S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc. NYSE:HRTG

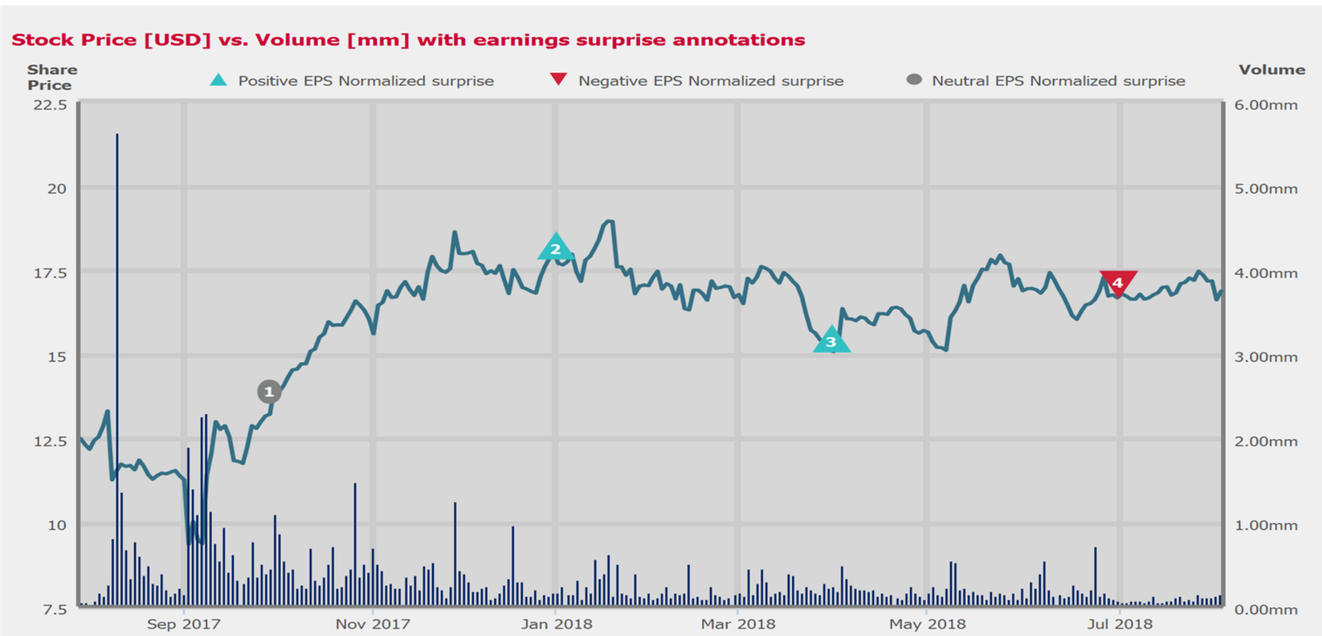
FQ3 2018 Earnings Call Transcripts

Thursday, November 01, 2018 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2018-			-FQ4 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.28	0.65	▲132.14	0.50	1.63	2.27
Revenue (mm)	126.19	125.30	▲(0.71 %)	126.81	483.16	517.26

Currency: USD
Consensus as of Oct-31-2018 10:44 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2017	(0.09)	(0.06)	NM
FQ4 2017	0.39	1.23	▲1 215.38 %
FQ1 2018	0.42	0.56	▲2 33.33 %
FQ2 2018	0.67	0.48	▼3 (28.36 %)

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Call Participants

EXECUTIVES

Arash Solemani
Executive VP & Director of Investor Relations

Bruce Thomas Lucas
Chairman & CEO

Kirk Howard Lusk
Chief Financial Officer

ANALYSTS

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

James F. Naklicki
Citigroup Inc, Research Division

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

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

Matthew John Carletti
JMP Securities LLC, Research Division

William Harry Broomall
Dowling & Partners Securities, LLC

Presentation

Operator

Good morning, and welcome to the Heritage Insurance Holdings Third Quarter 2018 Financial Results Conference Call. My name is Chad, 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 Solemani, Executive Vice President and Director of Investor Relations at Heritage. Please, go ahead.

