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Market Intelligence

# **Heritage Insurance Holdings, Inc.** NYSE:HRTG

## *Earnings Call*

*Wednesday, August 7, 2024 2:00 PM GMT*

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# Call Participants

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## EXECUTIVES

**Ernesto Jose Garateix**

*CEO & Director*

**Kirk Howard Lusk**

*CFO & Treasurer*

## ANALYSTS

**Jon Paul Newsome**

*Piper Sandler & Co., Research  
Division*

**Mark Douglas Hughes**

*Truist Securities, Inc., Research  
Division*

**Unknown Analyst**

# Presentation

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## Operator

Good morning, and welcome to the Heritage Insurance Holdings Second Quarter 2024 Earnings Call. [Operator Instructions] Please note today's event is being recorded.

I would now like to turn the conference over to Kirk Lusk, Chief Financial Officer for the company. Please go ahead, sir.

## Kirk Howard Lusk

*CFO & Treasurer*

Good morning, and thank you for joining us today. We invite you to visit the Investors section of our website, [investors.heritagepci.com](https://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 upon management's current expectations and subject to uncertainty and changes in circumstances. In our earnings press release and 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 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, earnings release and other SEC filings.

With me on the call today is Ernie Garateix, our Chief Executive Officer. I will now turn the call over to Ernie.

## Ernesto Jose Garateix

*CEO & Director*

Thank you, Kirk. Good morning, everyone, and thank you for joining us today. Before I discuss the second quarter, I and the entire Heritage family wish a swift and complete recovery to all those impacted by Hurricane Debby. Our team has been responding to policyholder needs and remains ready to provide outstanding claims service. With regard to the second quarter, we achieved another period of strong performance for Heritage as we continued to execute on our strategic initiatives focused on achieving rate adequacy, maintaining our underwriting discipline and allocating capital to drive growth and returns as we strive to deliver solid financial results.

As part of our strategic initiatives, we significantly curtailed writing personal new business in most of the Northeast and in the majority of the states in the Southeast, starting in 2022. Over the last 2 years, we have grown our top line through organic growth in our commercial residential portfolio and our E&S products combined with rate actions across our Personal Lines portfolio.

At the same time, we undertook significant underwriting initiatives aimed at improving the quality of our portfolio. These efforts have significantly improved both our underwriting results and profitability in 2023 and through the first 6 months of 2024. Our results this quarter are indicative of these actions with our top line gross written premium growing \$28 million or 7.1%, while our second quarter net income grew by \$11 million or 143% both as compared to the second quarter of 2023.

A key highlight of the quarter is the continued execution of our underwriting and rate adequacy initiatives, which have had meaningfully benefited our bottom line. From an underwriting perspective, we continue to strategically reduce our exposure in over-concentrated and unprofitable areas, while selectively increasing our presence in profitable geographies and products. This disciplined underwriting approach resulted in a policy count reduction of just over 69,000 policies or 14.1% throughout our footprint compared to the second quarter of 2023, while our premium in force increased by \$81.2 million or 6.1%. Through our risk-based management of policy count and total insured value and proactive engagement with our reinsurance

partners, we have maintained a stable supply of indemnity-based reinsurance at manageable costs. Importantly, we expect the headwind from declining policies to begin to moderate as we look forward over the next few quarters.

Turning to our rate adequacy initiatives. They have delivered significant rate increases, which are earning through our portfolio in 2024 as evidenced by our growing unearned premium balance. Looking to 2025, we anticipate an even more meaningful amount of rate to earn through our portfolio, which we believe will provide a healthy tailwind to our financial results. More importantly, we have reached an inflection point in our business, which positions us to selectively resume writing new business in these geographies.

As a result, we are now pivoting our strategy to one of controlled growth, anchored by our continued focus on risk management and stringent underwriting. This is an opportune time to accelerate growth given the disruption in many of our markets that we expect will open up significant market share. Additionally, recent legislative changes in Florida are having a positive impact on the economics of writing new profitable business in the state. In fact, we started writing business again in July and are optimistic with the growth perspectives that lie ahead.

As we turn our new business engine back on, we expect to leverage our existing sales and marketing teams that have largely been in place and will not require incremental expense. Our E&S business is another growth lever for Heritage as premiums grew nearly \$30 million or 177% as compared to the year ago second quarter as we continue to write business in California, Florida and South Carolina. What makes this business so attractive is that we can more nimbly adjust our rates and coverages to the changing dynamics state by state to ensure that we continue to earn appropriate risk-adjusted returns.

