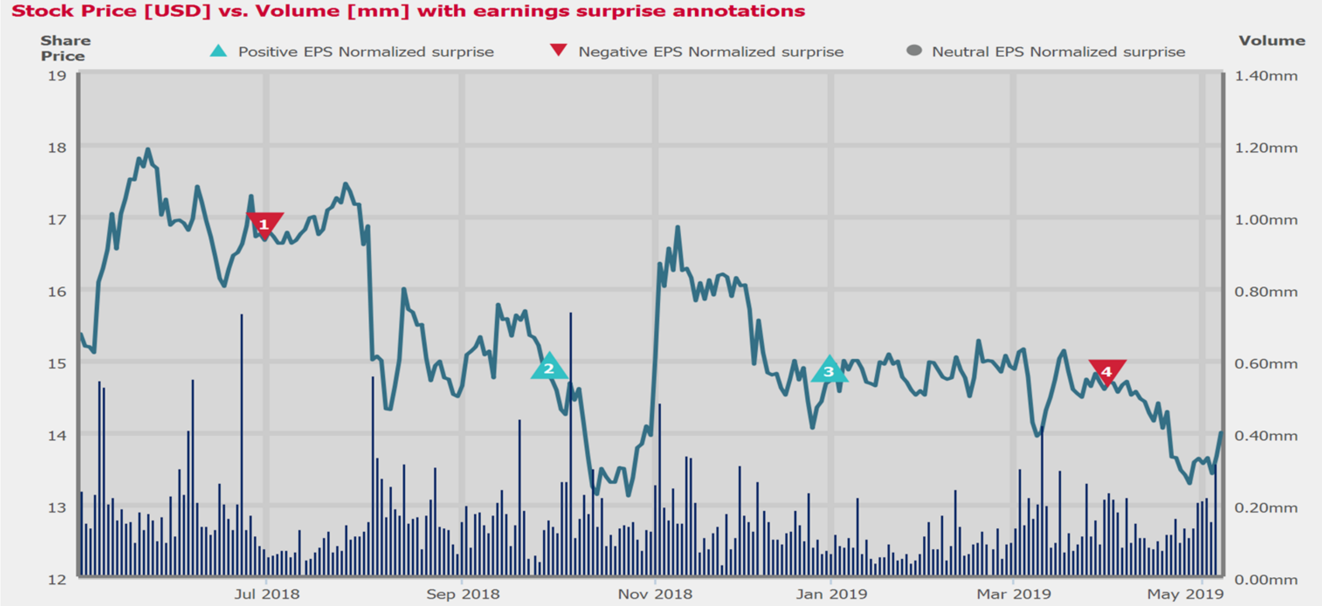
S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc.
NYSE:HRTG
FQ1 2019 Earnings Call Transcripts
Tuesday, May 07, 2019 12:30 PM GMT
S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.31	0.21	(32.26 %)	0.42	1.71	1.97
Revenue (mm)	117.18	118.26	0.92	119.35	477.82	520.34

Currency: USD
Consensus as of May-07-2019 12:10 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	0.67	0.48	(28.36 %)
FQ3 2018	0.28	0.65	132.14 %
FQ4 2018	0.03	0.18	500.00 %
FQ1 2019	0.31	0.21	(32.26 %)

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Call Participants

EXECUTIVES

Arash Solemani
Executive Vice President

Bruce Thomas Lucas
Chairman & CEO

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

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

William Harry Broomall
Dowling & Partners Securities, LLC

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings First Quarter 2019 Financial Results Conference Call. My name is Andrew, and I will be the operator today. Please note, this event is being recorded. [Operator Instructions] I would now like to turn the conference over to Arash Solemani, Executive Vice President at Heritage. Please go ahead.

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 expectation. 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 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 first quarter 2019 earnings call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company.

I am very happy with our first quarter results. Our gross written premium increased 2.9% year-over-year despite derisking $3.4 billion of total insured value, or TIV, from Florida's Tri-County region. Our gross written premium growth is primarily related to our multistate diversification as premiums grew by 6.6% outside of Florida but only by 0.1% in Florida.

We continue to see our book shift away from Florida and are projecting only 29% of our TIV to be within Florida by the end of 2019, which we believe is the best diversification amongst the Florida-based carriers. As of the first quarter, only 5.2% of our consolidated TIV stems from personal residential business in Florida's Tri-County region, which is well below our publicly traded Florida peers.

