S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc. NYSE:HRTG

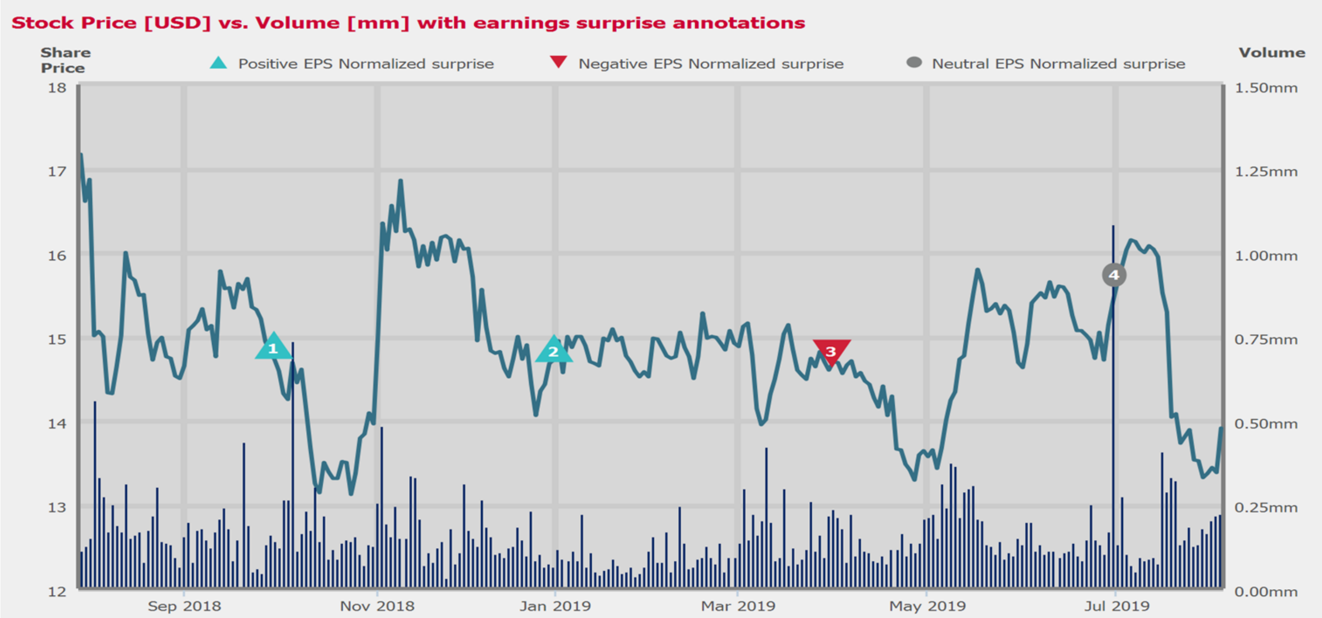
FQ2 2019 Earnings Call Transcripts

Friday, August 02, 2019 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.00	0.00	0.00	0.33	1.26	1.94
Revenue (mm)	119.62	122.84	2.69	121.55	482.33	515.08

Currency: USD
Consensus as of Aug-02-2019 11:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	0.28	0.65	132.14 %
FQ4 2018	0.03	0.18	500.00 %
FQ1 2019	0.31	0.21	(32.26 %)
FQ2 2019	0.00	0.00	0.00 %

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Call Participants

EXECUTIVES

Arash Solemani
Executive Vice President

Bruce Thomas Lucas
Chairman & CEO

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

Christopher Campbell
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 the Heritage Insurance Holdings First (sic) [Second] Quarter 2019 Financial Results Conference Call. My name is Cole, and I will be the operator today. [Operator Instructions] Please note, this event is been recorded.

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

Arash Solemani
Executive Vice President

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

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

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

I will now turn the call over to Bruce.

Bruce Thomas Lucas
Chairman & CEO

Thank you, Arash. I would like to welcome all of you to our second quarter 2019 earnings call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company.

Despite severe weather losses, we had excellent second quarter operating results. We continued to execute on our diversification strategy that is designed to reduce exposure in Florida, especially in fraud-prone areas like the Tri-County, while growing in states that have less volatility. Our ex Florida sales are up significantly accelerating across our footprint as we launch new states and expand with strategic partners.

In the Southeast, ex Florida, new business premium increased 90% year-over-year and 44% quarter-over-quarter.