Looking forward, we will continue to evaluate more states for E&S opportunities as we focus on our controlled growth strategy. Importantly, we remain committed to maintaining a balanced and diversified portfolio as no single state represents over 27.3% of our total insured value. This selective diversification helps reduce performance volatility and ensures our long-term stability, which we believe will be reflected in the value of our company over time. We remain committed to maintaining our focus on disciplined growth, operational excellence and effective capital management. We believe our strategic initiatives will continue to yield positive results, drive long-term profitability and enhance shareholder value. With the improvements we have made to the portfolio, we expect our net income to grow and build off the first half results.

To conclude, I would like to reiterate our dedication to navigating the complexity of our market with a strategic focus that prioritizes long-term profitability and shareholder value driven by our dedicated workforce.

Kirk, I'll turn it over to you.

**Kirk Howard Lusk**  
CFO & Treasurer

Thank you, Ernie, and good morning, everyone. As Ernie highlighted, the second quarter of 2024 was reflective of our efforts and an indication of the earnings we expect to deliver in the future. Our results this quarter reflect the success of our strategic initiatives and the positive impact of our disciplined underwriting, rate adequacy efforts and prudent capital management.

Starting with our financial highlights. We reported net income of \$18.9 million or \$0.61 per diluted share compared to \$7.8 million or \$0.30 per diluted share in the prior year quarter. This substantial increase in net income was driven primarily by higher net premiums earned and a significant increase in net investment income, which was partially offset by higher operating expenses.

Our total revenues for the quarter were \$203.6 million, up 9.9% from \$185.3 million in the prior year quarter. This increase was driven by several factors. Gross premiums earned rose to \$350 million, up 6.1% from \$330 million in the prior year quarter, reflecting our strategic focus on rate adequacy and organic growth in our commercial residential lines. Net premiums earned increased to \$190.3 million, up 7.6% from \$176.8 million in the prior year quarter as the growth in gross premiums earned outpaced the increase in ceded premiums.

Our strategic focus on organic growth of our commercial residential business have paid off with substantial premium in the segment contributing positively to our overall profitability. The commercial residential business, which tends to have lower attritional loss ratio, but in-force premium grew by 29.4% compared to the second quarter of 2023, while the total insured value only increased by 9.9%. This segment now accounts for 21.3% of our in-force premium, up from 17.5% in the prior year period.

Due to improvements in our reinsurance program from a cost and structure standpoint, coupled with growing gross premiums earned, we expect to have meaningful reduction in our ceded premium ratio going forward. We did incur reinstatement premiums from Hurricane Ian this year, which were \$8.7 million in the first quarter and \$10 million in the second quarter for a full half year impact of \$18.7 million. Net investment income was \$9.8 million, up \$3.2 million from \$6.6 million in the prior year quarter, reflecting actions to align the investments with the yield curve and take advantage of higher short-term yields.

Revenue in the prior year quarter was also impacted by a realized loss of \$1.6 million on equity investments. The net loss ratio for the quarter improved to 55.7%, down 4.6% from 60.3% in the same quarter last year. This improvement was driven by higher net premiums earned and slightly lower net losses and loss adjustment expense. Net weather losses for the current quarter were \$19.7 million, a decrease of \$14.1 million from \$33.8 million in the prior year quarter.

Additionally, the net loss ratio was impacted by net unfavorable loss development of \$8.7 million during the second quarter of 2024 compared to net favorable development of \$2.7 million in the second quarter of 2023. The loss ratio improvement reflects the positive impact on our underwriting efforts and the legislative changes in Florida aimed at reducing claim abuse. We have continued to see favorable trends in the current year loss costs attributable to legislative changes made in Florida and the improvements in our underlying portfolio in all states. We will continue to evaluate each state on an ongoing basis to make adjustments necessary to maintain rate adequacy and improved underwriting results.

Our net expense ratio increased to 36.8%, up from 34.8% in the prior year quarter. This increase was due to higher acquisition costs associated with the rise in gross premiums written, a higher general and administrative expenses from reduced ceding commission income and higher technology spend. The higher investment in technology includes a new claim system and prudent spending on cybersecurity as well as higher costs for liability insurance. These strategic investments in technology and infrastructure are essential for our long-term growth. The net combined ratio for the quarter improved to 92.5%, down 2.6 points from 95.1% in the prior year quarter, driven by the lower net loss ratio, partially offset by higher net expense ratio.

