S&P Global
Market Intelligence

Heritage Insurance Holdings, Inc. NYSE:HRTG

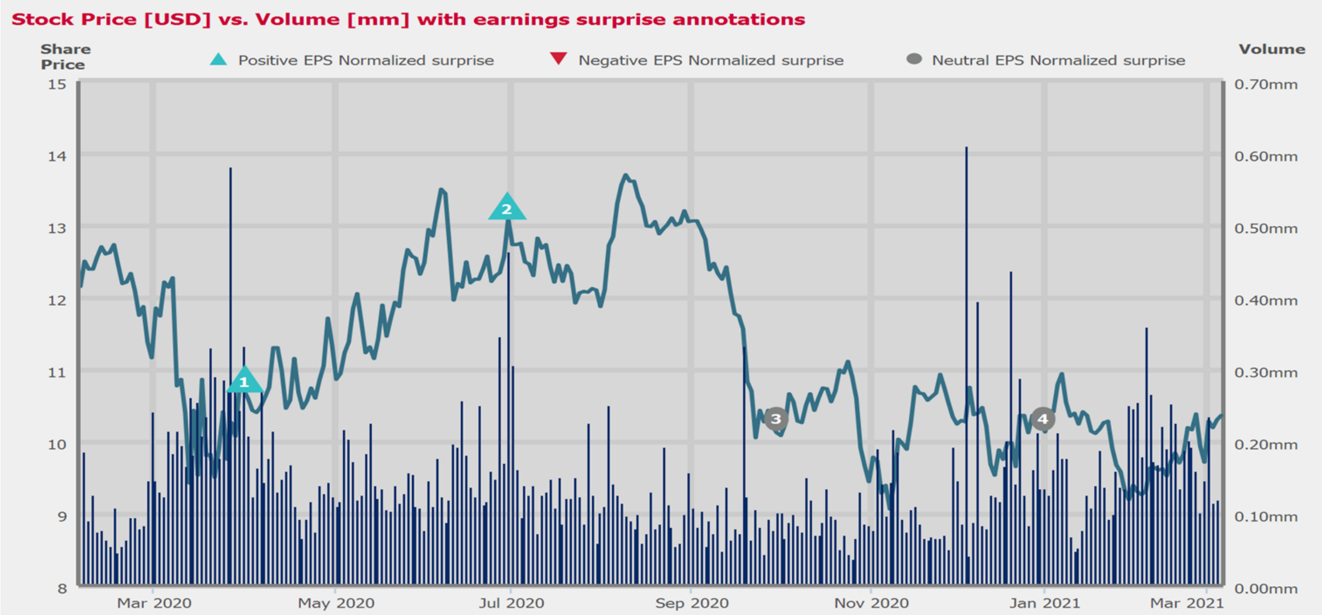
FQ4 2020 Earnings Call Transcripts

Thursday, March 04, 2021 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2020-			-FQ1 2021-	-FY 2020-			-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	(0.46)	0.03	NM	0.19	(0.62)	(0.47)	NM	1.32
Revenue (mm)	146.56	159.55	▲8.86	134.96	580.40	593.38	▲2.24	594.10

Currency: USD
Consensus as of Mar-04-2021 8:33 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	0.26	0.27	▲1 3.85 %
FQ2 2020	0.01	0.15	▲2 1400.00 %
FQ3 2020	(0.62)	(0.76)	NM
FQ4 2020	(0.46)	0.03	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

Matthew John Carletti
JMP Securities LLC, Research Division

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings' Fourth Quarter 2020 Financial Results Conference Call.

My name is Kate, and I will be your 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, and thank you for joining us today. We have been very fortunate that COVID-19 has had 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 our employees for their hard work and dedication to the organization.

Net income and book value per share growth were positive in the fourth quarter despite an unprecedented level of weather losses. We are also pleased to report our 10th consecutive quarter of favorable prior year reserve development. While our top line growth was solid at almost 20% in the quarter, our main focus in 2021 will be on the bottom line as we continue to raise rates across our footprint, including double-digit compounded rate increases in Florida.

We are also taking underwriting actions where necessary to further boost profitability. As mentioned in the earnings release, we recently launched a partnership with the Nutmeg Agency, a subsidiary of The Hartford, to offer home policies in select coastal markets. We look forward to working with the Nutmeg Agency and appreciate their partnership.

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. Gross premiums written for the quarter were $282.3 million, up $46.9 million or 19.9% from the prior year quarter. We started writing in Maryland during the fourth quarter, bringing the total number of active states to 16. For the full year, written premiums were up $142.2 million, which is an increase of 15.2% versus policies in force growth of 9.2% over the same period. As I mentioned last quarter, we are focused on making an underwriting profit and obtaining adequate rates. As we look forward, I expect our growth to slow as we focus on margin expansion.

