

Heritage Insurance Holdings, Inc. NYSE:HRTG

FQ4 2017 Earnings Call Transcripts

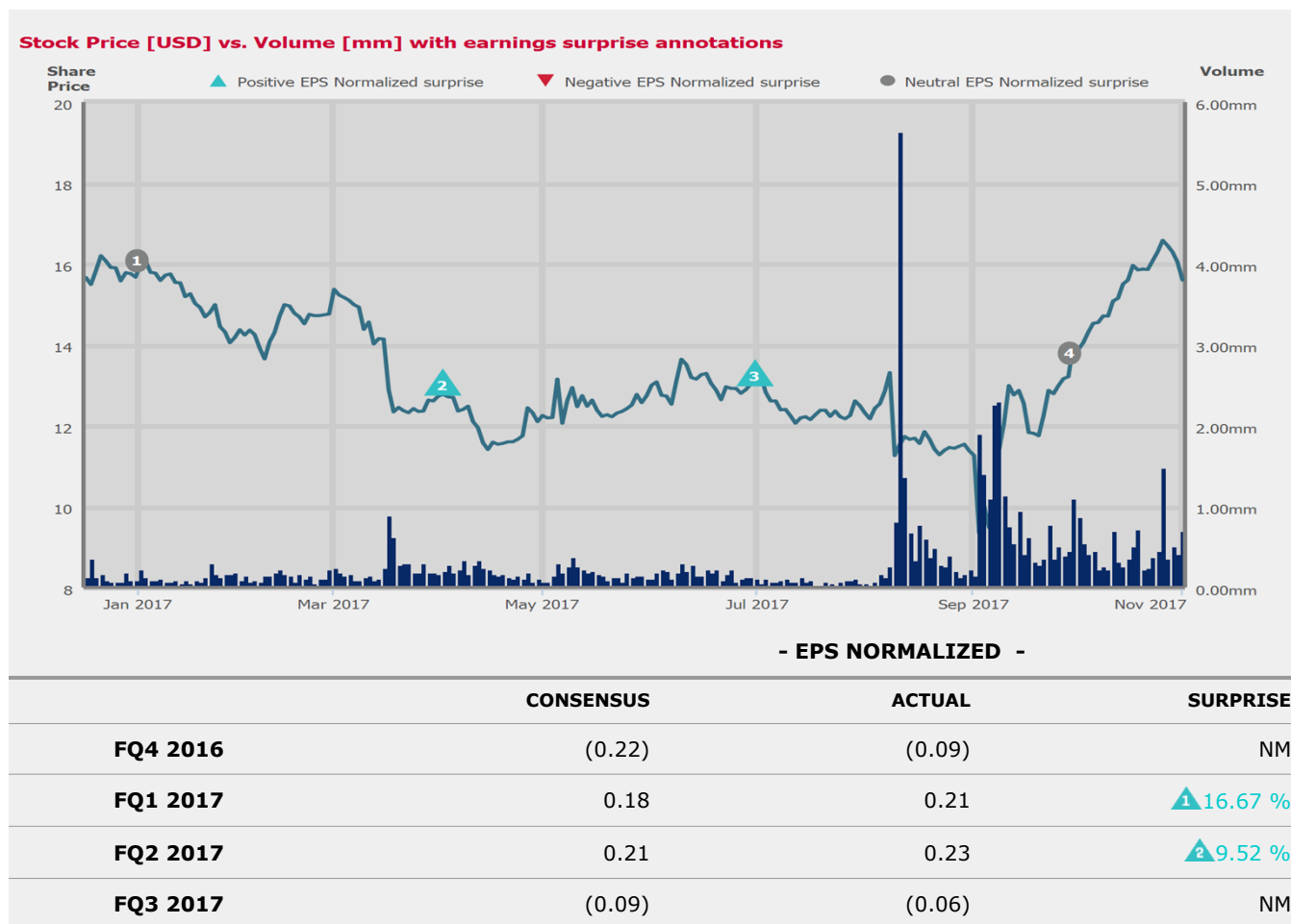
Thursday, March 08, 2018 1:30 PM GMT

S&P Capital IQ Estimates

| | -FQ4 2017- | | | -FQ1 2018- | -FY 2017- | | |
|-----------------------|------------|--------|----------|------------|-----------|--------|--|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL | |
| EPS Normalized | 0.39 | 1.23 | ▲215.38 | 0.61 | 0.77 | 1.53 | |
| Revenue (mm) | 101.35 | 108.62 | ▲7.17 | 146.11 | 398.34 | 406.62 | |

Currency: USD

Consensus as of Mar-08-2018 5:05 AM GMT



Call Participants

EXECUTIVES

Bruce Lucas

Chairman of the Board & CEO

Joseph Rene Peiso

Vice President - Compliance

Kirk Howard Lusk

Co-Chief Financial Officer

Unknown Executive

ANALYSTS

Arash Soleimani

*Keefe, Bruyette, & Woods, Inc.,
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James F. Naklicki

Citigroup Inc, Research Division

John Bakewell Barnidge

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Mark Douglas Hughes

*SunTrust Robinson Humphrey,
Inc., Research Division*

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings Second Quarter 2017 Financial Results Conference Call. My name is Rocco, 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

Vice President - Compliance

Good morning. We invite you to visit the Investors section of our website, heritagepci.com, where the current quarter's earning 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 comparable GAAP measures.

With us on the 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 Lucas

Chairman of the Board & CEO

Thank you, Joe. I would like to welcome all of you to our fourth quarter 2017 earnings call. Before we begin the call, I'd like to thank all of our nearly 450 employees for their dedication to our company.

I am very happy to report that we had our best quarter in the company's history and posted record adjusted net income of \$30.3 million. As mentioned in the third quarter, our strategic capital management decisions would accelerate shareholder returns. This is clearly apparent in the fourth quarter, as book value per share increased by 14.3%. Also for the fourth quarter, adjusted net income return to average shareholders' equity was an annualized 36%.

Over the past 18 months, I have stated that our consolidated loss ratios will continue to improve as we diversify production away from Florida's Tri-County area, where assignment of benefit fraud is widespread. Indeed, we believe our consolidated loss ratios continue to decline to some of the lowest levels in the Florida market. Our consolidated loss ratios for the past year are 43.3% in the fourth quarter of 2016 and 24.4% for the fourth quarter of 2017, an impressive 19-point improvement. This is particularly meaningful given the claims environment in Florida and our decision to strengthen IBNR by \$15 million in the fourth quarter.

Our favorable claims trend is attributable to 2 factors. First, we have a unique vertically integrated construction and repair model that allows us to get the losses quickly and contract directly with our customers. This allows us to enhance the customer experience and control the claims handling process. This model is unique to Heritage and helps to prevent AOB abuses by third party.