Arash Solemani
Executive VP & Director of Investor Relations

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

Today's call may contain forward-looking statements 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 detailed material risks that may cause our future results to differ from our expectations. Our statements are as of today November 1, 2018, and we have no obligation to update any forward-looking statements we may make. For 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 SEC filings. With us on the call today are Bruce Lucas, our Chairman and CEO; and Kirk Lusk, of 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 third quarter 2018 earnings call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company. Additionally, our thoughts and prayers are with everyone impacted by Hurricanes Lane, Florence and Michael. The third quarter was marked by several severe weather events. In Hawaii, Hurricane Lane caused light damage to our policyholders. The Hawaii book significantly outperformed modeled loss expectations. Only 154 claims were reported, 90% of claims were closed, and we booked an incurred loss of $600,000 including IBNR.

Hawaii was also impacted by tropical storm Olivia, but we have no incurred losses from this event. Coverage under the Zephyr policy is only triggered when a hurricane watch or warning is issued, which did not happen in connection with Olivia.

Our Carolinas portfolio was impacted by Hurricane Florence in the third quarter. To-date, 1,414 claims have been reported, and 83% are closed. Similar to Hawaii, our book outperformed modeled loss estimates. There are several reasons for the outperformance. First, 2 years ago, we decided to shift our business from coastal areas to Inland, North Carolina, because we did not believe the coastal market rates were adequate given the reinsurance rates and hurricane risk. Our portfolio shift from coastal areas has been very successful, and only about 30% of our North Carolina policies are in coastal zones.

Our partnership with National General Insurance in North Carolina has been very helpful during this process and highlights the intrinsic value of this strategic relationship.

Second, our costal portfolio was more focused on newer constructions, which performs better during the hurricane events. And finally, Contractors Alliance Network was our first response to the storm. CAN was quickly tarping roofs, removing trees and drying homes after Florence's landfall. CAN was instrumental in capping hurricane losses and helping us to outperformed modeled loss estimates. In the quarter, we booked a $20 million gross loss for Florence including IBNR. Heritage's retention was booked at $16 million pretax, and the remaining $4 million will be covered by our reinsurance program. The company is also booking our maximum potential retention for Hurricane Michael. This retention is $16 million of pretax and will be booked in the fourth quarter.

Our consolidated losses on daily claims have been very stable. Prior accident year reserves developed favorably in the quarter. Despite ranking third in premiums, as of the end of the second quarter, Heritage had more loss reserves posted than any of our publicly traded Florida peer companies on both a GAAP and statutory basis.

Losses on the current portfolio are improving, and our substantial loss reserves should bode well for the company moving forward.

In addition to favorable loss development, there are several key metrics pointing to a favorable claims trend. Our Tri-County portfolio particularly in Dade and Broward Counties continues to trend lower as the company's strategic diversification plan continues.

Fewer policies in AOB prone areas should result in lower claim frequencies and severities, and should reduce reserve volatility. Evidence of this trend can be seen in the new non-catastrophe Tri-county claims count, which is down 31% year-to-date. Our diversification away from the Tri-county lower claim trends and industry-leading reserves is positioning Heritage well for the foreseeable future. We continue to see improved operating metrics across the company. Our net combined ratio was 93.9% in the third quarter, and 11.6% improvement from 105.5% in the prior year quarter.

Book value per share increased to $15.16 per share, an 18% increase year-over-year. Policy sales continue to grow at new record numbers, and gross premiums earned increased 53% year-over-year largely due to the NBIC acquisition. We are also excited to announce that Heritage has expanded its relationships with GEICO's insurance agency to all states versus only NBIC states previously. GEICO's now partnered with Heritage, NBIC and Zephyr, and we're very appreciative of the relationship across our platform. 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 $6 million up from the prior year loss of $8.7 million in the third quarter of 2017. The significant year-over-year improvement reflects a better loss ratio, the addition of income from NBIC at a one-time charge in the third quarter of 2017. The one-time charge of $6.9 million in the prior year reflected the fair value adjustment of a non-cash derivative liability associated with a convertible debt that was issued in conjunction with the NBIC acquisition. The derivative liability reversed in 4Q of 2017, and was reclassified to shareholders' equity.