The ceded premium ratio was 42.9% in the fourth quarter, down 1.1 points year-over-year and down from the third quarter of 45.8%. The decrease year-over-year largely reflects a fourth quarter true-up that benefited the ceded premium ratio. Both the year-end and fourth quarter were significantly impacted by weather events. For the full year, the company had $134.2 million of current accident year weather losses, $58.3 million higher than 2019's $75.9 million total. For the fourth quarter, current accident quarter weather losses were $38.9 million, which was $23.7 million higher than 4Q 2019. The net loss ratio of 70.4% is higher than the prior year quarter net loss ratio of 51%. The increase is mostly attributable to cat losses and other weather events.

There are regional differences, but overall, personal lines non-cat pure premium trends are up between 4% to 6%, driven by long-term loss severity trend of 4% to 6% with long-term frequency relatively flat. Our personal lines overall rate increases were over 10% in 2020 and are anticipated to be just over 9% for 2021. Overall, personal lines rate increases for Florida across all personal lines products was over 16% in 2020 and anticipated to be over 10% in 2021, excluding any expedited filing for reinsurance rates. These numbers exclude the impact of inflation guard, which adds approximately 3% to 6% more rate depending upon geography.

The net combined ratio for the fourth quarter of 2020 was 108.7%, which is up from 89.3% in the prior year period, reflecting a higher net loss ratio. In the fourth quarter, we generated a tax loss for the year which, due to the CARES Act, we were able to carry back and deduct at the pretax reform 35% corporate income tax rate.

In 2019, we focused on our capital structure and continuing to refine our exposures in Florida and expanding our footprint into other states. In 2020, the growth of the top line was a result of those efforts. We are now focused on increasing our margins.
We are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Marla Backer from Sidoti.

Marla Susan Backer
Sidoti & Company, LLC

So can you talk a little bit -- with the new partnership with the subsidiary of The Hartford, can you talk us through a little bit about -- this has been a part of your strategy. It seems to be working well. Can you talk us through what portion of the new business historically has been generated by these partnerships and where you see that figure going?

Ernesto Jose Garateix
CEO & Director

Thank you, Marla. So yes, it is a strategy we've had for the last couple of years. We're continuing to value those partnerships with the large carriers that we've had. We don't necessarily comment on the specifics of those partnerships as we value them going forward. So with the Nutmeg Agency, that is a new relationship. And again, as we stated, we are working with them on select coastal markets. That is a new relationship we just started. But that continues to be a part of our strategy, and we'll move that forward with that as we grow the company.

Marla Susan Backer
Sidoti & Company, LLC

Okay. And then one more question, which is, as you start to think now about the 2021, '22 reinsurance season, is your strategy -- are you tweaking your strategy in any way as you get closer to some of those negotiations?

Ernesto Jose Garateix
CEO & Director

What I would say is that we're refining that strategy. We continue to stay on course with the diversification. Geographically, that helps us. We've seen it work in the past. We continue to believe that, that will work going forward. We've seen the savings. We've seen where we have not received the same rates as others had as we know the reinsurance market rates are going up. But we believe our strategy has continued to provide reinsurance savings to us, and we'll continue with that.

Operator

Our next question is from Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Ernie, you mentioned underwriting changes you're making. And Kirk, you pointed out that will probably lead to some deceleration in growth. Could you give a little more detail on that? Is there any particular geography or type of property that you're going to be a little more strict in your underwriting?

Ernesto Jose Garateix
CEO & Director

Sure. Good question, Mark. So what we're doing is looking at the underwriting bottom line. And at the end of the day, it's refining the strategy and ensuring that the margins are expanding. So as we look across our geographic footprint, there are some areas where we believe, right, the profitability is not there. So we're kind of closing that down, slowing the growth there. That will still allow us to grow in other areas where, obviously, profitability is better. And that way, it will increase the bottom line margins.

Kirk Howard Lusk
Chief Financial Officer

Yes. On top of that, [the only] other issues that we're really looking at is our concentration of risk and how that is driving our P&L and really trying to look at a geography to make sure that we are diversified geographically, which means that there are areas where we could probably write a significant amount of business, but we don't want to just from a concentration standpoint.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. On that topic, what's your sense of the Florida market? Are you -- do you have much appetite in Florida? And how do you see the competitive environment there? It seems like there's a lot of pain going through the system. Is there opportunity to grow profitably there?

Ernesto Jose Garateix
CEO & Director

I would classify as selective growth, right? It is not growth at the expense of the bottom line. We've got a pretty good-sized book that we're comfortable with. We will continue to evaluate opportunities and growth there, but it has to make sense to the bottom line. As you know, the competitive market here is there are a number of carriers that have shut down, have shed some policies. So we are in the position now where we're holding to our underwriting discipline and making sure that at the end of the day, it is providing an underwriting profit.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Is the -- I wonder -- from a, say, an ROE standpoint or your target combined ratio, I wonder if you could give some thoughts on that. Is your pricing -- do you think with the 9% rate increase and the inflation guard, is it adequate to get the target combined ratio or ROE you would like? Or do you need another year or 2? And if you do have some target numbers that notionally you'd like to share, I'd be interested to hear.