In the Northeast, new business premium increased 25% year-over-year and 35% quarter-over-quarter. In Florida, personal lines new business premium decreased 6% year-over-year, but increased 27% quarter-over-quarter. Across our entire platform, 64% of personal lines new business premium was generated outside of Florida. We have used our ex Florida growth to offset strategic nonrenewals in the Tri-County. In the second quarter, we dropped a remarkable $6.2 billion of total insured value, or TIV, in Florida's Tri-County year-over-year. This is a unique approach to diversifying away from the Tri-County in Florida, in general, that we do not believe is occurring with any of our competitors. Although, new business premiums outside of Florida and the Tri-County are significantly lower, they are more profitable because there is less fraud litigation and reissuance costs. Long term, we believe our portfolio will outperform peer companies that continue to focus on top line growth versus bottom line profit.

We strongly believe that aggregation in Florida and the Tri-County will continue to cause higher loss ratios and adverse prior year reserve development across the sector. With the exception of Heritage Insurance, adverse development continues to plague the Florida market and it is our belief that it is largely related to Tri-County claims that have elevated severities.

3 years ago, we began to pull out of the Tri-County and diversify away from Florida. Since then, we have evolved from a Florida company to a superregional carrier that has 70% of our TIV outside of Florida. During this time period, our claimed statistics related to the Tri-County have continually improved and we are at all-time lows for percentage of claims and losses related to the Tri-County. Fewer Tri-County policies and claims means less volatility related to reserves. As a result, I'm not surprised that Heritage stands alone as the only carrier to report favorable prior year development 4 quarters in a row. Our reserving philosophy is different, I have noted several times that our reserves have been the highest in the peer group, despite having lower exposures in Florida and the Tri-County, and we believe we have a more conservative and accurate approach to setting loss reserves as evidenced by our consistent favorable prior year development. This was particularly an issue in the second quarter in Florida as we had a surge in newly reported Assignment of Benefit or AOB claims in advance of the July 1 statutory reforms. In particular, we received a large influx of roof-related claims for hail events of prior quarters and for 1 PCS event in Florida during the second quarter. Including the Florida PCS event which impacted multiple Southeast states in the quarter, we had a total of 4 PCS events that impacted our Southeast footprint. Unlike the first quarter, we did not have a single event that was large enough to trigger reinsurance recoveries. As a result, we incurred approximately $21.5 million of current accident quarter severe weather losses that overshadow an otherwise stellar quarter across all metrics. It is worth noting that the vast majority of this loss is related to incurred, but not reported, or IBNR versus paid claims and this approach is consistent with our reserving philosophy. If these claims are truly related to a surge in AOB and/or do not develop, we will potentially have a significant amount of IBNR to release in future quarters. However, until and if that occurs, it is prudent to establish sufficient reserves now rather than incur adverse development later.

Moving on to capital management. We repurchased $2.3 million of common stock at a discount to book value. We have been stockpiling free cash at the holding company and will be opportunistic and intend to retire additional shares in 2019 as long as our share price is full of fair value.

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

Kirk Howard Lusk
Chief Financial Officer

Thank you, Bruce. Good morning. Net income for the quarter was $700,000 and was down from $2.4 million reported during the second quarter of 2018. As announced in our July 18 press release, weather losses during the second quarter of 2019 were the main driver of the year-over-year variance.

Gross written premium for the quarter were $255 million, which was down from $264 million for the second quarter of 2018. The drop in the second quarter reflects the continued derisking in the Tri-County region of Florida. In-force premium reductions in the Tri-County area for the second quarter of 2019 was one of the largest in-force reductions since the derisking began in 2016.

In-force premiums in the Tri-County area decreased by over $35 million year-over-year and by over $23 million in the second quarter of 2019 alone. Largely offsetting this significant reduction in the Tri-County area, in-force premiums year-over-year outside of the Tri-County area grew by over $25 million. We anticipate that our growth outside of the Tri-County area will continue and accelerate as we direct our marketing efforts outside that region and continue to evaluate our exposure in the Tri-County area. Despite the significant amount of derisking, gross earned premiums are relatively flat from the prior year quarter.

Ceded earned premiums are down year-over-year by 3.2% and down 2.5% from the first quarter of 2019. The decrease reflects NBIC-related synergy savings on the cat XOL reinsurance tree, and also the June 1, 2018 reduction of NBIC's gross quota share contract from 18.8% to 8%, and the June 1, 2019, elimination of the gross quota share, which was partially offset by an increase in the NBIC net quota share last December from 49.5% to 52% and increases in other reinsurance structures.

