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

## *Earnings Call*

*Friday, November 3, 2023 1:00 PM GMT*

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# Call Participants

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## EXECUTIVES

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

**Kirk Howard Lusk**  
*Chief Financial Officer*

## ANALYSTS

**Jon Paul Newsome**  
*Piper Sandler & Co., Research  
Division*

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

# Presentation

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## Operator

Good day and welcome to the HRTG Third Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, today's event is being recorded.

I'd now like to turn the conference over to Kirk Lusk, CFO. Please go ahead.

## Kirk Howard Lusk

*Chief Financial Officer*

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. Our comments today will also include non-GAAP financial measures. The reconciliations of and other information regarding these measures can be found in our press release.

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, and to everyone joining us today. I will discuss our third quarter performance, progress of our strategic initiatives and provide updates on our progress towards sustained profitability. After my overview, Kirk will delve into our financial metrics, and then we'll open the floor for questions.

Despite challenges in the property insurance space, including social and actual inflation, increased frequency and severity of catastrophic events and rising reinsurance costs, I'm encouraged to report a substantial improvement in our financial position and strides towards sustained profitability.

Our third quarter saw a net loss but with an improvement from the same quarter last year. Our policyholders, agents and employees were significantly affected by 2 catastrophic events this quarter. In early August, wildfires on the island of Maui caused devastating losses followed by Hurricane Idalia in the Florida Panhandle at the end of the month. Our policyholders and employees affected by these events remain in our thoughts, and we are steadfast in our commitment to fair and timely claim handling.

The strategic profitability initiatives we shared a year ago continue to guide our actions. We've seen a 25.5% increase in average premium per policy year-over-year and a 5.1% increase quarter-over-quarter. Our premiums-in-force are up by 8.4% at \$1.3 billion with a reduction in policy count by 13.6%. These improvements signify our meticulous efforts to manage exposures, particularly in personal residential business, while expanding commercial residential business.

In Florida, we selectively grew our commercial residential premiums-in-force by 75.3% while maintaining a disciplined approach that led to a 16% decrease in Florida personal lines policies-in-force year-over-year. This approach has created a more balanced and diversified portfolio with no state exceeding 27% of the company's total insured value, even with a significant commercial business growth.

Our total insured value outside of Florida accounts for 73.5% of our entire portfolio, slightly down from 74.8% in the same quarter of 2022. This change reflects a conscious strategy driven by careful exposure management and selective expansion in Florida's commercial segment.

Our focus remains unaltered. We continue to prioritize rate adequacy, selective underwriting and judicious capital allocation to products and geographies, promising long-term returns. We are committed to continuous improvements in claim handling, including an upgraded claim system and claim processes, which will allow our claims team to work more efficiently.

We remain resolute in our commitment to timely pay legitimate claims and deny or contest what we do not owe. We are confident that our strategic initiatives will continue to bear fruit, translating in consistent long-term quarterly earnings and enhanced shareholder value.

Let me turn things over to Kirk for a review of the results in the quarter and key financial performance metrics.

**Kirk Howard Lusk**

*Chief Financial Officer*

Thank you, Ernie. Good morning, everyone. Despite the loss in the quarter of \$7.4 million, equivalent to \$0.28 per diluted share, it does demonstrate a continued positive trajectory compared to a net loss of \$48.2 million or \$1.83 per diluted share experienced in the same quarter of 2022. Both quarters experienced net cat losses of \$40 million. The improvement in third quarter 2023 can be primarily attributed to growth in net premiums earned and increase in net investment income and lower weather and attritional losses.

Premiums-in-force increased to \$1.35 billion, which is an 8.4% increase from the third quarter of last year. This growth reflects our portfolio's rate increases and selective growth in commercial residential products while strategically reducing our policy count. The net result is an increase in the average premium per policy of 25.5% from the prior year quarter. In addition, our gross premiums earned experienced growth of 9.4% to \$337 million.