Second, we are disciplined underwriters and made a bold decision to stop voluntary sales in the Tri-County about 18 months ago. Our belief that claims abuses would accelerate in the Tri-County proved correct,

and we were able to dampen the impact on our financial results because we were the first major carrier to stop production in the region. Despite our decision to stop production in a major metropolitan area, our voluntary sales have consistently accelerated and reached record numbers in 2017.

For the full year, we increased our policies in force by 62%. Consolidated in force premium at the end of 2017 increased by 48% to \$940.8 million, and we look forward to crossing the \$1 billion threshold in the near future. Our production and acquisitions have consistently diversified our footprint, which reduces our cost of reinsurance and improves our loss ratio and drives better economies of scale.

Our total shareholder returns for the year are equally impressive. Book value per share increased 18.2% year-over-year, and this number increases to 20.2% when adding back dividends. This is an exceptional return in a year marked by a major Florida hurricane. When adding back our Irma retention and \$5 million of nonrecurring M&A expenses, the total shareholder return would be even higher than 20.2%.

Our strong economics are not accurately reported on a GAAP basis. As mentioned in the third quarter, we issued a convertible bond and needed shareholder approval to settle the associated option in cash or stock. GAAP required us to book a hypothetical liability related to the option until the shareholder vote was obtained. We obtained shareholder approval on December 1, and the hypothetical liability equaled \$35 million in the fourth quarter because the share price increased from the end of the third quarter until December 1 when the vote was approved. This is a noncash liability that negatively impacted the GAAP income statement for the quarter just as it did in the third quarter. It has no impact on taxes, book value or economic earnings in the quarter. Absent this noncash charge, our net income was \$30.3 million, a new record for the company versus a negative \$5 million on a GAAP basis. Absent the noncash charge, our full year net income was \$41.1 million versus a negative \$1.1 million on a GAAP basis. Additionally, our operating income for 2017 was \$49.5 million.

As mentioned, our quarterly and full year earnings would be even higher absent our retentions for Hurricane Irma and approximately \$5 million in nonrecurring M&A expenses related to our recent acquisition. Now that we have shareholder approval to settle the option in stock, there will be no more fictional liabilities running through our income statement going forward. Shareholders should completely ignore the fourth quarter noncash charge as it has no impact on book value, taxes or cash earnings.

Moving on to our acquisition of Narragansett Bay Insurance Company, or NBIC. We closed the transaction on November 30, 2017. The integration has been seamless, and we are working together to enhance the consolidated organization. The acquisition brings strategic partnerships, growth opportunities, operational synergies and reinsurance savings. NBIC considerably diversifies our organization and adds over \$325 million of premium in the Northeast. The spread of total insured value across the organization is much more balanced at the end of 2017, and Florida represents only 32% of the company's total insured value.

The projected ROI related to the acquisition of NBIC was considerably understated at the time of announcement. Likewise, the total dilution to shareholders' equity was overstated, and the transaction closed with substantially better economics. There are several factors for this. We issued \$40 million in common stock at closing to the sellers. At the time of the deal announcement and pricing of the convertible bonds, the \$40 million of equity issued to the sellers was assumed to be based on \$11.33 per share versus the actual settlement price of \$18 per share. This difference reduced the number of shares we issued to the sellers by 1.3 million shares.

Second, we were very opportunistic at and after the bond offering and repurchased \$53 million of stock at an average price of \$11.38 per share. Our decision to not fix the number of shares issued to the sellers and to leverage the transaction to retire 4.66 million shares at an absurd valuation is producing outsized returns. As a result of our efficient capital management, we were able to reduce our outstanding share count by 10% in 2017 at extremely attractive valuations.

Additionally, there were several positive developments that increased future book value and returns on the NBIC acquisition. Most notably, the change in 2018 effective tax rates will increase net income by an additional 22%.

In summary, the NBIC transaction significantly increases earnings per share and book value per share because we get accretive net income on a much lower share count. The combination of these factors will continue to drive outsized shareholder returns.

We are expanding our overwhelming success with Contractors Alliance Network, or CAN, to the NBIC states and will launch offices in additional Heritage states in 2018. We believe this will have a positive impact on the consolidated loss ratio for the organization. I am extremely proud of our accomplishments at CAN. CAN is a multifaceted, full-service construction and mitigation companies with operations across Florida. The division has grown at an incredible rate and posted its fourth consecutive year of record growth. In 2017, we grew the division to over \$100 million in revenue for the first time in our history. Although we have no immediate plans to spin off our construction division, I believe CAN has significant intrinsic value that is not reflected in our book value. As we continue to expand our operations across the East Coast, we will continue to evaluate a potential sale of the construction division, which could significantly increase our stated book value.

At the end of the quarter, we had approximately 32,000 Irma claims. CAN was able to respond to over 9,000 Irma claims. Our network responded to claims the day after the storm and immediately began to remove trees, tarp roofs, mitigate water damage and remove and haul away debris. Our network put our customers first and helped them in their time of need. This exceptional customer service separates us from the pack when it comes to catastrophe management.

With respect to reinsurance, we once again proved the strength of our reinsurance protection. At this time, we are estimating that Irma will produce a \$560 million ultimate loss. This number could increase over the next 3 years given to the claims environment in Florida. However, this projected loss only erodes approximately 12.2% of the company's 2017 consolidated reinsurance coverage.

By all accounts, we had an extremely profitable year. When I cofounded the company a little over 5 years ago, we were a start-up with 6 employees, a cutting-edge business plan and no revenue. In only 5 operating years, we have grown to 450 employees, built a \$100 million construction division and a multistate insurance conglomerate that we believe will surpass \$1 billion of in force premium in 2018. With the exception of Heritage Insurance, this magnitude of growth in our industry is unheard of, especially while maintaining strong profit margins that have outperformed virtually every competitor in the Florida market since 2013. I believe there is still a tremendous growth opportunity ahead of us. We are accelerating our sales, expanding into new states, offering new products and forging strong partnerships across our footprint.

Our shareholders routinely ask me about our capital deployment plans. I know the value of this organization and have heavily invested in its future. I have routinely purchased shares of our common stock and ended 2017 with 1.26 million shares, which makes me a top 5 shareholder in the company. Despite another tremendous year wherein we've outperformed virtually all of our peers, as of yesterday's close, we are trading at just north of 1.1x book value versus our Florida composite average of approximately 1.7x book value. In our opinion, this difference is not justified and does not remotely reflect the fair value of the company. As long as our share price is trading at a substantial discount to our fair value and market comps have underperformed our results for several years, we will continue to purchase shares because it will produce outsized returns for shareholders versus other forms of capital deployment. As mentioned, our capital management decisions related to strategic share repurchases contributed to exceptional returns in 2017, and we will continue with this trend until our share price reflects our fair value.

Finally, I would like to thank Steve Martindale for his service over the past 2 years. Steve is an incredibly talented executive that has contributed to our growth and profitability. While we wish Steve the best in his new career ventures, I am grateful that he will remain with the organization as a director.

