S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc. NYSE:HRTG

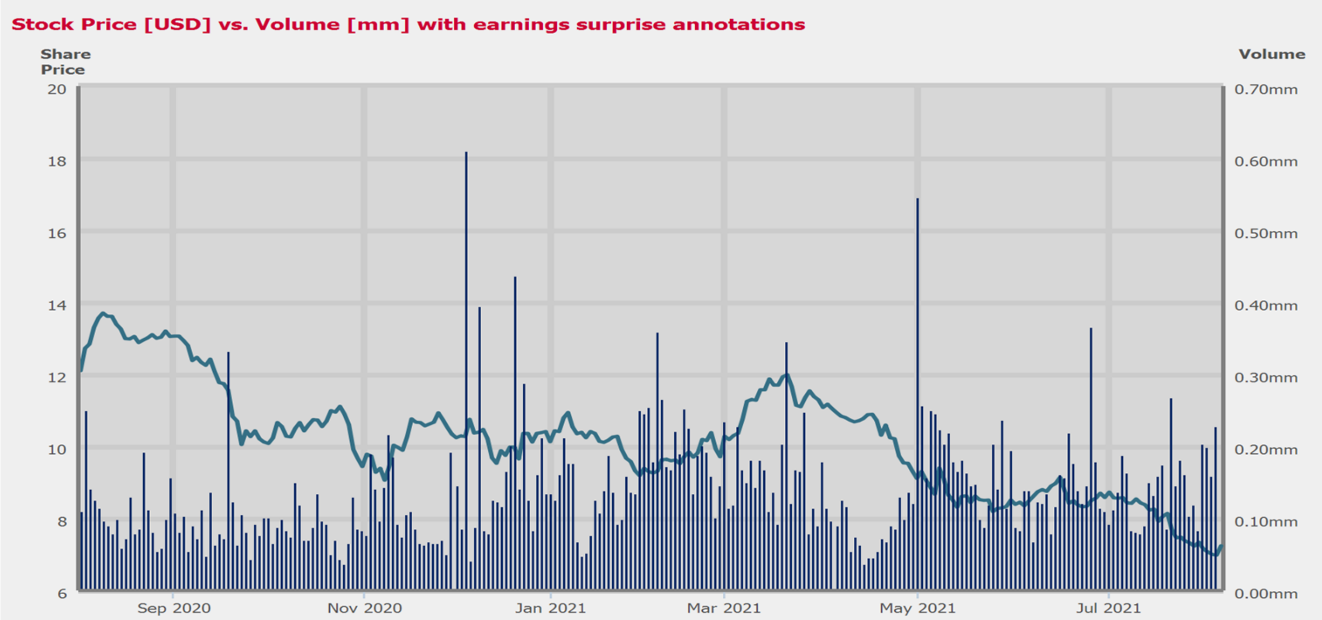
FQ2 2021 Earnings Call Transcripts

Friday, August 06, 2021 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.04)	(0.12)	NM	(0.01)	(0.06)	NA
Revenue (mm)	139.99	150.20	▲7.29	147.72	616.04	NA

Currency: USD
Consensus as of Aug-06-2021 7:34 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	(0.62)	(0.76)	NM
FQ4 2020	(0.46)	0.03	NM
FQ1 2021	(0.16)	(0.19)	NM
FQ2 2021	(0.04)	(0.12)	NM

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Call Participants

EXECUTIVES

Arash Soleimani
Executive Vice President

Ernesto Jose Garateix
CEO & Director

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Marla Susan Backer
Sidoti & Company, LLC

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings' Second Quarter 2021 Financial Results Conference Call.

My name is Eily, 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 Arash Soleimani, Executive Vice President at Heritage. Please go ahead.

Arash Soleimani
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 uncertainties 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 our results to differ materially from those described in the forward-looking statements, please refer to our annual report on Form 10-K, earnings release and other SEC filings.

With us on the call today are Ernie Garateix, our Chief Executive Officer; and Kirk Lusk, our Chief Financial Officer.

I will now turn the call over to Ernie.

Ernesto Jose Garateix
CEO & Director

Thank you, Arash. Good morning, everyone. Thank you for joining us today.

We have been very fortunate that COVID-19 continues to have virtually no impact on our business, and much of that has to do with our employees. Productivity remains high and we continue to provide our policyholders and distribution partners with the service they have come to expect from Heritage. I would like to thank all of our employees for their dedication.