Our total revenues for the quarter were \$186.3 million, a 12.6% increase from last year, driven by increase in net premiums earned of \$16.9 million and a twofold increase in net investment income compared to the third quarter of 2022. We have designed our investment and reinvestment strategies to align with the yield curve, consequently augmenting both liquidity and returns.

Losses and loss adjustment expenses decreased by 15.7% for the third quarter of 2023 mainly due to lower attritional and weather losses. Our net loss and LAE ratio improved significantly, dropping to 74.4% from 97.6% in the third quarter of 2022, reflecting higher premiums earned and reduced losses just noted.

The quarter concluded with a net combined ratio of 110.8%, reflecting our strengthening underwriting discipline despite 2 catastrophic events this quarter with retained losses of \$40 million.

Our corporate effective tax rate fluctuated, reaching an effective rate of 38.3% compared to an effective rate of 2.2% in the prior year quarter. The variance is driven by the impact of changes to a valuation allowance, which is updated quarterly, as well as permanent differences in relation to projected annual pretax income or loss. Valuation allowance relates to tax elections made by Osprey Re, the company's captive reinsurer domiciled in Bermuda. For the current year quarter, the valuation allowance decreased while for the prior year quarter, the valuation allowance was established.

Our book value per share has improved to \$5.65, which represents a 10.1% increase from the fourth quarter of 2022 and a 24.4% increase from the third quarter of 2022. Our annualized return on equity for the 9 months ended September 30, 2023, registers at 13.6% year-to-date, marking an improvement from the 96% loss reported for the 9 months ended September 30, 2022. This underscores the significant strides we've made in bolstering our financial stability and enhancing profitability.

Our results for this quarter demonstrate our continued focus on strategic profit initiatives and consistently improving our margins and overall financial position. We remain committed to enhancing shareholder value through prudent investments and sound business decisions.  
Thank you for your attention. We are now ready to take your questions.

## Question and Answer

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### Operator

[Operator Instructions] Today's first question comes from Paul Newsome at Piper Sandler.

### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Can you hear me now?

### Operator

Mr. -- we can hear you now. Yes, sir.

### Ernesto Jose Garateix

*CEO & Director*

Yes, we can hear you, Paul.

### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Sorry, I mute the phone. Can we -- perhaps we could talk about any signs of tort reform and your most recent views on this?

### Ernesto Jose Garateix

*CEO & Director*

I'm sorry, can you repeat that, Paul? We didn't hear you there.

### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Florida had some tort reform. Could you -- do you see anything in this quarter's results that stood out? And could you talk about your most recent thoughts there?

### Ernesto Jose Garateix

*CEO & Director*

Sure. So we are seeing slight decrease in litigation, which is the data trend we'd like to see on that piece of it. I think one of the things is as we received just to the 1-year anniversary of Hurricane Ian, we're monitoring that and see how that develops. But I think there are positive signs in the marketplace that litigation is down.

### Jon Paul Newsome

*Piper Sandler & Co., Research Division*

Fantastic. Super fingers crossed. Could you talk about where you're going from a pricing perspective, maybe ignoring the tort reform perspective, in Florida but also our outside Florida markets and how you think that ranks up with what you think the underlying claims inflation? So like sort of ignoring the cat losses, normalizing the cat losses for a moment, where do you think you are in terms of margin improvement on a written basis at the moment?

### Kirk Howard Lusk

*Chief Financial Officer*

Well, I mean, again, our focus is on rate adequacy in all our territories. We have taken substantial rate increases in -- particularly in the Southeast and the Florida market over the last couple of years. So that is actually, I would say, close to rate adequacy. And I would say that the other aspect of that is that the

claims inflation has dropped from the COVID years. Reinsurance rates are up substantially. So therefore, there still is some need for rate due to the reinsurance increases throughout the portfolio.

The Northeast, I would say that the claims inflation has been higher than in the Southeast recently. And so therefore, we'll probably be taking more rate up there. Also, reinsurance rates are increasing up there. And the Northeast has not historically had the type of rate increases that the Southeast has experienced. So there's a little bit of catch-up there from a rate adequacy standpoint. So that's where -- that's kind of how we see the landscape.