Operating income was $14.2 million for the quarter, which was up from $1.4 million for the same period last year.

Gross earned premiums for the current quarter were up 53% to $234.2 million from $154.1 million reported for the third quarter of 2017.

The significant year-over-year increase is mostly due to the addition of NBIC. The positive increase was partially offset by the Tri-county in-force premium decreased during the past year of 17%. As we continue our planned diversification away from regions that are more prone to assignment of benefits broad, our continued diversifications should improve operating results moving forward.

Ceded premiums earned increased to $115.9 million for the 3 months ended September 30, 2018, as compared to $57.9 million for the same period in 2017.

This increase relates primarily to the inclusion of the NBIC in the third quarter of 2018.

As a reminder, NBIC extensively uses quarter share in its reinsurance program. Excluding the effects of NBIC's reinsurance program, but including reinsurance synergies, ceded premiums were 35% of gross earned premiums down from 37.8% for the third quarter of 2017.

The reinsurance synergies are one benefits of geographic diversification of the Heritage portfolio.

To give a perspective on the change in the portfolio, Florida Total Insured value or TIV represented 71% of our consolidated portfolio at third quarter of 2017. And as of the third quarter of 2018, our Florida TIV is only 32% of the consolidated portfolio.

Loss and loss adjustment expenses for the quarter decreased 8% to $58.7 million compared to $64 million for the third quarter of 2017.

The decrease is due to a combination of lower CAT retentions and higher profit from Contractors Alliance Network. The retention from Hurricane Florence and Lane during the third quarter of 2018, was $16.6 million compared to the third quarter of 2017, Hurricane Irma retention up $20 million.

We continuously evaluate our reserves to ensure that they're adequate and appropriate. As mentioned in our second quarter earnings call, we've continued to focus on and evaluate the -- on an ongoing basis, our litigated claims in the State of Florida, particularly in the Tri-county area.

We increased our reserves during the second quarter of 2018 due to the litigated and assignment of benefits environment in the State of Florida.

During the third quarter, we've reevaluated our reserve position and currently believe that the actions we have taken should mitigate the future adverse impact of litigated claims.

We will continue to evaluate our exposures, reserves and pricing to position the company for long-term profitability.

The net expense ratio increased year-over-year from 38.2% at third quarter 2017 to 44.3% at the third quarter of 2018.

Ceding commissions of $18 million were offset against acquisition costs and operating expenses in proportion to the expenses associated with the production of business.

In comparison, excluding the impact of NBIC, the corresponding ceding commissions and a nonrecurring acquisition-related G&A expense of $7.1 million, the net expense ratio would have been 41.5% in the third quarter of 2018.

Our combined ratio for the quarter as a percentage of net premiums earned was 93.9%, which is down from 105.5% in the third quarter of 2017.

The improvement is related primarily to the reduction in the net loss ratio, partially offset by an increase in the expense ratio.

Our effective tax rate increased in the third quarter, primarily related to booking our true-up of the 2017 income tax provision to the 2017 income tax return and adjusting our 2018 effective tax rate to take Hurricanes Florence and Michael into consideration. Permanent tax differences served to increase our effective tax rate, given the lower resultant pretax income caused by the hurricanes.

The year-to-date effective tax rate through 9/30/18 is approximately 28.1%.
Moving to the balance sheet, notable movements since year-end 2017 and from the second quarter are substantial decreases in reinsurance recoverables on the asset side, related to the payment and collection of catastrophe losses and a reduction of unpaid losses on the liability side of the balance sheet. Cash and cash equivalents increased from year-end, largely due to collections on reinsurance recoverables. Shareholders' equity at September 30, 2018, was $391 million, up from $301.7 million at the end of the third quarter of 2017. Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions]

The first question will come from John Barnidge with Sandler O'Neill.