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

Kirk Howard Lusk
Co-Chief Financial Officer

Thank you, Bruce. Good morning. As Bruce mentioned, on November 30, Heritage Insurance Holdings completed the acquisition of NBIC for \$200 million in cash and \$40 million of stock. The \$40 million in stock was issued at a price of \$18 per share, which resulted in 2.2 million shares issued with the transaction. As part of the acquisition, I would like to say I'm thrilled to now be part of the Heritage team and to be with you this morning. I'm very excited about the synergies, opportunities and the diversification this deal brings to Heritage.

I would like to give a brief overview of the geographic diversification of the company. In force premiums at year-end 2017 were \$941 million, up from \$635 million at the end of 2016, an increase of 48%. Just as significant is the distribution shift in the in force premiums. At year-end 2016, 89% of the premium was in Florida, and at year-end 2017, that percentage has dropped to 57%. The next state with the highest percentage is New York with 19%, followed by New Jersey with 8% and then Massachusetts and Hawaii with 6% each. At year-end 2017, our policies in force totaled approximately 524,000. Overall, the geographic diversification will provide additional growth opportunities and reinsurance synergies.

Since the closing was on November 30, 1 month of NBIC's results will flow through the income statements for the quarter. NBIC's reinsurance program incorporates the use of quota share reinsurance. Even though only 1 month of NBIC's results are in the consolidated results, it does have a meaningful impact on the various operating ratios. Traditionally, Heritage has reported the various ratios as measured against gross premiums earned. With the quota share treaties, we believe that it's useful to report on and analyze our results using the net ratios. Therefore, in this quarter's reporting, we are transitioning to using net premiums earned as a denominator in the ratios. We will continue to provide some gross ratios when meaningful.

Gross premiums written for the quarter were \$169.7 million compared to \$154.9 million for the same period last year. NBIC contributed \$25.9 million of gross premiums written for the quarter.

Gross premiums earned for the current quarter were \$183.3 million, which included \$28.4 million earned on policies acquired from NBIC compared to \$160.2 million for the same period a year ago.

Ceded premiums earned for the fourth quarter were \$81.6 million compared to \$65.3 million for the fourth quarter of 2016. A large part of the increase relates to NBIC's quota share arrangements. The consolidated ceded premium ratio as measured against gross premiums earned was 44.5% for the fourth quarter of 2017 compared to 40.8% for the same period last year. Excluding the results of NBIC, the ceded premium ratio would have been 37.1%. The fourth quarter of 2016 ratio was negatively impacted by approximately 2 points due to a true-up in the non-catastrophe reinsurance programs.

The ceded commission earned on NBIC's quota share arrangements are reported as an offset to acquisition costs. The ceding commission is deferred and earned ratably over the contract period and was \$8.6 million for the month of December.

Loss and loss adjustment expenses decreased to \$44.7 million for the fourth quarter of 2017 compared to \$69.2 million for the same period a year ago. The fourth quarter of 2016 was negatively impacted by approximately \$19 million of losses from Hurricane Matthew. Our net loss ratio as measured against net premiums earned and net of reinsurance recoveries was 44% for the fourth quarter of 2017 compared to 72.9% for the same period last year. Hurricane Matthew added about 20 points to the 4Q 2016 net loss ratios. Excluding Hurricane Matthew, our net loss ratio declined an impressive 8.8 points year-over-year.

Our operating expenses, excluding the benefit of \$8.6 million of ceding commissions, were \$49.3 million for the fourth quarter of 2017 compared to \$37.3 million for the same period in 2016. Approximately \$5.4 million of the expenses were NBIC's expenses for the month of December. The fourth quarter of 2017 also includes M&A expenses of approximately \$4.3 million and \$2 million of amortization of intangible expenses related to the NBIC acquisition.

As measured against gross premiums earned, the operating expense ratio, excluding the benefit of the ceding commissions, was 26.9% for the fourth quarter of 2017 compared to 23.2% for the fourth quarter of 2016. The M&A-related expenses accounted for over 2 percentage points.

Our combined ratio as a percentage of net premiums earned was 83.8% for the fourth quarter of 2017 compared to 112.2% for the same period in 2016. The decrease reflects the improvement in the year-over-year losses for the quarter while keeping the expense ratio relatively flat.

Operating income for the quarter was \$23.2 million compared to an operating loss in the fourth quarter of 2016 of \$3.6 million. The year-over-year improvement was driven by Hurricane Matthew impacting the fourth quarter of 2016, the favorable loss experience in the fourth quarter of 2017 and a positive contribution from 1 month of NBIC's operating results, which partially offsets the additional M&A and interest expenses associated with the acquisition. For the full year, the company generated \$49.5 million of operating income, confirming the confidence stated during the third quarter.

As Bruce mentioned earlier, we are required under GAAP accounting rules to report for the quarter a \$35.3 million nonoperating adjustment related to the change in the fair market value of the convertible notes option associated with our financing. The noncash charge was required until shareholder approval was received to settle any conversions of the notes in shares. Although shareholder approval was obtained on December 1, the adjustment was still required to be recorded as of that day. For the year, the adverse impact to earnings related to the convertible option was \$42.2 million. We believe it is reasonable to eliminate this accounting entry when analyzing our results and in comparing it to prior years and to our peers. We have made this change in the earnings release in reporting non-GAAP adjusted net income of \$30.2 million for the quarter and \$41.1 million for the full year 2017.

Our net income for the quarter and full year would have been even higher absent the Hurricane Irma retention and non-reoccurring M&A expenses. The profit for the quarter reflects the 85% net combined ratio and a favorable tax benefit from the recently enacted tax reform and the fact we had large deferred tax liabilities primarily related to our M&A activity. The \$30.2 million adjusted net income would have resulted in non-GAAP adjusted earnings per share of \$1.23 for the fourth quarter of 2017, adjusting for the impact of the convertible note valuation and utilizing weighted average diluted shares. The adjusted net income yields a return on average equity for the quarter of 9% and annualized of 36%.

On the balance sheet side. Stockholders' equity increased to \$380 million at December 31, 2017, compared to \$358 million at December 31, 2016. In the last 12 months, we have repurchased 5.3 million shares at an average price of \$11.54 per share and also paid out \$8.2 million in dividends to shareholders.

Total invested assets were \$567 million at December 31, of which \$449.8 million was invested in fixed maturity securities with an average credit quality of AA and an average duration of 3.7 years. Our cash position was \$153.7 million as of December 31, and approximately \$56 million of cash was held by nonregulated entities. Our total assets were \$1.8 billion, which was up over \$700 million from December 31, 2016.

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

Question and Answer

Operator

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

John Bakewell Barnidge

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

My first question, you talk about expanding the contractor network to new territories. Can you expand on this a bit? How much should this save over the long term? Should we anticipate a tick higher in expense ratio? And are these new employees you'd be hiring, or are you simply moving them out of Florida?