2019 second quarter net earned premiums were up 2.6% from the second quarter of 2018, reflecting the slight reductions in the gross earned premium, which was more than offset by the decrease in ceded premiums earned just mentioned.

Losses in LAE were up 12.6%, or $8.3 million from the prior year quarter. The net loss ratio was 65.1% for the second quarter of 2019 compared to 59.3% for the second quarter of 2018. Current accident quarter hail and noncatastrophe weather losses from multiple events impacted the net loss ratio for the quarter by 18.8 points and for the year-over-year loss ratio variance by 10.4 points. The remainder of the variance is attributable to the change in loss development and reduced activity in our vertically integrated Contractors Alliance Network.

Policy acquisition costs were up $7.7 million, predominantly due to the expiration of the purchase accounting benefit obtained during the first half of 2018, and reduced ceding commissions associated with changes to our quota share reinsurance program.

General and administrative costs are down $6 million from $24.4 million at second quarter 2018 to $18.4 million at the second quarter of 2019 and relatively flat from the first quarter of 2019. The reduction from the prior year quarter is predominantly due to acquisition and integration expenses incurred in 2018, which was partially offset by a ceding commission reduction.

The combined ratio for the quarter as a percentage of net premiums earned was 105%, which is up from the 98.7% as of the second quarter 2018. The increase reflects the weather losses previously discussed with a relatively flat expense ratio.

Shareholder's equity at June 30, 2019, increased to $438.9 million from $435 million at the end of the first quarter 2019. The change predominantly reflects the net income for the quarter and the tax effected net unrealized gains in investments, partially offset by dividends to shareholders and stock buybacks.

Book value per share is $14.99, up from $14.78 at the end of Q1 and $14.43 at year-end.

Total cash plus invested assets increased $62 million from year-end, mostly driven by the receipt of reinsurance recoverables related to hurricane claims.

Total assets are $1.9 billion at the end of Q2.
Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] And our first question today comes from Mark Hughes with SunTrust.

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

On the ceded premiums line, it was about $116 million this quarter. How should we think about that for our Q3 when we get the full run rate on the new Florida reinsurance treaty?

Bruce Thomas Lucas
Chairman & CEO

Yes. When you look at that -- yes, this only reflects like 1 month of the reduction. So we will get a little bit more of a reduction and won't be -- yes, you can't extrapolate fully the reduction book by times 3. But I would think that when you look at the quarter-over-quarter reduction from Q1 to Q2, we're going to have about that same type of magnitude in the third quarter going forward.

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

Okay. Then how about the G&A expense, it's been little bit volatile. Is this $18 million, $19 million, is that a good number? Or how should we think about that?

Bruce Thomas Lucas
Chairman & CEO

Yes. I think that probably is going to tick up a little bit as we look at some of these initiatives we have both on the growth and on the claim side. So the claims cycle will actually move over to the loss dollars, but some of the activity we're going to incur. So I would look that going up slightly.

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

Okay. And then the AOB, you talked about the surge in filings in 2Q. Was that captured in your 2Q loss ratio? Is that going to have a spillover into Q3 on losses?

Bruce Thomas Lucas
Chairman & CEO

No. So it is captured in 2Q, Mark. We, along with everyone else saw the surge in AOB as they were racing to get their AOBs in before the 7/1 deadline. So there was a big ramp-up out there in the market, trying to recruit insureds to participate in the scam. So we saw that increase. A lot of it we saw was related to hail and other miscellaneous wind events. We have a hard time getting the AOB contractor to tell us exactly when these losses happen because they don't know. And so those losses were captured in that $21.3 million or $21.5 million severe weather number that we put out. The vast majority of the losses are IBNR. When you see an increase in claim activity like that, unfortunately, you have to reserve for it, like that's your latest trend. So we put up significant reserves and we'd rather be wrong about the reserves and have favorable development going forward like we've been doing in the past 4 quarters. But we can't change our reserving philosophy quarter-over-quarter, 1 quarter does not a trend make. So if these things don't develop then we should have a lot of reserves to release. But until and if that happens, we have to make sure that we're doing things according to our standard reserving protocols.

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

I'll ask one more modeling question. I apologize for that. But when you think about your underlying loss ratio. This quarter, you clearly called out that was 19 points from the severe weather. If we take them on a go-forward basis, do we just strip out the 19 points and then make some assumptions about the cats or what have you? Or would you say we ought to keep in some additional buffer for normal weather volatility?