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

I believe you said, you highlighted 41.5% for kind of a normalized expense ratio in the quarter. Should we expect that for run rate in 4Q '18? And where do you see it going next year once, we're kind of more than a year out from Narragansett Bay closing?

Kirk Howard Lusk
Chief Financial Officer

Yes, and that's actually going to be close to a run-rate basis, probably be slightly less than that just due to the one-time items that we have occurred. But -- and we do anticipate that by 2020 some of the integration expenses due to the dual systems that we're operating will have a positive impact. But that, again, it's like we're about a year away from realizing the benefit of that.

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

Okay. Last quarter, I believe you retired $10 million in convertible debt. Did you do any of that this time around?

Bruce Thomas Lucas
Chairman & CEO

We did not retire any convertible bonds in the third quarter.

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

And what about share repurchases?

Bruce Thomas Lucas
Chairman & CEO

We did no share repurchases in the third quarter.

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

Okay. And the ceded premium ratio was 49.5%. Is that run rate, you think?

Kirk Howard Lusk
Chief Financial Officer

Yes, that's pretty close. It's -- it was a little higher in the first half of the year that reflected a higher gross quarter share at NBIC. Subsequently, it will then reduce. So yes, that's probably more of a run rate.

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

And then my last question and I'll requeue. You got a convertible debt, you have a term loan that's somewhat price because it's on floaters. Can you talk about retirement options, given you got a Kroll rating during the quarter?

Bruce Thomas Lucas
Chairman & CEO

Yes, so we are excited to have the Investment Grade Kroll ratings. So we appreciate all the efforts by Kroll to go to that process with us.

We are looking at options right now to refinance some or all of the current capital structure. But since those processes are still in motion right now, I really can't comment on where they are, with whom and et cetera. But we are optimistic to have some type of color sent out to the market later this year.

Operator

Our next question will be from Mark Hughes with SunTrust.

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

Did I hear properly, the $7.1 million in nonrecurring expenses in the quarter? Or is that year-to-date?

Kirk Howard Lusk
Chief Financial Officer

That was for the quarter.

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

For the quarter. And that would be about 6 points of earned premium -- if I'm thinking about that properly. If you did 44% expense ratio and you took out 6 points, is the 38% more of a reasonable run rate?

Kirk Howard Lusk
Chief Financial Officer

Yes, it's actually going to be -- a little higher than that when you look at NBIC, some of the integration costs going forward. So it's probably between the 40%, 41% range.

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

Okay. And then on the loss ratios, some of that was offset by the CAN Network, the underlying loss if you took out your capita amount as in the favorable development, seems like that 38% loss ratio, is that a good underlying number for you, 38%, 39%?

Bruce Thomas Lucas
Chairman & CEO

Yes, so the difficulty with that is the loss ratio does shift quarter-to-quarter. And what you're seeing right now, Mark, are incredibly positive trends in the loss ratios. Some -- just additional stats that I can share with you on the call today, that kind of highlight what we're seeing in our portfolio. If you look at things like percentage of litigated claims that we have right now that are Tri-County versus other counties, my stats only go back 3.5 years. But we're at the lowest point today in that 3.5-year window of 67%.

Similarly, when you look at non-litigated claims in the Tri-County compared to the rest of the Florida book. Again, we're -- off my stats, we're at 41% of our non-litigated open claim count is in the Tri-County. That's the lowest number I have in the last 3.5 years. So I'd have to go back to 2013 and '14 to see if we're at a record low or if we had any periods in '13 or '14 that were at those levels. As we've been diversifying away from Tri-County, we've also noticed a positive trend in new water claims filed, just year-to-date for example, our Tri-County water claims are down 41% compared to the prior period. So we're seeing a real shift in the claims as they come in, new claims and existing inventories that are related to the Tri-County, related to AOB fraud, and litigation. And these things are starting to have a very positive impact on our reserves and our losses. And this is the first time in a while that we've had positive development in all prior accident years. And so we do think that being the first major company to pull out of the Tri-

County and our strategic shift to diversify the source of our business away from Tri-County in Florida is really starting to pay dividends. And on top of that, as of the end of the second quarter, we had more loss reserves than any of the publicly traded Florida peer group. So we're really set up for a -- we think a good run rate going forward. But it's hard for me to give you right now a specific loss ratio number for your model, given that we're seeing kind of an inflection point in the portfolio.