Turning to our balance sheet. We ended the quarter with total assets of \$2.6 billion and shareholders' equity of \$255.3 million. Our book value per share increased to \$8.32, up 32.7% from \$6.27 in the prior year quarter. This increase is primarily attributable to our strong net income and a reduction in unrealized losses on our fixed income securities portfolio. We expect unrealized losses will continue to decline as bonds mature and with any reductions in overall interest rates.

The average rating on our portfolio is A+ with a duration of 2.68 years. Our return on equity for the quarter was 30.8%, an improvement of 11.1 points from the 19.7 in the prior year quarter, reflecting our company's profitability and effective capital management. In terms of capital management, our Board of Directors has decided to continue the suspension of the quarterly dividend. This decision aligns with our strategy to strengthen our financial position and support our long-term growth initiatives. We will continue to evaluate our dividend distribution and stock repurchase strategies on a quarterly basis.

Looking ahead, we remain focused on executing our strategic initiatives, which include achieving consistent long-term earnings, maintaining underwriting discipline and driving shareholder value. We believe that our proactive approach to managing exposure, enhancing rate adequacy and investing in technology and infrastructure will position us well for continued success. Lastly, we are excited to embark on the next phase of our strategic initiatives as we initiate our controlled growth strategy and begin writing personal lines policies in Florida and the Northeast. We expect these to have a positive impact on our future earnings and build upon the results of the first half of the year. Thank you for your attention. We are now ready to take your questions.

## Question and Answer

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### Operator

[Operator Instructions] The first question is from Paul Newsome with Piper Sandler.

#### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Congratulations on your quarter. A couple of questions here. I wanted to ask a little bit more about the new growth effort. There are obviously multiple levers, one of which is just letting -- just allowing new business to happen. The other is a whole host of nonrate actions that companies often do. So could you talk a little bit about sort of where you are from -- do you essentially start from you weren't actually writing any at all? And then where you are from a nonrate action perspective in terms of turning on the spigot.

#### Ernesto Jose Garateix

*CEO & Director*

Yes. I could talk a little bit about that. So obviously, we've taken some action over the past couple of years on our underwriting appetite and where we're writing, especially in geographic areas, right, where we can see profitability. So as we mentioned is we will selectively be writing in those areas, anchored again by the underwriting criteria that we have. Some of it will be rates, some of it will nonrate on those portions of it. So we'll continue kind of doing that because that's proven to us that we can kind of make profit in those areas in the long term. So it is very selective and strategic on what we're writing the new business.

#### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Right. So you're not turning the spigot on completely at this point, you're...

#### Ernesto Jose Garateix

*CEO & Director*

No. No. We are very directed and focused on where we're writing and making sure that, again, from a long-term perspective, we are very focused on underwriting profitability. So we understand that as you take rates in some areas, we can write there quickly, other areas is to take a little bit longer. So it is not turning on the fire hydrant.

#### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

That's great. Could you talk a little bit about the reserve development in the quarter and sources and pieces and what drove it?

#### Kirk Howard Lusk

*CFO & Treasurer*

Yes. We actually -- yes, there were -- basically, that was due to Hurricane Irma. We still have a few claims outstaying on that. We're about 99.2% closed on that one, but there still are a few outstanding claims that we're resolving, and it really had to do with those claims.

#### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

So those are essentially case reserves that were true to be larger than you expected?

#### Kirk Howard Lusk

*CFO & Treasurer*

Correct.

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

Fantastic. And then just a final question, and I'll let some other few ask. Hurricane Debby, obviously, not the worst Hurricane they've got. But is there anything similar to an event in the past that you've had the consumers you heard you do?

**Ernesto Jose Garateix**

*CEO & Director*

Yes. So if you remember last year, Hurricane Idalia, kind of took a similar path stronger hurricane but similar path is where it made landfall. But again, in that area, is pretty roll, less populated. We don't have a large book in that area, very early right now. Now the difference between Debby is, Debby seems to be larger, slower, less powerful, but a lot of range. So we expect more flooding type claims not covered by us, but we still are taking those calls and helping people where we can.

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

Makes sense. Do you recall how big Idalia was just in general, obviously, it's a rough comparison, right?

**Kirk Howard Lusk**

*CFO & Treasurer*

Our ultimate on Idalia ended up being just a little over \$7 million.

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

Fantastic. I'll let some other folks ask questions, but I appreciate the color.

**Operator**

Next question is from Mark Hughes with Truist.

**Mark Douglas Hughes**

*Truist Securities, Inc., Research Division*

Could you talk about the growth in the E&S. I think you've highlighted that's been a good strong growth vector for you. I guess I'm thinking if you're seeing maybe more adequate rates in the admitted market, are you still seeing as much momentum in E&S? How are you seeing the interplay between the 2 different markets and maybe it function in different states. But if you could expand on that, that would be great.