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

Have you got any pushback in New York on rates? Obviously, Allstate was out yesterday talking about their challenges to get rate increases in New York.

**Ernesto Jose Garateix**

*CEO & Director*

No. I think New York has been very good to kind of work with. I think they've seen all the actuarial documents and data that we've provided regarding reinsurance and inflation on that piece of it. And I think they've been very good to work with on that -- in respect to that.

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

I'll ask one more question and let somebody else ask. One of your competitors was telling me actually yesterday that they need to make some changes in their Hawaiian business because reinsurance has really gotten very expensive there. And this is their book. It's not what's in your book. They're seeing -- they're essentially low single-digit returns because of the higher reinsurance costs. Is that your experience as well? Do you also worry about the increased reinsurance, particularly after what's happened there.

**Kirk Howard Lusk**

*Chief Financial Officer*

Yes. We are seeing a fairly substantial increase in reinsurance in the Hawaiian market, and we're addressing that and have already had discussions with the department over there.

**Operator**

And our next question today comes from Mark Hughes with Truist.

**Mark Douglas Hughes**

*Truist Securities, Inc., Research Division*

Can you hear me?

**Ernesto Jose Garateix**

*CEO & Director*

Yes.

**Mark Douglas Hughes**

*Truist Securities, Inc., Research Division*

The gross losses for the Maui wildfires and Idalia, can you share that number?

**Kirk Howard Lusk**

*Chief Financial Officer*

We haven't disclosed those individual numbers yet. We've just kind of given a combined number of the \$40 million net.

**Mark Douglas Hughes**

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*Truist Securities, Inc., Research Division*

That's your net? How much larger is the gross volume?

**Kirk Howard Lusk**  
*Chief Financial Officer*

The gross is not significantly large there. We have just a little bit of per risk reinsurance on there. It's actually about a little less than \$4 million.

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

Okay. So seemingly, the reinsurers will have made pretty good returns on your program this year. Is that fair?

**Kirk Howard Lusk**  
*Chief Financial Officer*

I think that is a fair assessment, yes.

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

Yes, yes. Okay. How much more room to run on the commercial residential business? How do you feel like your market share is there? Do you think it can get bigger?

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

We think we can get a slightly bigger on that piece. We're evaluating that as we look at the market right now as heading into '24 and making plans for that piece. But again, it's all going to be dependent on profitability, looking at areas and making sure we're not overly concentrated in any one area on that piece of it. But we do think there is some more runway on that piece.

**Kirk Howard Lusk**  
*Chief Financial Officer*

Yes. Also, there have been a number of meetings with agents to kind of explore additional opportunities. And we think that there are some opportunities there that would give us some additional runway.

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

Yes. Okay. Want to look at your non-cat, non-weather losses. They're definitely down substantially year-over-year, maybe ticked up a little bit sequentially. Is that some seasonality perhaps just around 3Q? Do you see a similar pattern last year? I think you had said, Ernie, that you're seeing improvement in litigation. Would you say that the progression from 2Q to 3Q was normal in terms of non-cat, non-weather losses good? How would you characterize that?

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

Yes. I would say it's good. It's also a bit of seasonality, right, when you get to that end of the third quarter on that piece last year. If you take a look at Ian, right, our whether attritional losses were low obviously after Hurricane Ian, right, which is normally what we see on that piece of it. But we are very pleased in the direction that it's heading and hope that, that continues.

**Kirk Howard Lusk**  
*Chief Financial Officer*



Yes. One other aspect about it is with our PIF count down, policy count down, that actually has a tendency to drive the frequency down a little bit there also. So when you look at the attritional losses, with our premiums being up and PIF counting down, that's also one of the drivers.

**Operator**

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

**Ernesto Jose Garateix**

*CEO & Director*

We appreciate everybody joining us on the call today and wish everyone a great weekend.

**Operator**

Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.

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