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

Can you say roughly how much benefit you got in the quarter? How many points from the CAN Network? Kind of above and beyond what would be normal trend?

Bruce Thomas Lucas
Chairman & CEO

Yes, we have not disclosed what CAN does. Some quarters, it's miniscule. Other quarters, it's more significant. We view that as kind of proprietary sauce here. We've spent tens of millions building out that network in that division. A lot of the Florida companies kind of scoffed at it. We're getting the benefits of it here and there throughout the year. But it's something that we don't want to just give a road map to our peer group as to how well the system works or doesn't works on the quarter-over-quarter basis. So we do not disclose what that impact is.

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

And there are other questions. But I'll re-queue.

Operator

[Operator Instructions] The next question will be from Christopher Campbell with KBW.

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

I guess I'm -- so -- I guess just thinking about the benefits that you're getting on the core loss ratio from the claims' adjustment income? I guess, how long does that continue? Like I guess, like post-storm.

Bruce Thomas Lucas
Chairman & CEO

Yes, I mean -- so if you look at CAN and what its focus was set up for, it's really set up for water mitigation is #1. And repair of roof claims, it's -- tarping services, tree removal, things like that. I mean you get benefits throughout the year on all those fronts. I mean we have a very large water mitigation division, that's out there in the field throughout Florida. So -- I mean, the benefits are ongoing. We do have some great quarters with CAN, and other times, you have expenses that catch up with revenue that you booked in the quarter and it reduces it. But it's been a pretty consistent earner for the company going back really since 2012 when we started it.

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

Okay. And then just I guess, I may have missed it, but what are your current Irma and Michael gross losses?

Bruce Thomas Lucas
Chairman & CEO

Yes, so we don't have an estimate on Michael, because it's just too soon after the storm. We do believe Michael will be a full event retention for us, and that is $16 million pretax, that is being booked in the fourth quarter. That would imply a $40-million gross loss, which we may or may not hit. I just cannot say at this point in time. I'd note that we really don't have a ton of claims there. We have about 850 Michael claims. So our frequency up there is pretty low. And the reason for that is, we were diligent on the front end for underwriting. We never believed that the construction codes up there were sound. We never really believed that the models were accurately capturing the AALs and the reinsurance risk. And therefore, we never even tried to grow up there. We have a very, very low market share. Our thought was, it wouldn't take much to cause a ton of devastation, so we avoided it. So it's hard to say, if we'll get to that $40 million number or not, because we're still in basically the second inning. But we did book a full $16-million fourth quarter retention. And then one update, we have 950 Michael claims, not 850.

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

Got it. And then Irma gross losses, I mean has that moved? You guys gave a range of like $700 million to $800 million last quarter.

Bruce Thomas Lucas
Chairman & CEO

Yes, we filed publicly in information of loss, noticed at 850, and quite some time ago. We're still under that number. But I don't have the exact number in front of me.

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

Okay, got it. And I'm just thinking about Irma loss for you, there was a competitor that also reported -- that reported like an additional amount. And I know there may be some market concerns, potentially some collaterable, maybe return to investors prematurely, especially if losses continue to creep upward. So I'm just wondering in Heritage specifically, are there any particular holes in the tower that could cause any adverse development before you reach to the top of the tower? And then I guess just a follow-on question, how much of limit do you guys have left, based on what was in place when Irma struck?