Bruce Thomas Lucas
Chairman & CEO

I mean there should be a little bit of buffer for normal weather volatility in especially 2Q and going into 3Q because those are the rainy months. But what we saw this quarter was, I think, we had 4 separate PCS events, 4 of them hit our Southeast book ex Florida, 1 of them hit directly in Florida. That's kind of unusual. So we put up a lot of reserves on those. So like I said before, hopefully, we've overshot it, but we won't know for another year, to be honest with you. But you're always going to have a little bit of weather volatility. I mean it's -- we expand our footprint, you're going to get more frequency events. But over the long haul, with reinsurance synergies, lower fraud costs, lower claim costs, it should more than balance out and should be pretty accretive to the bottom line as we continue with the business plan.

Operator

And our next question comes from Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Congrats on the quarter. I guess my first question is on the core loss ratio increase. I'm assuming those to be about as the storm-related income rolling off. Was there anything else that drove that increase as well that we should be thinking about as we model that forward?

Bruce Thomas Lucas
Chairman & CEO

Well, the core loss ratio is impacted by higher reserves, especially in the quarter. I mean we massively increased current accident quarter IBNR to encapsulate a surge in claims that we had. So it's that factor, in addition, we've just generally noted across Florida that the environment for claims abuses has -- is getting worse, I really can't say that I've seen it improving. And so that -- this goes to the heart of why we have been making the pivot for the last 3 years to diversify away from Florida. And to be honest with you, you can do AOB reform and you can change the format of the fraud, but the fraud will continue. And I just don't see it really ever going away, particularly in the Tri-County, Orange and Osceola or 2 other big ones. We just got to hit it with rate, which we're doing. We're getting about an average of 14-plus percent rate increases across our personal line platform in Florida. And that's in response to the higher loss cost that we're seeing across-the-board.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And post AOB reform, I mean I know you guys are only like a month in. I mean are you seeing like any drop in litigation or anything like that on the Florida book? I mean have there been a noticeable improvement in your like operational claims metric?

Bruce Thomas Lucas
Chairman & CEO

Yes. So you're right. It has been -- it is pretty early. And I can tell you that what our stats tell us is, on litigation, we actually saw, I'd say, pretty consistent levels in July because you have a lot of AOB claims that were, say, from first quarter or second quarter. They didn't get exact amount of money as they were looking for. And so they end up filing suit and because those AOBs are pre 7/1 they're covered -- they're not covered by the new statute. So we haven't really seen that tail off as much because there's a bit of a lag there. Last half of July was lower than the first half, I can tell you that. And in terms of AOBs that we have seen since July 1, yes, we've seen a pretty sharp decline. And of the ones that have -- that were filed with us, I think, in total, we had a few hundred AOBs, which really isn't that much. And only about 30 or 40 of them even attempted to comply with the new statute. So they were summarily rejected. So we've seen a pretty big drop off in the amount of AOB activity on front end claims in the month of July.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And there's no other area that like they're being create -- the plaintiff's bar as far as being creative about, like trying to open up new areas for?

Bruce Thomas Lucas
Chairman & CEO

Yes. They are. And I won't mention them on the call. But they -- we have different lawyers trying different strategies to try to circumvent the AOB statue. So we're on top of those issues as well. But that kind of goes to my point, you can't stop the fraud in certain areas of Florida, you can't stop it. There's -- it will find a way to creep into your numbers through one mechanism or another. It is there, it is not going away. We've noticed it getting worse every year of our operation, which is why we've so steadfastly been derisking out of those areas and growing outside of Florida. The only way to stop the fraud is to not have the actual exposure.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then can you give us color -- I mean I know you guys aren't interested in M&A in Florida, but has like the environment post reinsurance rate increases for competitors who took higher rate increases than you guys did, has that changed the outlook of sellers? And are you seeing more companies down there willing to entertain offers?

Bruce Thomas Lucas
Chairman & CEO

Well, that's a really good question. And you know we've kind of led the market on the M&A front. We are not interested in M&A in Florida, but I can tell you that there are several companies that are teasing potential sales to prospective buyers. We're just not seeing the buyers come in for those companies. I mean they're generally smaller in scale. They have a lot of Tri-County business. You got to get in the reserves. You got -- they don't have the reinsurance leverage that the bigger carriers have. We're really not seeing any activity. The only activity I'm aware of is one company that I believe acquired a book of business from another within Florida. But I don't think they actually took on the entity itself.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And would there be like -- would there be a price like if something was trading at like a large price-to-book discount. Would there be a discount at which like you might get you -- Florida might look more attractive, if you could get something for like 70% a book?