We are continuing to expand our geographic footprint across the East Coast and wrote our first policy in Virginia and launched our commercial residential program in New Jersey during the first quarter. Our year-over-year growth is impressive, particularly considering that we have been derisking in Florida's Tri-County where premiums per policy are among the highest in the country and we have been avoiding high concentrations of coastal business in our Southeast states.

Good underwriting leads to good claims experience. Our claims metrics continue to impress every quarter, which is the exception in the Florida market. The percentage of Heritage's non-hurricane open claims in Florida's Tri-County is the lowest in the company's history and down 15 points year-over-year. Similarly, the percentage of Heritage's active non-hurricane losses in Florida's Tri-County is at a new record low for the company and is down 14 points year-over-year.

I have adamantly noted that companies that diversify away from the Tri-County region in Florida as a whole will outperform the peer group over the long run, which is heavily concentrated in these loss prone areas. It is not surprising that virtually every claims metric is improving quarter-over-quarter and year-over-year as we have diversified away from the Tri-County. This is especially evident in our loss reserves, which developed favorably for the third consecutive quarter in the first quarter 2019. We expect continued improvement in our loss trends as we execute on our business plan, and the passage of Assignment of Benefit reform in Florida will only help these results going forward.

Our first quarter loss ratios were excellent until a large hailstorm hit Brevard County at the end of March. In connection with this event, we booked a net retention of $10.2 million in the first quarter. Going forward, 80% of losses above this number are covered by reinsurance, and we do not expect losses from the storm to develop in excess of current reserves.

With respect to capital management, we continue to strengthen our balance sheet by retiring $15.8 million of debt principle in the first quarter. We also repurchased 347,740 shares at a 3% discount to the first quarter book value per share. Our share repurchase authorization of $45 million is remaining, and we are committed to retiring our common stock as long as our share price is below 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 $7 million, which equates to $0.24 per diluted share. Before going into more details on the quarter, I would like to address our net income seasonality. As we have previously stated, the first quarter is typically the heaviest loss quarter for NBIC. As such, we expect the first quarter to be our weakest net income quarter in non-hurricane years due to our net exposure to winter weather. We then expect progressively stronger income throughout the year, again absent any hurricanes, with the fourth quarter being by far the strongest.

Looking ahead, we believe we are well positioned given the steps we've taken to improve our overall risk profile and diversification. One of those steps includes the structure and growth of our premiums in force. Florida premiums in force decreased by $12.4 million or 2.4% year-over-year as at March 31, 2019 while at the same time, premiums in force outside Florida grew by $19.2 million or 4.7%, resulting in higher in-force premiums and better diversification.

In the quarter, gross premiums written increased by 2.9%, which was driven by a 6.6% growth outside Florida and a 0.1% growth in Florida. We continue to expand in the geographies that we view are more profitable while shrinking in areas we believe rates are insufficient. Heritage's geographic diversification has already yielded reinsurance synergies, and we are encouraged by improving claims metrics.

Ceded premiums and the ceded premium ratio are down year-over-year. The decrease in absolute dollars and in the ratio reflects reinsurance synergies obtained via geographic diversification and the June 1, 2018, reduction to NBIC's gross quota share from 18.75% to 8%, which was partially offset by the December 31, 2018, increase in NBIC's net quota share from 49.5% to 52%.

Total revenue increased by $6.2 million or 5.6% reflecting the increase in net premiums earned and from unrealized gains on equity securities.

Losses for the quarter were up $9 million over the prior year's first quarter. The increase stems from higher current accent quarter net losses and LAE. Our reserves remain strong, and the first quarter 2019 represents the third consecutive quarter of favorable prior year reserve development. In addition, our claims metrics have been trending favorably with improvement in both the total number of open claims and the percentage of litigated claims. In 2016, when we began to reduce our exposures in the Florida Tri-County's area, that region accounted for 67% of our open non-hurricane claims. That statistic is now down to 46%.

Operating expenses increased year-over-year predominantly due to the favorable impact of NBIC-related purchase accounting in the first quarter of 2018 policy acquisition costs and reduced ceding commission income associated with the smaller NBIC gross quota share reinsurance program. The purchase accounting benefit mostly impacted the first 2 quarters of 2018 as policy acquisition costs mostly normalized by the third quarter. General and administrative expenses were lower year-over-year as staffing, compensation and benefits are aligned to company performance.

