S&P Global
Market Intelligence

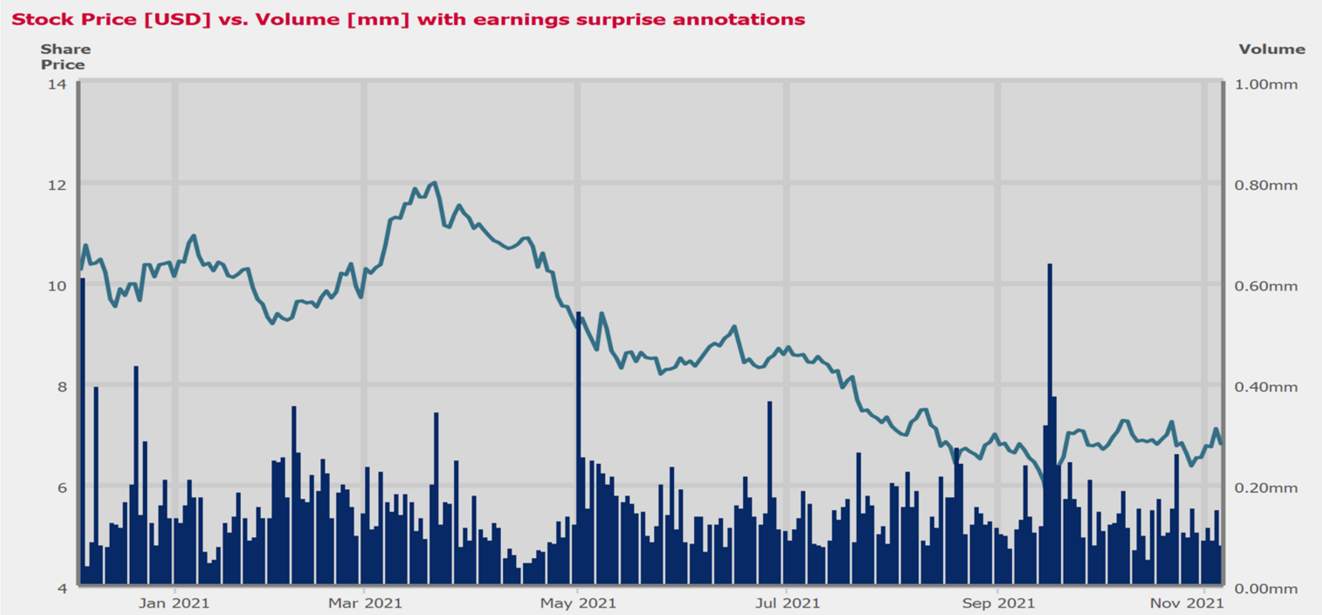
Heritage Insurance Holdings, Inc. NYSE:HRTG
FQ3 2021 Earnings Call Transcripts

Friday, November 05, 2021 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.27)	(0.59)	NM	0.40	(0.16)	NA
Revenue (mm)	153.57	167.41	9.01	169.54	620.55	NA

Currency: USD
Consensus as of Nov-03-2021 8:33 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	(0.46)	0.03	NM
FQ1 2021	(0.16)	(0.19)	NM
FQ2 2021	(0.04)	(0.12)	NM
FQ3 2021	(0.27)	(0.59)	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

Matthew John Carletti
JMP Securities LLC, Research Division

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good morning, and welcome to the Heritage Insurance Holdings Third Quarter 2021 Financial Results Conference Call. My name is Ian, and I'll be your operator today. [Operator Instructions] Please note that this event is being recorded. I'd now like to turn the conference over to Arash Solemani, Executive Vice President at Heritage. Please go ahead, sir.

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, for 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. First, let me start by thanking our employees for their hard work and dedication over the past few months. Our employees continue to provide superior customer service to our agents and policyholders and demonstrate Heritage's ability to serve in its market as a super regional carrier.

While we were disappointed with the loss in the quarter, I'm encouraged by the underlying signs of improvement that I expect will continue next quarter and throughout 2022. Excluding realized capital gains, pretax income improved by about $10 million year-over-year, which was largely driven by a 10-point improvement in the net combined ratio, including almost 7 points of net loss ratio improvement. Even though current accident quarter weather losses were up about $4 million year-over-year, the corresponding current accident quarter weather loss -- net loss ratio actually improved by almost 3 points. These improvements are driven by our focus on rate adequacy and underwriting optimization.

For example, as of quarter end, premiums in force were up 13%, while policies in force were only up by 3%, resulting in premium growth outpacing policy growth by over 10 points. This was even more pronounced in our Florida homeowners book, where quarter-end premiums in force were up 7.5%, while policies in force were down 5.4%, with premium growth outpacing policy growth by [2] points.