Bruce Thomas Lucas
Chairman & CEO

Yes, so I have heard, it's interesting you mentioned that, and I've heard that rumor too that there was a Florida writer that has a $100 million hole in the middle of their program, because they release collateral. Let me be clear, that is not us. We have no holes to the top of our tower. And the top of the tower stretches up to like the $1.6 billion-ish number, that's where our reinsurance recoveries become completely exhausted. We have no concerns at all about additional retention amounts in connection with Hurricane Irma. It's a nonissue for us. I don't know if those $100 million rumors are true for somebody else. But I'll leave it to them to report it or not report it, and then we'll know.

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

Okay, got it, that's very helpful. And I guess just -- so it doesn't sound like you're ready like with the acquisition up North to kind of give an idea on what you think the net loss ratio is going to be going forward? But I guess, you're fine with the expense ratio on a run rate being about 41.5%. Is that right? I guess, it's...

Kirk Howard Lusk
Chief Financial Officer

Yes, it's slightly going down. I think they are going to be -- probably going to be right around the 40%, 41% range.

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

Okay. And then basically, the issue with the net loss ratio -- I mean is there an idea on the core loss, the net core loss ratio? Where you think that those combined books are going to run? I know the loss ratio is going to include, you guys have some reserve movements, catastrophe, maybe consolidated reinsurance programs. I guess, how are you just looking at the underlying performance of those books?

Bruce Thomas Lucas
Chairman & CEO

Well, you start with Zephyr, which doesn't have any daily losses. Then you look at NBIC, and we use a pretty sophisticated net quota share -- gross quota share and aggregate layer to try to mitigate risk. They've worked incredibly well for us. Particularly, if you look at first quarter when our storm activity was near a record in term of losses, but performed really well. So the amount of quota share that we put on, the amount of adds that we put on has an impact on the core loss ratio pretty significantly, severe weather events up there have a pretty significant impact. Down here in Florida, you can get that occasional hailed event, we have one the other quarter. We were the first to report that one, by the way. And we also have a positive trend in our Florida loss ratios, just based on our Tri-county diversifications. So there's a lot of moving pieces to that. And as we get closer to year-end and place the net quota share and aggregate layers for NBIC, we'll have a little bit more clarity as to what we think is a good projective loss ratio moving into 2019.

Operator

The next question will be from James Naklicki with Citi.

James F. Naklicki
Citigroup Inc, Research Division

Just looking to get some -- just some, I guess what your view is as to the 2019 rate environment, particularly the legacy Citizens property book? And then, I guess the overall book for Jan 1?

Bruce Thomas Lucas
Chairman & CEO

Yes, so we did put some double-digit rate on the Florida portfolio in 2018. The kind of legacy Citizens filing had a roughly 14%-plus rate increase that, I believe when effective, [5.15%]. So we're about halfway through that filing. The voluntary filing also was a positive roughly 14% in Florida. That filing went effective, I believe, [8.15%]. And so we've got a lot of runway to go in terms of the current rate structure. Up in the Northeast, we have moved forward with some very modest rate increases, I mean there are low-single digits, nothing unusual. And I think Hawaii is flat. Hard to say what rate we'll need next year, that just depends on how losses continue to trend and what happens on the reinsurance front.

Operator

The next question will be from Bill Broomall with Dowling & Partners.

William Harry Broomall
Dowling & Partners Securities, LLC

Just one quick follow up on CAN. I can appreciate that you don't want to give out financial specifics. But can you just help us think about the split in terms of contribution from Florida versus the Carolinas and Florence? And what kind of opportunity? What maybe is the difference is in the opportunity in Florida versus outside of Florida? Just some magnitude would be perfect.

Bruce Thomas Lucas
Chairman & CEO

Yes, so we have CAN in place in Hawaii, I mean, that is an active system. We did not utilize the CAN Network in Hawaii because the loss was so small. I mean, to have 67,000 policies and give 150 claims. I mean there is no point in really using the network there. The Northeast, we do have water divisions that are operating. And they're starting to pick up some pretty good steam, particularly, in New York, and New Jersey. So we're seeing some additional incremental revenue coming online through Narragansett Bay. But

Florida on the Southeast in general is kind of the core of that operation, that's where you're going to see most of the benefit.