Overall, we achieved a 97.3% net combined ratio for the first quarter of 2019, which is slightly higher than our internal projections due to the Brevard County hailstorm.

As stated at year-end 2018, we anticipate that our refinancing efforts would reduce interest expense by over $7 million annually. In the first quarter of 2019, interest expense and the amortization of debt issuance costs were down $2.7 million year-over-year.

Book value for the first quarter increased by $9.8 million to $435.1 million from the year-end 2018's $425.3 million. First quarter 2019 book value per share is $14.78, a 2.4% increase from year-end 2018. Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Freddie Sleiffer of KBW.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Firstly, I was wondering if you could provide an update on your Irma and Michael gross loss estimates. And roughly how many open claims you still have for each of those?

Bruce Thomas Lucas
Chairman & CEO

Sure. Irma is relatively unchanged. It's approximately $900 million open claims there, maybe 2,000 in total-ish, give or take, 100 claims here or there. Michael right now, we're still projecting roughly $40 million. It will probably continue to develop a little bit higher, but we're not seeing a ton of activity on Michael and maybe we have a couple hundred open claims there.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just following up on Irma, what are your current Irma gross incurred losses, your gross paid losses? And how much IBNR do you have left?

Bruce Thomas Lucas
Chairman & CEO

Well, all of those things together total about $900 million. I don't have the breakdown between each bucket in front of me, but that is our incurred loss with IBNR.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just on you're ceded premiums in the quarter, they were a little bit above the last 2 quarters in dollar terms. Is that related to the higher cost for the NBIC renewal at 1/1?

Kirk Howard Lusk
Chief Financial Officer

I'm sorry, what's the question?

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

The ceded premiums were a little higher than the last couple of quarters. It was like $119 million and more like $115 million in the last 2 quarters.

Kirk Howard Lusk
Chief Financial Officer

Yes, it has been. So basically an increase in the net quota share. The net quota share increased at year-end at 12/31 from 49.5% to 52%. So the third and fourth quarters would have seen a reduction in the gross quota share, the first quarter will see the increase in the net quota share.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And then just moving on to expenses. I think, Kirk, you touched on this in your opening remarks, but why were your G&A expenses so much lower versus 1Q '18?

Kirk Howard Lusk
Chief Financial Officer

A couple items there. One is when we look at some of the expense accruals, and then also our staffing year-over-year is down slightly.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just on the accrual, how much lower was this and your expected accrual worth in dollar terms?

Kirk Howard Lusk
Chief Financial Officer

It was about right where we expected it to be.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And just following up on that. So your G&A was a bit lumpy last year. So what should we use as a run rate going forward on that? Is the year-over-year comparison on last year's quarter best? Or is this quarter's close to $20 million a better run rate? Or any guidance you can provide on G&A expenses.

Kirk Howard Lusk
Chief Financial Officer

Yes. I mean I think that our G&A is probably going to tick up a little bit in future quarters but should not be substantial.

Bruce Thomas Lucas
Chairman & CEO

Yes.

Kirk Howard Lusk
Chief Financial Officer

So I think the run rate you say it is, is not bad. Just double up slightly from there.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And then is there any color that you can provide on your -- on the mid-year renewal? Any changes you might be making to the structure of your tower or anything you're hearing in terms of pricing?

Bruce Thomas Lucas
Chairman & CEO

We do have indications on pricing. But since we haven't closed our program yet, we cannot comment on it. I can tell you, our renewal is going, I think very well. We should hope to have that sewed up here in the next couple of weeks. But other than that, I really can't comment.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just lastly on the AOB legislation. How do you think this will impact you and your book? And do you think you'll move to offer any non-AOB product?

Bruce Thomas Lucas
Chairman & CEO

Well, I do think that the AOB statute has got some promise to it and it could be very, very helpful in reducing some of the fraud abuses that we've seen in the Florida market. But the attorneys on the other side are pretty crafty. So we're going to wait and see what happens, but our general feeling is that this is beneficial, this will reduce AOB abuses that we've seen in the past. I think it's particularly helpful on hurricane losses because that's where you see the big surge in Assignment of Benefits. It's after the cat. And so that's going to have the biggest impact for us.

We do see a lot of AOB in Florida's Tri-County region. But given that our reduction there has been about $24 billion in TIV over the past 2.5 years, we just don't have the concentration there. So it's not going to be as impactful on the dailies for us because we have a much smaller portfolio than the Florida Group. But I do think it'll have an outsized return on the hurricane events just given the sheer number of claims that you get after one of those events.