Bruce Thomas Lucas
Chairman & CEO

Maybe. I mean I'm never going to say no. But for us, we need to find a -- let's just say that hypothetical, was there -- we would need to find a company that has our reserving philosophy, and I can just tell you that nobody has it. And that's the reason we're the only carrier that has been reporting favorable prior year development every quarter. I'm not really looking to inherit somebody else's headaches. We're diversifying the company away from Florida, that is our business plan, it's different than everyone else in this market. We're going to stick to it. It is working for us. We've seen it in our operating profit over the last several years, it has been very strong. We're going to have frequency events, more of them as we expand outside of Florida. But in general, we just find incredibly stable claim markets, environments outside of the state of Florida, particularly outside of Tri-County, Orange and Osceola.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And then as you diversify outside of Florida, what are the ROEs? I mean Florida have like pretty large premiums and it's a very volatile market, but usually pretty high ROEs. Now as you expand outside of Florida, are you expecting those to compress? And then just thinking at a high level about valuation, right? I'm thinking price-to-book as a function of future ROE. If you're expanding outside of Florida, how does your competitor set change whereas most people will throw you in with the other 4 Floridians? Does your competitive set change? And should we be thinking about the valuation any differently as you become a superregional versus a predominately Florida carrier?

Bruce Thomas Lucas
Chairman & CEO

Really good question. So I would say no, that the ROEs are not compressing as we expand outside of Florida, and there are several reasons for that. First, we have lower claim experiences outside of Florida. It's way more stable, there is less fraud, there's just -- law suits just don't exist. PAs just don't exist. We don't see them in our books. We're not in Louisiana. We're not in Texas, where you see this stuff. We've purposely removed ourselves from those markets. The market that we're in are very, very stable. They have higher retention ratios and we are also -- so that's the first reason. The second reason that we don't believe that ROEs are compressing, in fact, we think they're accelerating is because we're getting significant reinsurance synergies as we expand the footprint away from Florida. The reinsurance costs that we have in Florida are significantly higher than ex Florida. And so more concentrations outside of Florida, particularly where our book lie, in the Southeast, it's more of an inland book, not a coastal book like some of our peer companies. And we're picking up tremendous reinsurance synergies that are helping the bottom line. And you get rid of the fraud and the fluctuations in IBNR. And those things are very, very positive for the company.

In terms of part b of your question, which was the competitive landscape. Yes, we're going head-to-head with more of the major carriers, there's no doubt about that. We do see some of the Florida peers in our states. There's one in particular that we see a lot. But we are focused more on inland book versus the coastal book in a lot of these states that I think is a differentiator. But we are going up against companies like Travelers and big household names that you would normally see. But we're growing at the remarkable pace outside of Florida, well in excess of what we had modeled. And so our strategy is working and we are gaining traction to market share as we move the footprint away from Florida.

Operator

And our next question comes from Matt Carletti with JPM (sic) [JMP]

Matthew John Carletti
JMP Securities LLC, Research Division

Matt Carletti at JMP. A few questions. Bruce, I was hoping you could -- just back on the weather losses real quick. Can you give us the rough split of what were Florida events and what were ex-Florida events? I know you mentioned North Carolina as the biggest one, but kind of how that splits out?

Bruce Thomas Lucas
Chairman & CEO

Yes. I think the -- most of it was related to Florida, it was related to the AOB claims that we got in the quarter. I don't know that I have that split in front of me. I'm kind of looking at the screens now. But we have a much bigger portfolio in Florida than we do in North Carolina. So although, Georgia, Alabama and North Carolina got pounded pretty hard by these PCS events. I would say that the majority of the loss came out of Florida.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. And then sticking on kind ex Florida. Can you talk a little bit about -- now you've added some new partnerships with other larger national companies, how are those coming along and are you pleased with what you're seeing so far?

Bruce Thomas Lucas
Chairman & CEO

Yes. They're actually going very well. So the 3 main large partnerships that we have are GEICO, National General and Safeco. So those are the 3 kind of more national carriers that do wheels that we're partnered up with. I can tell you that the relationship there with all 3 companies has been fantastic. It is helping us with our growth, no doubt about it. We're looking to expand that relationship in the new markets and products, especially, here in the second half of the year. So I would never give actual data about any of those 3 carriers, that's something that we feel is proprietary and we would need their consent to release. But their relationships have definitely outperformed what our expectations were.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And just one quick numbers question on the investment portfolio. With the pullback in rates here, what's the new money yield and what's the book yield?

Kirk Howard Lusk
Chief Financial Officer

I'm looking at -- we are -- our yield is about 2.84, duration is 3.49.