Operator

The next question will be from Matthew Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Bruce, I just want to ask you about the GEICO relationship. It seems like a really good step. A couple of things, just one, kind of can you help us think about the potential that it has for kind of business production for Heritage? Two, as we think about it rolling out to the other states, if it will change your footprint in those states at all? If there are states where you are more coastal if you'll kind of -- it will help you move Inland, if that's what you want to do? And then lastly, last quarter, I think you mentioned kind of 2 partnerships in the works. So I assume this is one of them. Is there still another one that we should expect at some point?

Bruce Thomas Lucas
Chairman & CEO

Yes, Matt. There is one more and once that launches we'll do a press release on it. But we are anticipating a fourth quarter launch. It could bleed into the first quarter with the holidays. But we're quite excited about the relationship. And once we actually launch it to market, we'll definitely put out some PR on that. With respect to GEICO, I mean they're just great organization, very professional, great to work with, savvy. We are absolutely thrilled to be working with them across our platform. But we do have a policy, wherein we do not disclose where strategic business is coming from and in what amounts, and in different regions. And that's an agreement we have across all of our producers. So unfortunately, I -- given the kind of the sensitivity of that information, I can't disclose that. But it's needless to say, GEICO has a -- will have a nice impact on our production just because of their sheer size.

Operator

The next question is a follow-up from John Barnidge with Sandler O'Neill.

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

Maybe on CAN like in the quarter, the Carolina's CAN production, was it guys that drove up from Florida? Or is it people that were already based there?

Bruce Thomas Lucas
Chairman & CEO

We sent 20 working crews to North Carolina. So that's a lot.

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

Did you have any working crews in the state?

Bruce Thomas Lucas
Chairman & CEO

Yes, from Florida, we pulled them out of Florida. We basically sent the convoy of Heritage vehicle up there, box trucks, dry outs, rooftops, you name it. So they were up there. I still think we have one crew still there working losses. So the response was really an internal response, where we moved resources from Florida to the Carolina's.

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

So it's not as if it's a CAN Network within the state? I'm -- what I'm trying to get to is, if you had a storm that hit the Carolinas and then they hit Florida, a different storm kind of like what we had with Texas and Florida last year, would you be able to handle that? Or would you be pulled apart?

Bruce Thomas Lucas
Chairman & CEO

We wouldn't be pulled apart. But we would definitely rely on more of the network resources rather than internal resources if we had 2 simultaneous losses. And I can tell you, for example, we had something similar happened between Florence and Michael, but the extent of those losses were, I mean, pretty small, 1,400 total claims in the Carolinas. It's pretty easy to get to a small number like that with our resources. And no sooner than we were wrapping up in North Carolina, Michael hit the Panhandle, and so we sent our crews to the Panhandle. So we've been able to -- and we're still there right now working claims in the Panhandle and helping our customers.

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

Okay. What inning or percent basis, if you could say you are in the full build-out of CAN throughout your footprint?

Bruce Thomas Lucas
Chairman & CEO

We're probably about 60% of the way where I want to be.

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

Okay. And then in some of the elevation in the expense ratio coming from CAN build-out, would that be reasonable to think?

Bruce Thomas Lucas
Chairman & CEO

No, the increase in the expense ratio in the quarter primarily relate to 2 ongoing disputes that we have. We thought it was prudent just to book some numbers for those. They're not fully resolved yet, so I'm not going to comment on what they are. But they are expense related, just given their classification. And that's -- in the third quarter that's what helped to elevate the expense ratio.

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

Okay, that makes sense. My last question, I don't want to front-run an election, it's a week out, but the candidate for governor that's a Democrat seems to be pulling ahead in the polls. What is your thought on the [toward] environment if we have a Democratic governor of Florida?

Bruce Thomas Lucas
Chairman & CEO

Yes, I mean, that's an interesting question. I mean I'm going to bite my tongue, and just say no comment.