Ernesto Jose Garateix
CEO & Director

Yes. Well, again, when we look at our target combined margins and that type of stuff, it's -- really, it's a timing issue. So we are pricing to rate adequacy. However, it does take a period of time for that premium to earn through. So when we look at the ROE targets and getting to the combined ratio targets, we do think that the rate increases do get us to where we need to go. It's just a timing issue as far as how that earns in over the period of time.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And what is that target either combined or ROE?

Ernesto Jose Garateix
CEO & Director

I think our long-term target ROE is in the low double digits in non-cat years. And in cat years, we want it to be in the high single digits. We do think that we are not going to have some of the very high ROEs or some of the very low ROEs because of the amount of retention that we take in the reinsurance program and the amount of reinsurance we purchased. So the idea is we're actually aiming to be a little bit more stable on the ROE in the long term.

Operator

Our next question is from Paul Newsome from Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

Could you talk a little bit about the components of that 20% growth in the quarter? And maybe just start there.

Arash Soleimani
Executive Vice President

Paul, the growth -- this is Arash. The growth was higher outside Florida and a bit lower in Florida and rate is a bigger contributor to growth in Florida.

Operator

[Operator Instructions] At this time, we have no more questions. So this concludes our question-and-answer session. I would like to turn it back to Ernie Garateix for closing remarks.

Wait, wait. We have 2 more questions. I'm sorry. We'll go on with a question.

So we have Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

The weather losses this year, the $134 million versus $75 million last year, is there a kind of an expected level? I'm just sort of curious whether 2019 was a good year, 2020 was a bad year? Or how you think about the -- about that question?

Kirk Howard Lusk
Chief Financial Officer

Yes. That's a very good question. And I think that the question is, are some of the weather losses we're seeing now the new norm or are they abnormalities? When you look at the last several year, weather losses have been up since about 2017. And generally speaking, we look at 2019 as not being a good year either. And so therefore, 2020 was extraordinarily high. However, as we look at our rates going forward, we are looking to contemplate as much of the weather losses we can and as we look at our own results and including that in the indications. So again, I think that it was probably high for '19, but -- and then that just even gives you an idea of how much higher 2020 is. But the question is, is that the new norm or not? And we're, I think, hoping for the best but planning for this being maybe a new norm.

Ernesto Jose Garateix
CEO & Director

And Mark, keep in mind, 2020 had record 30 named storms this year. So just keep that in mind as we go forward. Will that be the norm, as Kirk mentioned, going forward? Hopefully not, but we're preparing nevertheless.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Understood. How about from a rate perspective in Florida, I think you described 9% overall? Arash pointed out most of the growth in Florida was rate. What do you think -- what are you requesting in Florida? And what do you think the average is when you look across the industry for rate increases?

Ernesto Jose Garateix
CEO & Director

What I would say is, I mean, across the industry, everyone is taking rate. Obviously, you're seeing double-digit rates being taken in Florida. We have always held steady that we continue to take rate when rate is needed not just when there's a bad year and storms. So we constantly are looking at that and making sure actuarially sound rates are in our portfolio. So we'll continue to do that going forward. We have taken some rate and those have been smaller increases over time, that's been happening for a number of years now, and we'll continue to do that looking forward.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Is the industry up double digit?

Ernesto Jose Garateix
CEO & Director

Yes, it definitely is.

Operator

Our next question is from Matt Carletti from JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

I just wanted to kind of follow up on the comments around you're focusing a little more on profitability. I think you made the comment about targeting longer term, a low double-digit ROE in clean years and a higher -- high single-digit in cat years kind of reducing volatility. Are you guys contemplating any change -- material changes to your reinsurance structure to help achieve that?

I'm thinking like in sort of just kind of the excess of loss, any sort of sideways protection? I mean 2020 exposed kind of, as you mentioned, a huge frequency of events. Is that something you're thinking about? Or you think your current structure is sufficient for your exposure in your footprint?

Ernesto Jose Garateix
CEO & Director

What I would say is we're looking at all the options right now, especially as we're in the middle of negotiating our reinsurance placement. So that is something we're working with our broker. And again, we'll look for every opportunity to ensure that, that reinsurance placement makes sense for us and, at the end of the day, hits the bottom line.

Operator

This concludes our question-and-answer session. I would now like to turn the conference back over to Ernie Garateix for closing remarks.

Ernesto Jose Garateix
CEO & Director

We'd like to thank everybody for joining us today. We hope you have a safe and wonderful weekend.

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