Operator

The next question comes from Tom Shimp of Sandler O'Neil.

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

I'm going start out with the combined ratio. On your last call in early March, you noted an expectation for the combined ratio, it would be right around 90.4%, just like it was in 2018. Do you still expect that to be at 90.4%? Or has your thinking changed? And then to add to that, does the 90.4% include a cat load for a hurricane in the third quarter or fourth quarter and if so, by how much?

Bruce Thomas Lucas
Chairman & CEO

Yes. I mean we're not really giving guidance right now, Tom. But I could tell you that any guidance that we've given in the past did not include a cat load. We generally approach it from the ex cat vantage and as a result, there would not be a cat load there.

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

Okay. And then for the expense ratio, is the 40.7% that was reported something we should think of as a run rate going forward?

Kirk Howard Lusk
Chief Financial Officer

Yes. I think our previous guidance I think is -- or the previous indicates we've given are still in line.

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

Okay. And then from CAN, can you let us know how much that benefited underwriting in the first quarter?

Bruce Thomas Lucas
Chairman & CEO

Well, it's hard to really quantify because how much do we save on a loss when we're out there mitigating the water damage versus what we would have paid without the mitigation effort? I mean it's just -- it -- we know it's there. We know that it is a tangible benefit. We know that it improves the loss ratios, but it's just impossible to quantify it because you don't know what a loss would be but for the remediation efforts that we had CAN in the quarter.

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

Okay. And then I was hoping you could just give some high-level comments on the AOB reform. Just your expectations for the tort environment underwriting in Florida just in general.

Bruce Thomas Lucas
Chairman & CEO

Well, I think the #1 thing that the AOB legislation does is that it stops a lot of the abusive litigation tactics we've seen. We've seen attorneys who report losses on day 1. In some instances, they reported via a lawsuit. The new statute sets forth parameters that allow the insurance company to complete its investigation. Once that is done and you've made a determination on coverage and damageability if there is coverage, if the plainant wants to sue, they have to give you a notice, it's a 10-day notice in advance. We then have an opportunity to put up our kind of final settlement offer. Their number that they respond with is very high. They have to collect at least 50% of that delta in order to collect on attorney's fees. And if they don't get that, they don't get attorney's fees at all and they don't get attorney's fees just by filling the lawsuit, which is a different approach than what we've seen in the past.

They're also on the hook for our attorney's fees if final judgment comes in within 25% of that delta that I mentioned earlier. So it's really putting a lot of risk on them to actually go to court, win and prove damages in order to get attorney's fees. And we just don't think that the outstanding plaintiff claims that we have and will see in the future are willing to go to trial across the board, but I can tell you that we are. And that is a conviction that we have internally. We will go to court. We will go to trial. We will make them prove it. And if at the end of the day they're paying our attorney's fees, so be it. But we feel pretty confident in our claims examination process, that the numbers that we're putting out are correct.

And so it really I think will have a big chilling impact on the amount of litigation that you get, and I would also make the point that the disclosures required to the consumer are pretty high. A lot of consumers have no idea that they're signing away their rights under their own insurance policy and the right of rescission now is 14 days versus 3. And the information given the consumer is pretty thorough and detailed, and I think that will also have a chilling effect on AOB.

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

Okay. Great. That was helpful. Just one last question. I just want to talk about the first quarter in general. We now had 2 heavy first quarter -- 2 heavy first quarters post-NBIC. Are you experiencing a level of weather volatility greater than what you expected before acquiring the company? And if that's the case, is there a way to mitigate the volatility a bit more?

Bruce Thomas Lucas
Chairman & CEO

Well, I would say no. I mean we do understand that first quarter for NBIC almost always -- I can't think of a time in their financials where they made money in the first quarter ever. So they always lose money in the first quarter and that kind of goes to Kirk's point of earnings for the company are going to be -- as a whole, will be the lowest in the first quarter and the highest in the fourth quarter just given the nature of how the northeast winter storm activity plays out in 1Q.

We did have an incredibly volatile year last year because we had record activity in terms of winter storms. This quarter was not nearly as volatile. I think NBIC as a whole only lost a couple hundred thousand dollars this quarter. So it actually played out pretty well for us. We did increase in the net quota share to try to hedge some of the volatility, but we took a 10-point reduction on the gross quota share. So our retained losses did increase vis-à-vis the quota share activity that we had in place at year-end. But overall, NBIC is performing exactly as we expected. I'm incredibly happy with the integration and the financial results from that acquisition.