Bruce Lucas

Chairman of the Board & CEO

Yes. Thanks, John. We are expanding the network into the Southeast, so we have in particular North Carolina, South Carolina, Georgia and Alabama. We're also going to roll out Contractors Alliance Network this year in all of the NBIC states. There's 5 states in the Northeast. There are new employees that will come on board to further our expansion efforts. There is a G&A expense associated with that. However, the profit margins that we make there more than outweigh the G&A. So we believe it's net-net accretive to the company, even though we're expending some additional dollars for G&A.

John Bakewell Barnidge

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

Okay, great. And then with Narragansett, you're now exposed to winter weather. I know they have a very robust reinsurance program. But could you talk about that maybe and maybe what you've seen so far this year? Because I know in early January, I was supposed to go to New York and Boston and couldn't because there was too much snow.

Bruce Lucas

Chairman of the Board & CEO

Yes. Yes, you're absolutely correct. That's -- the most volatile quarter for Narragansett Bay is the first quarter. The company typically loses money in the first quarter and makes all of its profit in quarters 2, 3 and 4. You are correct, we heavily hedge against the winter storm exposures. We have a quota share, a net quota share in excess of 50%. We have an 18.5% gross quota share on top of that. We have an aggregate layer that also drops in and fills in retentions. This is something that Narragansett Bay has done extremely well for the past several years. Storm activity this year is -- it's a little bit higher than what we expected, but it's nothing shocking to us at all. So the reinsurance programs that we have in place are mitigating any downside risk at Narragansett Bay.

John Bakewell Barnidge

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

Okay. And then my last question, and then I'll probably requeue is, you talked about putting in new forms in the Florida market, which would cap nonnetwork claims to \$10,000. Obviously, it takes some time to run these through on renewal. But could you give us an update on maybe how that's progressing?

Bruce Lucas

Chairman of the Board & CEO

Yes. So there are forms in the marketplace right now. In particular, it's the Citizens form that does cap certain water claims at \$10,000. So those forms are available. We're in discussions with regulators as to how to improve them. We think that there are a couple of issues with those forms that kind of make it easier for the bad guys to skirt the cap provisions. But I'll give this: our Florida regulators are very keen to the issue. They're trying to curb fraudulent abuses. They're very receptive to changes. And they're trying to find a proactive approach that helps keep rate increases in line so that consumers can benefit

and companies can benefit. I really don't view it as a major challenge in this market. It's just it takes a little bit of time to get it all worked out.

John Bakewell Barnidge

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

Maybe I should have asked it a different way. If you were to say what inning are you in, in kind of rolling these through -- these new forms out through the applicable book, how would you maybe categorize that?

Bruce Lucas

Chairman of the Board & CEO

Seventh inning, eighth inning.

Operator

And our next question today comes from Mark Hughes, SunTrust.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

On the loss ratio, what were the moving parts there in terms of current accident year and the benefits from the contractor network? Any development in the quarter?

Bruce Lucas

Chairman of the Board & CEO

Well, we report our numbers on a consolidated basis. Obviously, there are some margins at Contractors Alliance Network that save us money on our loss ratios and help us keep our rates in check. The biggest moving part was we had about \$6 million of reserve strengthening related to Hurricanes Matthew and Irma from prior years. And that's really a reflection of door knockers kind of going door to door, trying to drum up some business. And then we had an additional \$6 million or so of additional reserve strengthening in the quarter. And that's mainly due to the fact that our reported claims in the fourth quarter for day-to-day losses was extremely low. And so we took a very conservative approach here, that we haven't seen the claims in the fourth quarter, but we should still put up additional IBNR to cover them in case they arrive. But overall, Mark, our trends are consistently moving lower quarter-over-quarter and year-over-year.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

And then in terms of outlook, you had provided some initial financial guidance or projections at the time that you announced the Narragansett transaction. I think some of the -- some things have turned out better in terms of the shares issued. With what you're seeing on the reinsurance side, I'm sort of curious to get your latest thoughts on whether you think the reinsurance synergies will meet your early expectations. And then more broadly, do you think that earlier guidance is still good when we think about 2018?

Bruce Lucas

Chairman of the Board & CEO

Yes. So great question, Mark. So when we announced the transaction in the earlier part of cat season, I think we were projecting a full year of around \$70 million in net income, low 70s, somewhere in there. That's easily good still, no doubt about it. We have obviously a potential for rate increases, for reinsurance losses, but you couple that with reinsurance synergies that we pick up on the transaction. That's pretty unique in our market. We're actually heading into a hard cat market and a hard reinsurance market with substantial synergies. Those synergies will start to kick in on the June 1 renewals, and then you'll earn them out ratably over the following 12 months. And then there are some additional synergies on multiyear contracts that we'll pick up in 2019 that'll accelerate some gains there as well. I'd say overall, on reinsurance, there's -- the jury is still out as to what happens. There were a lot of calls for, I mean,

some really crazy rate increases that we were hearing from reinsurance pricing. I'll say this. I do think rates are moving higher. I can't tell you by how much, but I can tell you that there are several things that are unique to Heritage that are driving lower rate increases than I would expect in the Florida market. The first is we have a massive amount of multiyear reinsurance at prior year prices. And so that is helping us to fill capacity needs at much lower rates online. Our hedging strategy that we put in place 4 years ago is working extremely well now that we've had an event. I'll also comment that our loss adjustment expenses on Hurricane Matthew, they're right at the bottom of the market. In fact, they're extremely low. They're about half of what we're seeing from our Florida competitors. We saved our reinsurance partners tens and tens of millions of dollars on loss adjustment expenses. And we've already heard from a lot of our major reinsurers that, that is absolutely going to be taken into account when they price and underwrite our program. Indeed, we've already had line quotes for, I mean, big ones, hundreds of millions at flat pricing. And so we are optimistic that we're going to be able to control our reinsurance pricing better than our Florida peers because we have reinsurance synergies, the lowest LAE that I'm aware of in the Florida market, and we have multiyear reinsurance treaties in place. This really improves the outlook as we move forward.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

And may I ask, the \$70 million in net income, I think, was -- just you're -- you look good on that measure. I think that was provided prior to tax reform. Would we assume some benefits from tax reform, and so the net number post-reform would be higher, i.e., the...

Bruce Lucas

Chairman of the Board & CEO

Well -- yes, I'm sorry, Mark.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Yes. I was going to say, i.e., sort of the pretax guidance is consistent. That's the question.

Bruce Lucas

Chairman of the Board & CEO

Yes. So I mean, you get a benefit from tax reform, but if reinsurance rates move higher, it eats into some of that benefit, right? And so we don't know what the pricing is on reinsurance to determine whether or not the offset you get from a lower tax rate will outperform the increase that you get on reinsurance pricing. But we do feel extremely confident that, that baseline \$70 million number, we are not concerned about meeting that number at all. And we -- I do think that there is considerable upside above that number. But we are kind of reluctant to give forward guidance right now because we don't know what the reinsurance pricing is going to be, and that's our single largest expense at the organization.