I'm confident in our business plan and the underlying improvements that have started to emerge should become even more visible next quarter and particularly in 2022. 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. The net loss for the quarter was $16.2 million compared to a net loss of $5.2 million during the prior year quarter. The primary drivers of this branch relates to significant realized gains in the prior year. For reference, in the third quarter of 2020, we realized $20.4 million of realized gains compared to none this year.

The high level of severe weather and storms continue to be a major driver of losses and the losses for the quarter. Net accident quarter weather losses of $51.4 million are $4.1 million higher than the same quarter in 2020. The 2021 third quarter losses are also $32.7 million higher than the third quarter of 2019 and $27.8 million higher than the third quarter of 2018. To put the 2021 year-to-date net weather losses into perspective, the 2021 year-to-date net weather losses were $118.3 million compared to $95.3 million in 2020, $60.6 million in 2019 and $50.4 million in 2018.

With the reoccurring severe weather events, we are factoring these losses as well as the experienced social inflation into our rate indications as soon as possible. Despite the weather events and the loss for the quarter, we are seeing favorable trends that we believe will lead to continued improvements in subsequent quarters as we return to consistent profitability. As Ernie mentioned, premiums in force were up 13% year-over-year while policies in force were up only 3% over the same time frame, representing premium growth outpacing policy growth by 10 points.

In Florida, where our personal lines business represents nearly 37% of our policies in force, in force premium growth outpaced policies in force growth by 13 points. Our emphasis on rate increases over policy growth is consistent with our focus on margin expansion and rate adequacy. We anticipate that we will continue to have substantial rates earning through the portfolio this year in 2022 and 2023. We are undergoing detailed reviews of our business and curtailing the volume of new business we will accept as well as business we will renew while we focus on rate adequacy.

Additionally, we are implementing a number of underwriting changes to improve the quality of our book of business. This includes [minimum coverage amounts], shutting down certain ZIP codes, making changes to our agency force, implementing minimum roof age in certain geographic areas, among other things.

Ceded premiums are up 13% year-over-year, but were outpaced by the gross earned premium increase of 15.5%. And as a result, the ceded premium ratio dropped from 45.8% in third quarter 2020 to 44.8% in third quarter 2021. The ratio was also down from 48.7% in the second quarter of 2021, which was negatively impacted by a $9.4 million reinstatement premium associated with severe conducted storm reinsurance agreement. The 79.8% net loss ratio was down 6.8 points year-over-year. The improvement reflects lower attritional current accident year loss ratio, which partially stems from improving rate adequacy and was partially offset by lower favorable prior year development.
Our net expense ratio decreased by [3.4] points, reflecting our focus on expenses and economies of scale associated with rate-driven premium growth. The net combined ratio for the quarter was 112.5 and down 10.2 points from third quarter of 2020 of 122.7. Although we are not pleased with the loss in the quarter, the amount of rate earning through the portfolio, the lower attritional loss ratio and the expense ratio are indicators of improvements in future quarters. We are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] We'll take our first question here comes from Matt Carletti of JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Kirk, you mentioned a few times, I think, substantial rate working it's way through the portfolio. Can you give us an idea of the ballpark on average? I know it will vary by state and territory and so forth, but is it kind of mid-single digit, high-single digit? Or what sort of rate are we talking about?

Kirk Howard Lusk
Chief Financial Officer

We're talking about mid- to high-single digits in most jurisdictions. However, there are going to be several that are going to be in the double digits.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then you guys have, over the past several years, really grown particularly outside of Florida through a number of partnerships with large national companies. Can you just comment on kind of how those are going in general? And about what portion of the book today is kind of that represents?

Ernesto Jose Garateix
CEO & Director

Yes. So we're very pleased with the growth that we've had outside of Florida with our national partners, but we continue to kind of refine where those growth areas are. Obviously, those areas that are profitable, or is where the focus is going to be. And then the overall book that we have with them probably accounts for about 25% of the portfolio.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then I guess my last question, just a broad question, I guess, probably for you, Kirk, something around capital, kind of how do you feel about Heritage's capital position currently, particularly given kind of the moderation and exposure currently? And just how should we think about it as we go into '22?

Kirk Howard Lusk
Chief Financial Officer

Yes. I think we're positioned well from a capital standpoint. I mean one of the things we did do is, we did refinance our debt in the second quarter with our four syndicate banks, which was led by regions of BMO, which we're very great to work with. We were able to lower our costs, get more flexibility and we increased our revolver by 50% there. So I feel pretty good about that. And when we look at deploying capital in the future -- and really the focus is on profitability. I think that there are some areas where we are going to see our PIF count decrease much like we have this year, but the premiums are going to increase due to the rate increases. We do have some areas also, particularly at North, where we think that the -- we are going to have a positive PIF growth and premium growth on top of that.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. I mean, as you look forward, would you -- it sounds like you clearly believe capital is at a minimum adequate. Do you foresee excess capital position? Should investors be thinking about the potential for share repurchases at some point? Or are we getting ahead of ourselves?