Operator

And we have a follow-up from Freddie Sleiffer of KBW.

Frederique Suzanne Sleiffer
Keefe, Bruyette, & Woods, Inc., Research Division

I just have a quick follow-up question on the Irma gross losses. Is there any reason -- is part of the reason why you're not increasing gross losses related to the reinsurance renewals not coming up? And also, how much do the reinsurers have your gross losses -- and does this differ from your $900 million?

Bruce Thomas Lucas
Chairman & CEO

I know we're not moving gross losses up or down based on reinsurance renewals. We have a duty to adjust claims in reserve. We're where we are because we have a lot -- had a lot of IBNR out. I don't know what the number is now, but we're not really seeing a big change in Irma results at this time. I mean over the long haul, things are probably going to trend up somewhat just because they have another 11 months to file claims. But with respect to the second part of your question, I have no idea where reinsurers have our losses. I mean I think they probably have our losses where we're setting them. That's the only information they have.

Operator

The next question comes from Bill Broomall of Dowling & Partners.

William Harry Broomall
Dowling & Partners Securities, LLC

On other legislation out there beyond AOB, when we look at the increase in the FHCF cap from 5% to 10% that can be collected, do you think that has any impact on the upcoming 6/1 renewal? Or is that longer term? Would that be reflected in the industry?

Bruce Thomas Lucas
Chairman & CEO

Well, I'm sure the reinsurers are adjusting their models. I mean they would have to. I mean they're -- the reinsurers are good underwriters. Our partners are pretty thorough. They put LAE loads into their models every year for everybody. And if the layers that are alongside and on top of the cat bond that are impacted by an increase of LAE from 5 points to 10 points at the FHCF, that obviously reduces their risk. It should flow through to pricing. But I've yet to see anybody kind of break down what that does to pricing on their end, but I'm sure that they have adjusted their models for it.

William Harry Broomall
Dowling & Partners Securities, LLC

Great. And just one more on the AOB legislation. I just want to make sure I kind of understand all the moving pieces and how it works. I mean this kind of attorney's fees addresses when there's kind of an AOB is assigned. But if a lawyer goes direct to a consumer or an insurer without kind of signing that AOB over to -- a claims mitigation, that kind of falls outside of this legislation. Is that -- am I understanding it correctly?

Bruce Thomas Lucas
Chairman & CEO

That is absolutely correct. And we've always said that AOB on our book is probably 15% to 20% of the problem, but direct lawsuits with the insurer out of the Tri-County region is the balance of that. Now what it does do, though, I mean, it is more difficult to get an insured individually to sign up to a lawsuit because most people just don't want to go through the legal process. They don't want to be deposed, have to go to court, be cross-examined, do examinations under oath. Most people don't want to do that.

However, the AOB contractors are more than willing to do it. I mean these are corporations that were taking the Assignment of Benefits and then they refused to submit to examinations under oath. They took the position with a lot of success that they were not bound by the policy terms and conditions because they're not the insured. They just have the benefit of the payment. And when you are able to skirt all of the policy provisions, examinations under oath, et cetera, it -- you're really not going to hesitate to file the lawsuit.

When you're required to submit to the policy terms and conditions, be cross-examined, deposed, et cetera, totally different ballgame. And most insureds are not going to want to do that, and I think there's a lot of AOB vendors that are not going to want to go through that process either.

William Harry Broomall
Dowling & Partners Securities, LLC

Perfect. And one last one. Last quarter, you talked about your strategic partnership with Safeco to offer the bundled home and auto. Do you mind just giving us a quick update on where you kind of stand with that?

Bruce Thomas Lucas
Chairman & CEO

Sure. We did launch it in the Northeast. We've had some great success there. We really do appreciate the partnership with Safeco. We're hoping to expand that relationship to other states. But it -- this is a nice start for us. It was a long time coming and they're just -- they're a great partner to have in our portfolio. But other than that, I never comment specifically about premium we get from any source of production.

William Harry Broomall
Dowling & Partners Securities, LLC

Okay. Maybe can you just tell us maybe how many states it's in?

Bruce Thomas Lucas
Chairman & CEO

Right now, we are in one state.

Operator

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

Bruce Thomas Lucas
Chairman & CEO

I would just like to thank everyone for attending our first quarter earnings call.

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