Operator

And our next question is a follow-up from John Barnidge of Sandler O'Neill.

John Bakewell Barnidge

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

Should we be modeling a 21% effective tax rate? Or do you think it could actually come in a bit lower than that?

Bruce Lucas

Chairman of the Board & CEO

Yes. No, actually, the effective tax rate's going to be a little higher than that when you contemplate the impact of state taxes. We're looking at, they're probably around the 25% -- 24%, 25% range.

John Bakewell Barnidge

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

Okay, that's very helpful. And then I think you've previously talked about utilizing NBIC as a beachhead to, say, link New England to the Southeast. Could you provide us an update on that or your current thoughts on that?

Bruce Lucas

Chairman of the Board & CEO

Sure. So we are filing Narragansett Bay in 4 new territories as we speak. And so our business plan is that Narragansett Bay will take Virginia all the way through the Northeast. Heritage will remain a Southeast player. And that really just goes to market brand in those areas in the mid-Atlantic is probably stronger with NBIC because they have a longer presence in the region. So that's something that we have underway. And then we're set to launch in Pennsylvania as well. We have a license there. And we are also filing in Tennessee for Heritage. And we still have our Mississippi license that we plan to roll out as well. So you add it up, in total, and you probably have about 7-plus new states where we're going to start rolling out operations this year. We're really going to see the benefit of that in 2019.

John Bakewell Barnidge

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

And then how long do you think the NBIC deal puts you on the sidelines from an acquisition perspective? And then what else, kind the areas maybe or types of lines of business, would you be interested in, in the future?

Bruce Lucas

Chairman of the Board & CEO

Yes. So I don't really think it puts us on the sideline. It just depends on the mechanics of the deal is a -- more of an equity-based transaction versus a cash-based. But I can tell you that we are already in discussions on a couple of other acquisitions as we speak. So we're certainly not resting on good strategic opportunities that diversify and enhance shareholder returns. It's just that every transaction we do, I have a very strict guidance on the return on investment. It's substantially higher than what P&Cs in our sector would trade or produce on an annual basis. And so I need an outsized return, and that limits the field. We've been pretty selective about what we've picked up, but we are currently looking at a couple of other acquisitions right now that, if they do move forward and pass due diligence, would be very accretive to shareholder returns. And then in new products, I mean, we're going to look at some enhancements on our homeowner products. We're going to look at umbrella products and commercial lines as well.

John Bakewell Barnidge

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

Okay. And then where do you see the ceded premium ratios settling in at in '18 and '19, if you can speak to that at all?

Kirk Howard Lusk

Co-Chief Financial Officer

[indiscernible] cost though.

Bruce Lucas

Chairman of the Board & CEO

Yes. I mean, it's hard to come up with that number until we know our reinsurance pricing.

John Bakewell Barnidge

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

No, that is a very fair point. My last question, I was a bit surprised you were talking about evaluating the potential to sell your construction business. Is that something that's more longer term? Or could that even

be a 2018 event? And then related to that, how would that, like, change the economics of the vertical integration?

Bruce Lucas

Chairman of the Board & CEO

Yes. So that's something that we've been weighing. I mean, we have a \$100 million construction division right now and growing. And it would be a unique transaction. If we were to spin off that organization, look at somebody like a Crawford & Company, they get a 15 P/E on their earnings. I'm not going to disclose what our earnings are now because it's a unique hedge to us. It's -- we do very well there. I just don't want to make it easy for our peer group to understand our model. But I could tell you that we're not looking to do that right now in '18. We want to grow it more. And if we were to sell it, that would -- it would impact our net loss ratio, so there's an earning offset. But if you're being paid upfront for the future value of that offset and it's highly accretive to equity, we're absolutely going to go that route. So it's just something that we have on our radar. We have been approached by people who had an interest in the network. It's not on the market currently, but in full disclosure, I do think there is substantial value there that people don't really understand, especially the scale we have and the profitability that we have in that division.

Operator

And our next question today comes from Arash Soleimani of KBW.

Arash Soleimani

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

Can you hear me? Sorry about that.

Bruce Lucas

Chairman of the Board & CEO

No worries.

Arash Soleimani

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

So one thing I wanted to just double-check is the tax rate. So you said that there was a DTL write-down, just to be clear, right?

Bruce Lucas

Chairman of the Board & CEO

That's correct, yes.

Arash Soleimani

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

Okay. And what was the amount of the write-down?

Bruce Lucas

Chairman of the Board & CEO

Well, there were some write-downs, and then there were some marking up of some other assets that we had. But on a net-net basis, our income tax changed in the quarter. It added \$12 million to the bottom line.

Arash Soleimani

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

Okay. And the other question I had, and I know this might be something that you can't answer in detail, but can you provide some clarity on why there was a CFO transition?

Bruce Lucas*Chairman of the Board & CEO*

Sure. I mean, we have a great relationship with Steve, obviously, or he wouldn't be continuing with the company as a member of our directors and on the Audit Committee, et cetera. We have 2 really quality CFOs. Steve wanted to pursue some consulting opportunities and have a little bit more freedom with his time. That kind of fit okay because we had Kirk that was willing to step in and move down to Clearwater. But that's really it. It's really just a personal choice to pursue other opportunities that fit his lifestyle and his expectations more. So he's going to do great in the financial consulting field, no doubt about it. But I am pleased that he's agreed to at least stay on as a member of our Board of Directors.

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

And in terms of the share count, how should we think of that going forward as the share price increases, just given the treasury method accounting?

Bruce Lucas*Chairman of the Board & CEO*

Yes. And obviously, as our share price increase, the diluted average outstanding share count will increase. It's kind of a complex mathematical formula. We have a tool. I think we may have given you that tool and other analysts and shareholders as well that helps you to calculate it. That's probably the best way to do it. If you hit certain price assumptions, just plug in the price. It tells you the expected dilution that would occur.

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

Okay. And in terms of the construction business, so if you did sell that, to what extent would you, I guess, have an adverse impact by losing the -- I guess, the savings that, that business generates?

Bruce Lucas*Chairman of the Board & CEO*

Yes. It would -- I mean, that would require me then to disclose what our profit margin is on that business. That's something we closely guard because we don't want our peer group getting a blueprint to do the same thing that we've been working on for the past 5 years. It would negatively impact loss ratios, no doubt. And so the expected purchase price that we would get would have to more than offset the increase in our loss ratios that go along with that. And there is kind of a -- we've -- I've done some modeling on this. I kind of know what that point looks like. You're looking at a slight increase in the loss ratios but a huge increase to book value if we were to go ahead and spin off the asset.

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

Okay. And that \$100 million, is that like a revenue number that you're -- like what's the \$100 million represent?

Bruce Lucas*Chairman of the Board & CEO*

That was -- we did a \$100 million of actual revenue in 2017.