At first glance, the second quarter's negative net income appears disappointing, but there is a brighter story underlying the quarter's results. Despite a $9.4 million reinstatement premium in the quarter and a $4.1 million uptick in weather losses relative to the first quarter of this year, net income improved sequentially, suggesting the benefits of our underwriting and pricing actions are starting to show. It's still early innings, but we're optimistic that we're on the path to improvement. We're continuing to aggressively raise rates and taking underwriting actions to improve our profitability. As we previously communicated, our focus is firmly on bottom line results rather than top line growth. We demonstrated this in the second quarter, as gross premiums written growth decelerated from the first quarter. Additionally, premiums in force growth significantly outpaced policies in force growth, which is indicative of our focus on rate adequacy.

We renewed our core excess-of-loss reinsurance program in the second quarter, and I believe we are solidly positioned for hurricane season. Relative to prior year's program, we've prepaid all reinstatement and eliminated co-participation above our retention. Overall, we have a solid program with fewer moving parts, which is a testament to our relationship with our valued reinsurance partners.

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

Kirk Howard Lusk
Chief Financial Officer

Thank you, Ernie. Good morning.

Despite the loss in the quarter, we are seeing favorable trends that we believe will lead to continued improvements and return to profitability. Gross premiums written for the quarter were $337.7 million, up $47.3 million or 16.3% from the prior year quarter. Premiums in force were $1.17 billion and up 18% from June of 2020, while policies in force were up 8.4% over the same time frame. The premium increase outpacing the policy increase reflects the higher rates we are implementing throughout our book of business, which is consistent with our focus on margin expansion and adequate rates. We anticipate that we will continue to have substantial rate earning through the portfolio this year and into 2022.

The ceded premium ratio was 48.7% in the second quarter, up 2.1 points year-over-year. Second quarter ceded premiums were impacted by $9.4 million of reinstatement premium associated with the severe convective storm reinsurance agreement. The reinstatement premium added 3.3 points to the ceded premium ratio and 6.3 points to the net combined ratio.

The net loss ratio for the quarter was 68.8%, which is 7.7 points higher than the net loss ratio in the second quarter of 2020. As previously disclosed, second quarter weather losses were $35.5 million, which is approximately $8.7 million higher than the second quarter of 2020. In addition, we had $0.6 million of favorable prior year reserve development in the second quarter of 2021, down from $5 million last year. The combination of these 2 items impacted the net loss ratio by 6.5 points. Our net expense ratio decreased by 2.5 points, reflecting our focus on expenses and reduction in executive compensation. The net expense ratio also benefited by roughly 80 basis points from a $1.2 million premium tax benefit.

The net combined ratio for the first (sic) [second] quarter of 2021 was 105.2%, which is up from 100% in the prior year period, reflecting a higher net loss ratio partially offset by a lower net expense ratio. The $9.4 million reinsurance -- reinstatement premium in the quarter mentioned previously was attributable to increase in the net combined ratio by 6.3 ratio points in the second quarter of 2021.

Although we are not pleased with the loss in the quarter, net income did improve from the first quarter of 2021 despite having a substantial reinstatement premium and higher weather losses, which we think demonstrates the very early benefits of the rate increases earning through the portfolio and the underwriting actions we are taking.
We're now available to take your questions.

Question and Answer

Operator

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

Marla Susan Backer
Sidoti & Company, LLC

So obviously realizing that the weather is an unknown and something over which you have little control, can you give us any sense in terms of timing around -- we are starting to [indiscernible] some of the benefits of your proactive strategy and initiatives, but can you give us any sense around timing for when you expect to see a more meaningful benefit from some of the measures you've undertaken?

Ernesto Jose Garateix
CEO & Director

Sure. So as we mentioned in the earnings call here, all right, we're starting to see that rate come through. Those rates were taken in January of this year as well as April. So from a renewal cycle, those started as early as March but will take 12 to 18 months to cycle through our entire portfolio. So as we mentioned, we're starting to see the early signs of it. The remaining rate should be taken and coming through the third and fourth quarter of this year and well into '22.

Marla Susan Backer
Sidoti & Company, LLC

Okay. And then last question for me is we've seen you in the past eliminate certain policies that you considered perhaps [risky at score and risky at] [indiscernible] [regions]. And I think your business was different at that point when you took those initiatives, but do you see yourselves potentially not renewing or eliminating other policies going forward?

Ernesto Jose Garateix
CEO & Director

Well, what I would say is that's a continuous effort. We're always looking at the profitability of each policy, each region and where we write. And again given some of the rate adequacy, those policies will be kind of analyzed to determine, if it was based on reinsurance rates based on loss trends, whether those policies will keep or those policies may be non renewed, but it is an ongoing effort. And it is something that is a continuously thing from an underwriting perspective that we do. We take a look as markets do change. So we're constantly taking a look at that and making sure we have the most profitable policies on the books.