Matthew John Carletti
JMP Securities LLC, Research Division

And that's book yield?

Kirk Howard Lusk
Chief Financial Officer

Yes.

Matthew John Carletti
JMP Securities LLC, Research Division

And then what's the -- what's new money rate?

Kirk Howard Lusk
Chief Financial Officer

I don't have the new money rate. We've got...

Bruce Thomas Lucas
Chairman & CEO

We've got to take a look at that. Yes.

Operator

[Operator Instructions] And your next question comes from John Barnidge with Sandler O'Neill.

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

Gross premiums written growth has decelerated every quarter since 2Q '18. I know it's a real positive, the risk reduction in Tri-County. But as we look forward, when we should expect that risk reduction eventually turns to growth given the real strong growth you're having in the expansion states and partnerships?

Bruce Thomas Lucas

Chairman & CEO

Well, you know the derisk that we had in the second quarter was the largest in the company's history. And we did that in advance of reinsurance season, to be honest with you. We just didn't want to have all that TIV on our books during wind season and pay the cat premium for it. So there's a lot of factors -- it's a great question, there's a lot of factor that kind of go into play. We saw positive growth in the first quarter. Second quarter was the largest derisk in the company's history as mentioned, yet our in-force premium went down less than 1% year-over-year. So it was very negligible. But that was a targeted reduction. As we're seeing acceleration in the ex Florida states, which has been incredibly strong, we do think that plus rate increases moves us into positive growth trajectory moving forward. But 2Q because of the derisk for the reinsurance purposes was a big offset to that tremendous growth we had in second quarter.

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

Is the derisking completed? Or maybe asked another way, the $6.2 billion in TIV reduced during the quarter, how much on a percent basis does that represent of the current Tri-County exposure?

Bruce Thomas Lucas
Chairman & CEO

It's a good question. I'll let them pull up TIV metrics here, we'll try to get you that number. But I can tell you kind of rough numbers. We're going to derisk more and that is our trend. So investors that like less fraud, volatility and adverse development, I mean this is how we get there. There is more policy derisking that will take place, we're not writing any business down there at all for personal lines. You can bank every year on at least 15% to 20% of those policies disappearing just from natural attrition. We have been very focused on commercial residential in the Tri-County. We've noticed that there are some companies that are still underwriting those exposures at what we believe is an insufficient rate. So we have done a lot of derisking in commercial residential, particularly in Dade, where we do not believe that market rates are sufficient to cover the cat load and the attritional loss ratios that you have for that book.

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

Okay. You mentioned you've got no interest in Florida M&A really. Do you have interest in M&A outside of Florida? And if so what geographies or lines of business?

Bruce Thomas Lucas
Chairman & CEO

Yes. Another great question. Yes. We would look at M&A outside of Florida. It is not our focus. We were focused on Zephyr and Narragansett Bay, those were the 2 targets, we closed on both transactions. We are not actively pursuing any M&A in the market right now. But if we did look at M&A, it would have to be outside of Florida unless there was just some crazy deal out there that made a lot of sense to us.

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

All right. And I think this will be my last question. You're getting a -- it's sounded like a 14.9% earn rate increase on your Florida book. But can you like dimension what your claims inflation level is? I'm just trying to triangulate how long we should be thinking about underlying margin deterioration prospectively?

Bruce Thomas Lucas
Chairman & CEO

Well, a lot of that depends on severe weather and a lot of that depends on how much favorable or unfavorable development we have in the book. I can just tell you that loss costs in Florida are elevated versus a year ago, versus 2 years ago. And that is really related to the unique fraud mechanisms that are in place in Florida with or without AOB, you see it. So there is going to be some loss cost inflation in the portfolio, offset by the rate increases. If the loss cost weren't there, we wouldn't be able to get 14.9%.

And that rate increase is really targeted at Tri-County, where the average rate increase is 25% on that filing. So it -- you take a statewide average of roughly 15%, but 25% is going to 3 counties. It shows you that the loss cost inflation ex Tri-County isn't really that high, it's the Tri-County portfolio, which is why I mentioned in my comments earlier that we believe a lot of the adverse development occurring in the market right now is happening -- is related to -- or in connection with Tri-County exposures.

Operator

And this will conclude our question-and-answer session. I'd like to turn the conference back over to Bruce Lucas for any closing remarks.

Bruce Thomas Lucas
Chairman & CEO

I would just like to thank everyone for participating in our 2Q earnings call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. And have a good day.