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

Okay. And then you were just saying, in terms of the CAN network billing internally to Heritage?

Bruce Lucas*Chairman of the Board & CEO*

That's correct.

Arash Soleimani

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

Okay. And in the storm that we had in the third quarter, I mean, I know one of your competitors was able to generate adjusting income off of that. Did CAN do the same thing with Irma?

Bruce Lucas

Chairman of the Board & CEO

I mean, CAN made some profit on repairing homes. We got the 9,000 houses. That's really what generates some profit for us. Adjusting revenue, I mean, we didn't charge off \$45 million of profit. But all we kind of looked at on LAE was what's the most efficient way to handle it. So we used a combination of outside resources and internal resources to keep the LAE number low, but our real focus on Irma was construction.

Arash Soleimani

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

Okay, that makes sense. In terms of cash, how much excess cash would you, I guess, estimate that you have now?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. The nonregulated entities, we had \$153 million.

Arash Soleimani

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

Okay. And can you provide -- what was holdco cash at the end of the fourth quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

\$56 million in nonregulated entities.

Arash Soleimani

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

And in terms of RBC, I know there was a change in the calculation. Can you -- do you have the RBC ratios for each of your, I guess, statutory entities?

Bruce Lucas

Chairman of the Board & CEO

Yes, they're pulling that right now.

Kirk Howard Lusk

Co-Chief Financial Officer

Yes, the Heritage was a little over 320%, about 322%. The NBIC one was a little over 440%.

Arash Soleimani

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

Okay. And I just wanted to confirm, Bruce, you mentioned a couple of development numbers. I think it's the -- in your prepared remarks, you mentioned \$15 million that was added to IBNR, but then I think you said there was \$6 million plus \$6 million later. So I just wanted to make sure I understood and I have that written down correctly what the actual development was in the quarter.

Bruce Lucas

Chairman of the Board & CEO

It was an additional \$3 million for the quarter that was put up on top of the other \$12 million that I disclosed.

Arash Soleimani

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

And was this all prior year development?

Bruce Lucas

Chairman of the Board & CEO

Kirk...

Arash Soleimani

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

Could you break out prior year -- I'm sorry, go ahead.

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. I'd look at -- for the year, there was about \$12 million of prior year development.

Arash Soleimani

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

So was that \$12 million all reflected in the fourth quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

The bulk of it was, yes.

Bruce Lucas

Chairman of the Board & CEO

And about half of that was Hurricanes Matthew and Hermine, yes, not day-to-day claim activity.

Arash Soleimani

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

Okay. So about \$12 million from Matthew and Hermine that hit in the fourth quarter. And then was there any current accident year development that hit in the fourth quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. Hermine and Matthew was actually earlier in the year. It was like \$6.5 million that was earlier in the year.

Arash Soleimani

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

Wait, sorry, can you repeat that?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. The Matthew and the Hermine development was earlier in the year. It was about \$6.5 million.

Arash Soleimani

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

Okay. So just to be clear, because -- well, when you say it was earlier in the -- oh, that was not in 4Q. You mean you didn't impact the fourth quarter as well?

Kirk Howard Lusk
Co-Chief Financial Officer

Correct, correct, correct.

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

Okay. So just in terms of what did hit the fourth quarter, can you just -- I just want to -- I have a lot of numbers written down, I just want to make sure I have it right.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes. Yes, if you want to look at what hit the fourth quarter, about \$10 million.

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

Okay. \$10 million of prior year development?

Kirk Howard Lusk
Co-Chief Financial Officer

Yes.

Bruce Lucas
Chairman of the Board & CEO

And most of that -- and, Arash, most of that's reserves strengthening because we had a much lower claim count in the fourth quarter than we expected, right? So we're going to be conservative and not book an absurd loss ratio in the fourth quarter. We know that, that stuff gets impacted by the hurricane. So we're going to put up additional IBNR over what we would have to normally do in the quarter because we believe that it will develop over time. That's just being cautious. That's not a negative thing. That's a really strong positive for us. I mean, overall, on our book of business with, call it, \$600 million in premium, essentially, we're talking a handful of millions here. That's the [indiscernible] development. It's pretty close to what we expected.

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

And then -- and did you say there was anything from 1Q to 3Q of 2017 that you strengthened in the fourth quarter of 2017?

Kirk Howard Lusk
Co-Chief Financial Officer

No.

Bruce Lucas
Chairman of the Board & CEO

No.

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

Nothing, okay. And if I back out that \$10 million that you mentioned, so the net loss ratio you had in the quarter was 44%. If I back out the \$10 million, you get to about 34%. So that still seems like a huge

improvement on a core basis. Is there anything else in there that's driving that? Is it just because the fourth quarter was very quiet after the storm?

Bruce Lucas

Chairman of the Board & CEO

Well, fourth quarter was quiet, but we put up a lot of IBNR for that quiescence, right? So that all balances out. I mean, if you look at our loss ratios over the past year, we have improved our loss ratio -- forget the cat. Day-to-day claims, we have improved our loss ratio every single quarter. And we guided to a declining loss ratio trend in 2017, and we actually outperformed that.

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. When you look at the fourth quarter, yes, it was actually coming in much lower than that. And we booked to that -- to the number that you were seeing there so that it actually was even lower than that. So you're right, it was a very quiet fourth quarter.

Bruce Lucas

Chairman of the Board & CEO

Yes.

Arash Soleimani

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

Okay. So how -- like how should we think of the loss ratios on a net basis going forward? And I know you guys used to kind of give us some direction on the gross loss ratios, but since we can't use those with the quota share, like how should we think of the net ratios?

Kirk Howard Lusk

Co-Chief Financial Officer

We're pulling the stats on it now to help you out.

Bruce Lucas

Chairman of the Board & CEO

Yes. It's -- the problem with NBIC is that it distorts everything because of the net and gross quota shares. And so it's hard to give that. I'll tell you that things are fairly consistent there, but if you want to look at historically what we've reported in Florida, we're projecting an additional downward trend in our net loss ratios. We don't know what that number looks like now, but as we've continued to derisk away from Tri-County, we get fewer and fewer Tri-County claims with AOB abuses and lawsuits. And every policy that we're writing outside of the Tri-County area -- by the way, we had record production again last year outside of the Tri-County, and that's helping to drive the overall loss ratios lower and lower. So hard to give an exact guidance because the quota share just -- it absolutely turns all of the numbers on its head. But if you want to look at the Florida book, we are projecting a continual improvement in our loss ratios into 2018.

Arash Soleimani

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

Okay, perfect. And in terms of the quota share, what percentage of your total premiums would you say now are quota shares with the -- in terms of the consolidated entity?

