the future that kind of fits within that box, so be it. And if it doesn't, I think we have to be disciplined.

Operator

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

Bruce Thomas Lucas
Chairman & CEO

I would like to thank everyone for joining the Second Quarter Earnings Call.

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