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

I thought you would.

Operator

The next question is a follow up from Mark Hughes with SunTrust.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

The crews you have for Michael, how would you think the magnitude of the volume of work that you'll do there in the fourth quarter versus what you did in the third quarter for Florence, will it be comparable, little less?

Bruce Thomas Lucas
Chairman & CEO

I think that we're going to have some pretty good traction in Michael versus Florence, because the loss severities were significantly higher.

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

Then, probably be more of a benefit in the fourth quarter?

Bruce Thomas Lucas
Chairman & CEO

Yes, so Michael I think will have a higher penetration ratio. Because the wind speed was so significant that you got a lot more roof claims. And when you have roof claims, you have water claims. Whereas, the severities that we saw in Florence were pretty muted, all in. I mean, they weren't very bad. And so you look at forward wind speed and there is no comparison between Michael and Florence, so higher wind speed, higher damageability. And then just in general, the construction class in the Panhandle lags behind rest of the state. So I think that presents a really nice opportunity for us in the fourth quarter.

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

Without getting the specifics on the GEICO or any other partners, anything you can say in terms of what the growth rate for Heritage ought to be, if you look at the, just sort of organic expansion? Should you grow, how much 0 to 5, 5 to 10? Just some thoughts with the kind of production you see and anticipate in your policy retention. How should that kind of shake out?

Bruce Thomas Lucas
Chairman & CEO

Well, yes, you mentioned a lot there. And that's always something that we're trying to model in and get a better handle on for our internal projections. But you're right, it depends on your renewal rates, and where they are, and what those premiums look like, it is your strategic producers and dependent agents, new states that have come online. There are a ton of factors. And then you throw things like rate increases, and those -- that impact on the book, because that has a meaningful impact on top line. It's something that we typically start looking at a hardcore, more concrete projection at year-end. I know that we have licenses now in Virginia and Maryland, and so those states are going to come online in 2019. And we feel like there are some good opportunities there. We recently launched in Georgia and Alabama. We're seeing excellent production in both of those states, primarily inland by the way. So we're feeling pretty good about where we are in terms of our diversification plans and new business growth. But we're just not at a point where we could forecast that out to the market.

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

In the AOB lawsuits, what's your general observation about the overall level of suits? Your -- you're down I think because your penetration is down, but what do you think is happening across the states?

Bruce Thomas Lucas
Chairman & CEO

I think that the problem is only getting worse, there is no doubt. I mean it's definitely Dade and Broward are the leaders in the AOB kind of brought prices that we see. But you see it in Orange County, you see it in pockets of Hillsborough. It's kind of scattered here and there throughout the state. But Dade and Broward definitely lead that charge. It's probably 80% of the problem. But you know, we note that Orange County is rife with problems as well. And I think other carriers are seeing those results, too. So the problem I think is getting worse. That's why, we focus on credit scores. And we focus on good front-end underwriting. We run claim reports on the front end along with the, I guess, it's insurance scores, shouldn't say credit score. So you're getting an idea of kind of the profile of the customer, what their claims history is. We like that newer construction home, with a good insured in it and avoid areas like Dade and Broward. And that additional diligence on the front end is really helping loss ratios, reserve development, open Tri-County litigation, open Tri-County claims. Every metric that we have to monitor the extent of that AOB crisis is improving, quite significantly in many cases. So we note that the problem is getting worse. But on our portfolio, it seems to be getting better because of the efforts that we've taken to mitigate the risk.

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

And final question. Kirk you had mentioned how those opportunities perhaps in 2020 for a little large in improvement, if you eliminate the dual systems. Anything you can tell us in terms of the magnitude of the opportunity?

Kirk Howard Lusk
Chief Financial Officer

We're talking at -- a couple of million dollars, depending upon. Because I know we're in the process of negotiating the current system. And there might be some efficiencies gained with it also. So just eliminating some of those old systems is going to save a few million dollars from NBIC's expenses.

Operator

Ladies and gentlemen, 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 their participation in our third quarter earnings call.

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