Bruce Lucas

Chairman of the Board & CEO

Well, we do about 55% on the net basis at NBIC. And that's \$330 million times 55%. And then of that premium number, we also have an 18.5% gross quota share that's in place. So you have to kind of add those 2 moving pieces up to get the full picture of the quota share, but those are the only quota shares

we have at the company. And then we also cede out some premium at Narragansett Bay for aggregate protection against winter storms so that we don't have massive earnings volatility in the first quarter.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes. Yes, so I think you can get [numbers] with the 18.75%, and it's 50%. So...

Bruce Lucas
Chairman of the Board & CEO

Yes.

Kirk Howard Lusk
Co-Chief Financial Officer

[indiscernible]

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

All right. And can you -- what's the difference between those, when you say the net and the gross quota shares? So I just want to make sure I understand the mechanics.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes. One is going to be net of the hurricane, and then the gross is basically -- it's gross of everything. So it applies just across the board.

Bruce Lucas
Chairman of the Board & CEO

Ground up.

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

Oh, okay, so the net one, you're just saying is x cat?

Bruce Lucas
Chairman of the Board & CEO

That is correct, but it helps to protect against your retentions as well.

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

Sure, okay. And the expense ratio, you said it was \$4.3 million from like professional fees and such [indiscernible] transaction?

Bruce Lucas
Chairman of the Board & CEO

I think it went up. It was over \$5 million for onetime M&A expenses in the quarter.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes. That would have been like the fourth quarter number. For the full year, it was higher.

Bruce Lucas
Chairman of the Board & CEO

Yes.

Arash Soleimani

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

Yes. I think -- because I know you -- in the release, you mentioned amortization of debt issuance and interest related to transaction, but I was -- I'm looking specifically, like aside from that, like whether it's legal fees, professional fees, anything that hit the fourth quarter.

Bruce Lucas

Chairman of the Board & CEO

Fourth quarter was \$5 million plus because we had to close NBIC. So there are fees that are paid to professionals and to lawyers, but that's non-reoccurring.

Arash Soleimani

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

No, I know. So was that around \$5 million? I just want to see what the core number is.

Kirk Howard Lusk

Co-Chief Financial Officer

Yes.

Bruce Lucas

Chairman of the Board & CEO

Approximately, yes. It was just north of there.

Arash Soleimani

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

Just north, okay. Let me just see if I have anything else. And how much premium -- I know you put in the release the earned -- gross earned premiums from Sawgrass and NBIC. Can you just remind me what were the gross written premium impacts in this quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. NBIC was \$28 million, and Sawgrass was...

Unknown Executive

For the quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. Was \$7.3 million for Sawgrass.

Arash Soleimani

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

Okay. And do you have the net loss and expense ratios for each of Heritage and NBIC in isolation for the quarter?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes. We look at that as a single segment as opposed to breaking them out separately.

Bruce Lucas

Chairman of the Board & CEO

Yes.

Kirk Howard Lusk
Co-Chief Financial Officer

So it's like a better look at it at a group level.

Bruce Lucas
Chairman of the Board & CEO

Yes, but they're pretty close, Arash. There's no big material difference between these -- those ratios.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes.

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

But basically, in terms of the combined ratio profile of the whole company, it should stay pretty similar to what you were expecting even before the transaction, with the exception of maybe improvement from reinsurance synergies?

Bruce Lucas
Chairman of the Board & CEO

Yes. I think there's more potential for upside than there is for downside, for sure. And so we gave our number. It was \$70 million in net income, but our optimistic view is that if I had to take the over/under, I would definitely take the over. It's just I can't give you any clear guidance until I've locked in my reinsurance costs.

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

Right. And I know historically, Bruce, you weren't a purchaser of quota share. When you guys buy a consolidated reinsurance program, do you anticipate purchasing quota share again? Or will it be on an excess of loss basis exclusively like it was before?

Bruce Lucas
Chairman of the Board & CEO

Well, I can tell you that for Narragansett Bay, our game plan going forward is to maintain quota share protections. If you don't do that, you have massive earnings volatility in the first quarter. We have a lot of winter storms up there. I wouldn't want to have a big retention in 2018 in the Northeast because it will decimate your first quarter earnings. So we're going to continue to hedge the risk. It makes sense to hedge it. We believe that's at fair pricing. And most importantly, we're not going to have a couple of events in the first quarter that wipe out half of your year's profit. That's too much risk. And so we're going to maintain that structure in the Northeast. For Florida, we've never done a net quota share, simply because we consistently outperform on the loss ratio. And it's -- you're actually giving away economic margin if you're outperforming on the loss ratio, so it makes more sense for us to retain that risk and just stick to cat XOLs.

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

Right. That makes sense. And on the taxes, you said 22% upside from tax reform, right?

Kirk Howard Lusk
Co-Chief Financial Officer

No. The 22% was the increase in the net income. It basically -- that's a difference between what you keep. Even though the tax rate went down by 14%, if you were keeping 61% before and now you're keeping 75%, that's a 22% increase. When you look at the effective tax rate, we're seeing around 24%, 25%.

Bruce Lucas

Chairman of the Board & CEO

Yes. And so like when I model acquisitions, one of the things I look at is goodwill ROI. If I have a company that's \$100 million on the acquisition side, it has \$50 million in hard book value as your surplus. I pay them \$50 million. I get \$50 million back, right? That's an even swap. But what is my ROI on the goodwill? We -- that's how we always model it. And it modeled a heck of a lot better with tax reform. It went up 22%. So it's meaningful. It means the transaction had substantially better terms than what, I believe, shareholders really thought it would have when we closed the -- or we announced the deal back in August.

Arash Soleimani

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

For sure. Okay, so -- and 24% to 25% is what you said we should model for 2018?

Kirk Howard Lusk

Co-Chief Financial Officer

Yes.

Bruce Lucas

Chairman of the Board & CEO

Yes, because there's state income tax as well.

Operator

And ladies and gentlemen, our next question is a follow-up from John Barnidge, Sandler O'Neill.

John Bakewell Barnidge

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

Your reinsurers must love your construction network since it cuts down on fraud and closes claims quicker. Do you think they give you any benefit on reinsurance pricing because of that?

Bruce Lucas

Chairman of the Board & CEO

They're going to this year. So it's one of those things where -- and listen, to our credit, we've got a fantastic reinsurance panel. They are -- I look across the board and say, who's on the panel? It's quality underwriters, and they spend time getting to know this company. And it's something that we were able to demonstrate in Hurricane Matthew. But hey, what do you do on a large-scale basis? And we proved that in Irma, and we've got some ideas to increase the efficiency by as much as 30-plus percent on the next event. And what the repair network did, not only does it control claim costs and save the reinsurers on indemnity payments, it saves on LAE. If I go out to someone's house the day after the storm and they have a hole in their roof, and I'm removing the tree, tarping the roof and sending out a dry-out team, they are not pressing us immediately to have an IA go out. And indeed, a lot of times we're able just to give a scope of loss on the repair side because we know what it takes to fix it, sign up the customer and fix it. And then there's loss adjustment expense. And so that's a -- that repair network is a major driver in our really record-low LAE that we're seeing in the industry right now. I know of some companies that are 40%, 45% LAE. I'd say the Florida mean average is mid-20s to mid-30s. And we're low teens. And so that type of outperformance has really grabbed a lot of people's attention in Bermuda. And like I said, we already have quotes in on big parts of our program, huge lines at flat pricing.