Operator

Our next question comes from Mark Hughes with Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

What -- how are you looking at growth in the back half of the year? Where are you seeing policies that at this point seem attractive to you?

Ernesto Jose Garateix
CEO & Director

So as we look at the continued new business growth, right, we are cautiously optimistic at looking in certain areas as the rate comes through, that those policies are rate adequate. That's not just in Florida but throughout the Southeast region, even into the Northeast region as well. So we have a lot of healthy new business growth, but we are ensuring that it is profitable growth as it comes through. So we'll kind of be a little more selective in those areas to ensure that we, again as we mentioned earlier, have the most profitable policies on the books. We've mentioned that growth is great but not at the expense of the bottom line, so there has to be a nice balance between that.

Kirk Howard Lusk

Chief Financial Officer

Yes. I think we'd expect our gross earned premium to continue to increase quarter-over-quarter because of the amount of growth that we've experienced in the past. However, when you look at a gross written premium standpoint, that growth is going to start slowing.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

So Ernie, do you see the pricing as adequate in most of your markets at this point?

Ernesto Jose Garateix
CEO & Director

Yes. We're looking at that end. And because the market has been taking more rate, that is a very promising sign for us as we can continue growing in some of these markets, but we will not stop looking at the rate adequacy in these markets. And if there's a need to take more rate, we definitely will be doing that.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then what's your latest thinking about the SB 76 new changes that have been put in place? How much progress are they really going to make in limiting losses in Florida?

Ernesto Jose Garateix
CEO & Director

Yes. So I would say I'm very cautiously optimistic that, that will help, but keep in mind that just went into effect July 1. So we're very, very early in that. I'd like to see the proof after several months of SB 76 taking -- being in place and see how that pans out, but I am cautiously optimistic that, that could help down the road.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And do you think several months will be enough time to get a good look at it?

Ernesto Jose Garateix
CEO & Director

Yes. I would think, right, that a few months into it, I would say fourth quarter, would give us a little bit better indication and feeling of how things are going, and then well into -- obviously into the beginning of '22, because that way -- again, having been signed into effect July 1 and here we are in August, it's kind of tough to tell whether that's taking hold, but several months should give us a better indication.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Are there any momentum building for any further either regulatory or legal changes in the state? I'll throw in also: What's the OIR's view about the further price increases? How much distress is there -- out there in the sector? What else might be coming to make things better?

Ernesto Jose Garateix
CEO & Director

Well, I would say that there are some more things, I think, we would want some legislative assistance with and that we'll be going back to the table on that next legislative session on that piece of it. I do believe the OIR has been very helpful with us in getting rate adequacy in the market. As far as distress out there in the market, I would say it's a very tough market, but I think those who are keeping to their underwriting standards, understanding rate adequacy, are those that will get through the market. And others, unfortunately, may not.

Operator

[Operator Instructions] Our next question comes from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

Maybe if you could talk a little bit more about the components of the rising inflation sort of excluding catastrophe losses and that -- and there's a lot of talk about sort of issues in Florida with respect to liability, but it does seem like a lot of this is just like non-cat weather and other issues that maybe just aren't related to that tort reform or tort issues that -- other issues.

Kirk Howard Lusk
Chief Financial Officer

Yes, yes. So for example, in the second quarter, there was one very large PCS event, [PCS 2120 -- or PCS 2115], which was very large, and that impacted a number of carriers. It's a little bit different than the second quarter of last year where there was an unprecedented number of PCS events. This quarter was just like had to had the one large one. There was a couple other smaller ones. When you look at the claims inflation that we're seeing, some of it is COVID related. When you look at the price of lumber, when you look at the price of building materials and some of the repair costs, that type of stuff, that has augmented the claims inflation. That is starting to subside. I -- as far as being able to build that into your rates, because of the -- how we look at the [rates we look at] over a longer period of time, some of that will get itself in, but it'll take longer for some of that inflation, if it holds, to get into the rate activity. However, we are starting to see that subside. We think that probably claims are going to be -- not go down to the level they were before, but we think that they are going to go below where they are right now.

Paul Newsome
Piper Sandler & Co., Research Division

And that's a severity and pure inflation issue. Or is it also a frequency-of-loss issue? And [I know as in] not cat when I'm -- I'm just trying to get my arms around it, sort of like what you'd call weather or nonweather stuff.

Kirk Howard Lusk
Chief Financial Officer

Yes. It's more or less a severity issue than it is a frequency issue. I would say that frequency is up slightly but not to the extent of severity.

Operator

This will conclude Our question-and-answer session. I'd like to turn the call back over to Ernie Garateix for any closing remarks.

Ernesto Jose Garateix
CEO & Director

We'd like to thank everybody for their participation today and hope everybody has a great weekend. This concludes our call.

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