**Ernesto Jose Garateix**

*CEO & Director*

Sure. So we have seen growth in the E&S market. As you know, we're in 16 different markets, and each of those markets are quite different. So we look at it as another tool in the tool set to address not just rate. There's coverage issues and other things that we can address. So we still see that E&S market continuing to grow, particularly in California, Florida and South Carolina. So as you're right, in some admitted markets, we're getting the rate that trade adequately, but we still see the E&S market growing for us in selective areas.

**Mark Douglas Hughes**

*Truist Securities, Inc., Research Division*

Yes. And what do you think the general trend is going to be in terms of rate increases you're getting to a better spot. But as we think about, say, over the next 12 months across your book of business, what would you anticipate? And I might ask Florida specifically, then maybe overall, just kind of a rough sense of how much rate you think you'll be pursuing.



**Kirk Howard Lusk***CFO & Treasurer*

Okay. Well, first of all, let me address the Northeast where I think that we are still going to be seeing fairly substantial rate increases due to loss trends and also reinsurance costs. I would say in the Florida market that is starting to moderate substantially due to the legislative changes and some of the other loss cost decreases we've seen. So from that standpoint, we think it's going to moderate, but I think there still is some loss cost inflation that will probably be pushing rates modestly higher, but not significantly and probably not to the level we've seen in the past several years.

**Mark Douglas Hughes***Truist Securities, Inc., Research Division*

Yes. Then the...

**Kirk Howard Lusk***CFO & Treasurer*

And again those rates are indicative of the loss costs that we're seeing. And again, because the trends right now are very favorable.

**Mark Douglas Hughes***Truist Securities, Inc., Research Division*

Yes. Yes. And I think your initial take on the legislative changes was kind of wait and see if I'm interpreting correctly, you seem more upbeat here. Is that a fair reading? Is there -- as you look at the events over the last quarter 2, 3, have you had real meaningful change in how that you've experienced that.

**Ernesto Jose Garateix***CEO & Director*

Yes, Mark. I mean we've always set out used the words, in, you've heard me say cautiously optimistic, and that was because early on, there wasn't really any data as we've now been through a couple of months, a couple of quarters here, we've actually seen the data coming through the numbers. So we have said that those legislative reforms have made an impact. We can see it in the actual numbers, whereas a year ago, I would use the term cautiously optimistic. So I would now say that we're looking forwardly optimistic, right, to those trends continuing through the data that we've seen.

**Mark Douglas Hughes***Truist Securities, Inc., Research Division*

Yes. Yes. Very good.

**Operator**

Next question is from Carol Shmygol with JMP.

**Unknown Analyst**

I got one question here regarding the net investment income for the quarter, it was a nice beat. And I read that it was mainly because of the higher yields on the shorter side of the yield curve that you utilized. And I'm wondering, is this yield run rate for the projections? Or do you think you will go longer duration assets going forward?

**Kirk Howard Lusk***CFO & Treasurer*

Well, we are anticipating interest rates to drop. We are starting to go -- actually, we already started that at the beginning of the quarter to start going out longer on the yield curve in anticipation of rates dropping. So yes, we are starting to go a little bit longer. I mean our duration is still short. It is still under 3 years. It's like 2.69 years A+ rated, but we are trying to go a little bit out on the yield curve anticipating that the rates are going to drop.



**Unknown Analyst**

Okay. But do you think a net investment income of \$9 million to \$10 million per quarter would be a good run rate?

**Kirk Howard Lusk**  
*CFO & Treasurer*

Yes.

**Unknown Analyst**

Okay. Great. And then just another question, just a random question. I know you said that you're being cautious with Florida. And then in the past, you guys were always very cautious with Tri-County and trying to get out of Tri-County. But do you think that the Florida dynamic has slowly changed in the favor of maybe looking into the possibility of Tri-County again?

**Ernesto Jose Garateix**  
*CEO & Director*

So what I would say to that is, yes, there's a size for us, right, in the state, and we do believe that Tri-County, there's a certain amount of concentration that we're comfortable with. As I mentioned earlier to Paul, we're not turning on the fire hydrant and writing everything that comes across, but we will be selective, including into the Tri-County area.

**Operator**

Ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to the management team for the final remarks.

**Ernesto Jose Garateix**  
*CEO & Director*

We appreciate everyone joining the call to do. We wish everyone a great day. Thank you.

**Operator**

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

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