Kirk Howard Lusk
Chief Financial Officer

Well, we have about $26 million worth of cash -- nonregulated cash right now. We did do some minor stock buybacks in the third quarter, and that is something that we will evaluate going forward.

Operator

Our next question comes from Paul Newsome of Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

I was hoping you could talk a little bit more about what you're seeing from a claim cost inflation perspective. Other companies have reported depending upon their businesses, pretty high rates of severity. And I guess the concern would be maybe a mid-single-digit increase in rate isn't actually sufficient to overcome both the severity from sort of underlying cost of repairing things plus whatever you think there may not be happening from a weather type deterioration perspective?

Kirk Howard Lusk
Chief Financial Officer

Yes. No. And I would say that, that inflation is very real. I think that we're seeing it also. And one of the things we did with our portfolio starting June of 2020, we increased our inflation guard factor in the Southeast to 8%, except for North Carolina, which was in 6%. The Northeast has been a little lower at 4%. So when we look at the inflation guard factor plus the rate increases that were -- we've contemplated, we think that, that is going to be sufficient for that. So you are correct. We actually have increased what we consider our loss cost factor substantially over the last couple of years.

Paul Newsome
Piper Sandler & Co., Research Division

Fair enough. Progressive was talking about pulling back in Florida and the Gulf regions. Any further updates on the competitive environment? Are the people getting out or are they get managed pretty similar to what you saw in the last couple of quarters?

Ernesto Jose Garateix
CEO & Director

Regarding the bulk as far as other states in the Gulf area?

Paul Newsome
Piper Sandler & Co., Research Division

The example I used Progressive said their home insurance business that they're going to try to essentially deemphasized the Gulf area, Florida and actually expand elsewhere outside of those regions, but they're only one -- they're decent sized [floor writer] I think.

Ernesto Jose Garateix
CEO & Director

Yes. So our current approach is to stay where we're at. We're not really kind of increasing our Gulf exposure. We do not have plans to expand into all the Gulf states, i.e., Texas and Louisiana at this time. So that remains to -- we'll see what the future holds down the road there, but we're very happy with our current exposures in the Gulf. Really, our focus has been in the Carolinas and up north.

Paul Newsome
Piper Sandler & Co., Research Division

So I'm sorry, I wasn't clear. I was just asking to see if you see your peers to be more or less competitive than your markets?

Ernesto Jose Garateix
CEO & Director

We have not seen more competitors in the market. I think everyone is taking a pause with some of the exposures from -- and what they've seen on the latest storms that hit the Gulf, but we have not seen more competitors come in.

Operator

[Operator Instructions] Next question is can come from Mark Hughes of Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

When you put together some of those pluses and minuses around the top line, more rate, maybe some tapering and PIF counts in certain markets. What do you think the top line looks like overall next year? Do you think it's up a bit? Flat?

Kirk Howard Lusk
Chief Financial Officer

Yes. No. We think it's going to be up next year because of the amount of rates that we have. I mean we took some substantial rates this year, which continue to earn into the portfolio next year, and we're anticipating taking even more rate next year. So with that, even in those jurisdictions where we have discount going down, we anticipate premiums are going to be going up because of that rate increases. As far as like the bottom line improvements, I would say we are not only addressing it from a rate standpoint, we're also addressing it from an underwriting standpoint, looking at where we write, how we write, what policies, what is the roof age? So we're actually trying to address it from not only the rate, but also from underwriting perspective.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And what's your latest take on some of those regulatory reforms in Florida that kicked in earlier this year? They having much of an impact?

Ernesto Jose Garateix
CEO & Director

What I would say is this, is we've seen a slight decrease in litigation -- new litigation coming through. We're still cautiously optimistic as we're still a couple of months into it to see. So hopefully, that trend continues.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then how about any -- maybe some provisions around roof issues. Were there any real changes there? And is that helping?

Ernesto Jose Garateix
CEO & Director

No. Again, I don't think there were many roof -- many changes on that perspective. Again, we're kind of seeing what's going to happen there going forward on that piece, but we are working actively with the [OR] to see if there are improvements we can make going forward.

Operator

[Operator Instructions] At this time, it looks like we have no further questions. I would now like to turn it back over to the team for any closing remarks.

Arash Soleimani
Executive Vice President

Thank you for attending today. Everyone has a great weekend.

Ernesto Jose Garateix
CEO & Director

Thank you.

Operator

Conference has now concluded. Thank you for attending today's presentation. You may now disconnect.