John Bakewell Barnidge

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

And then I think the last question I have on my list would be, you closed the NBIC deal just after Thanksgiving. I know in Florida, it doesn't snow during that time of year or if at ever. But did you have any cats in the NBIC portion in the fourth quarter to speak to at all?

Bruce Lucas

Chairman of the Board & CEO

No, no. It's -- their cat season's really first quarter.

Operator

And our next question today is a follow-up from Mark Hughes of SunTrust.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Yes. I don't know whether you touched on this. I had to jump off for a second. But what is the share count at the start of the year, the diluted share count?

Bruce Lucas

Chairman of the Board & CEO

Hang on a sec, we got to click that tab.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Okay. And then I'll ask, if it didn't come up, the -- Bruce, you talked a lot...

Bruce Lucas

Chairman of the Board & CEO

Yes. The total outstanding shares at the end of 2016 were 28.8 million, and we ended the year at 25.8 million, call it 25.9 million.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

So when we think about first quarter, is it the 25.9 million? Is that what we're -- and I'm sorry, what was the difference between 28.8 million and 25.9 million?

Bruce Lucas

Chairman of the Board & CEO

28.8 million was the end of 2016.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Oh, okay. And 25.9 million?

Bruce Lucas

Chairman of the Board & CEO

25.9 million is the end of '17, yes.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Yes. Okay, very good.

Bruce Lucas

Chairman of the Board & CEO

Down 3 million shares after issuing \$40 million of consideration to the sellers at NBIC. So that's a true net number.

Kirk Howard Lusk
Co-Chief Financial Officer

Yes. Yes, so that's ending share count.

Bruce Lucas
Chairman of the Board & CEO

Yes.

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

Right. And then the voluntary production, when you'd -- I think you'd expressed enthusiasm about some of the revenue synergies with NBIC. You said you'd be surpassing the \$1 billion in premium mark in a reasonable time frame. Can you talk about the -- how you see it now, what kind of underlying growth potential there is in the combined entity?

Bruce Lucas
Chairman of the Board & CEO

Yes. I mean, there's a tremendous amount of growth that -- a lot of the growth is -- you got to look at the segments and where the growth comes from. For example, our largest Florida book is our legacy Citizens HC3 filing. We just got approved yesterday for 14.5%, and that kicks in, in May. That's by far the biggest segment here in Florida. So we've got other lines as well that are getting rate increases, which are justified. And in this market, everybody's rates are moving higher. So you're going to get a lot of growth just from the rate increases that are baked into the system. We're writing in new states now, and we've recently launched Georgia and Alabama. And so we're excited to get those products in market. And as mentioned, we're filing in, call it, 7 new territories, 7 or 8 this year. So the faster we can get them up, the better, but we feel very confident in excess of \$1 billion in top line this year.

Operator

And our next question comes from James Naklicki of Citi.

James F. Naklicki
Citigroup Inc, Research Division

My first question is around the CAN revenue that you gave for the year, the \$100 million. I'm curious, if you looked at the second half of the year, what was the revenue from the business in the second half of the year?

Bruce Lucas
Chairman of the Board & CEO

Yes. It's probably about half the revenue or so, roughly.

James F. Naklicki
Citigroup Inc, Research Division

Okay. So there was no benefit to that business from Hurricane Irma second half of the year?

Bruce Lucas
Chairman of the Board & CEO

No, there was a benefit. I mean, we were able to get out the 9,000 additional claims, but we've got a pretty robust network. We do a lot of business throughout the year. There was absolutely a benefit.

James F. Naklicki

Citigroup Inc, Research Division

Got you. On the tax reform, beyond 2018, I'm trying to get a sense for, if you think that, that is sustainable or will it get passed through into pricing, the benefit from the lower tax rate?

Bruce Lucas

Chairman of the Board & CEO

Yes. Yes, I mean, I don't think that's going to be hitting rates as we move forward. That would really surprise me. I mean, it could go down so much, a little, but you got to remember, we're in a hard market. And reinsurance prices go up. That offsets -- more than offsets anything that happens on effective tax. And we are in a claim inflation market in Florida, there's no doubt about it. AOB is not dead. It's been dampened on our financial results because we've made really good underwriting decisions around the Tri-County and built out a very vast repair and mitigation network. But it could have some downward pressure, but I really think rates are moving higher.

Operator

And ladies and gentlemen, our next question is a follow-up from Arash Soleimani.

Arash Soleimani

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

On the commercial residential business, I think you mentioned that part of the loss ratio improvement came from reducing exposure there. So I wanted to get some more clarity there. So I know a lot of companies have talked about competition there. Is that still a business you're excited about? Or how are you looking at it now?

Bruce Lucas

Chairman of the Board & CEO

Yes. I mean, we're pretty happy with our book. I mean, we've got our book right in the sweet spot where we want it. There is a ton of competition in commercial residential, mainly from surplus line carriers. They will write rates at a very low price, and we're going to look at it. At the end of the day, we are not fixated solely on top line growth. We are fixated on definitely getting the top line up, but number one, is it profitable business? There's no point in taking risk if you're not making a margin. And so there are some policies that we have strategically decided to non-renew. And that's both from a rate standpoint and, honestly, more than anything else, from a risk management standpoint. We had several large policies that were \$500 million, \$750 million in TIV in one spot. And we look at the hurricane activity and say, "Gosh, I just don't think that, that type of risk concentration is responsible as we move forward." So we did non-renew some very large policies. They were profitable for us, and so it has some of the impact on our operating margin, but it also has an offsetting benefit in that you have better sleep at night protection, less risk concentration, lower probable maximum losses for reinsurance and thus lower reinsurance pricing. So there is a corresponding offset to that decision. But overall, we're happy with our book right now.

Arash Soleimani

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

Perfect.

Bruce Lucas

Chairman of the Board & CEO

Yes. And I'd say, Arash, one follow-up, the main thing that we're -- that we have focused on is derisking TIV in the Tri-County just because of some of the activity that's down there. We've dropped almost \$8 billion in TIV in the Tri-County area in 2017. So some of that's personal line and some of that's commercial residential. But it further diversifies our footprint away from the Tri-County, away from claims volatility and abuses, away from reserving volatility. And it also gives us substantially improved reinsurance pricing.

Operator

This concludes our question-and-answer session. I'd like to turn the conference back over to the management team for any closing remarks.

Bruce Lucas

Chairman of the Board & CEO

I'd just like to thank everyone for joining the fourth quarter conference call.

Bruce Lucas

Chairman of the Board & CEO

And thank you, sir. Today's conference has now concluded. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.

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