



Heritage Insurance Holdings, Inc. NYSE:HRTG

FQ3 2014 Earnings Call Transcripts

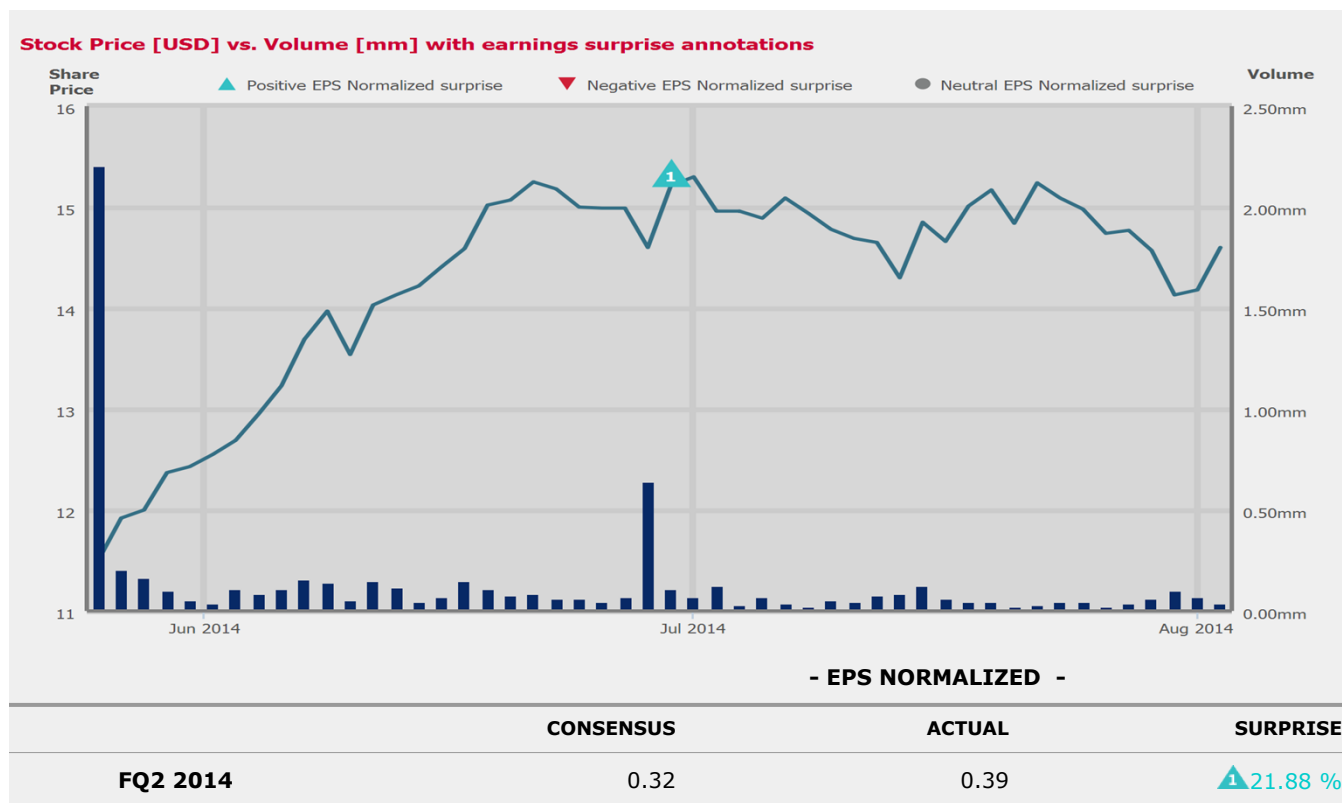
Thursday, November 06, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.27	0.33	 22.22	0.40	1.47	2.62
Revenue (mm)	45.45	58.01	 27.63	54.09	189.98	314.30

Currency: USD

Consensus as of Nov-06-2014 9:55 AM GMT



Call Participants

EXECUTIVES

Bruce Lucas

Chairman of the Board & CEO

Stephen L. Rohde

Advisory

ANALYSTS

Christine Amanda Worley

*JMP Securities LLC, Research
Division*

Mark Douglas Hughes

*SunTrust Robinson Humphrey,
Inc., Research Division*

Unknown Analyst

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings Third Quarter 2014 Financial Results Conference Call. My name is Keith, and I will be the operator today. [Operator Instructions] As a reminder, this conference call is being recorded.

All the matters discussed in this call are forward-looking statements based on current management's expectations involving risks and uncertainties that may result from those expectations not being realized. Actual events, outcomes and results could differ materially from whether expressed or forecasted forward-looking statements within this call due to numerous risks and uncertainties, including, but not limited to the risks and uncertainties described in this conference call or press release issued yesterday and other filings made by the company with the SEC from time to time.

Forward-looking statements made during this presentation speak only as of the date on which they are made, and Heritage Insurance Holdings specifically disclaims any obligation to update or provide any forward-looking statements to reflect new information, future events or circumstances or otherwise.

Now at this time, I would like to turn the conference over to Mr. Bruce Lucas, Chairman and Chief Executive Officer of Heritage Insurance Holdings. Please go ahead, sir.

Bruce Lucas

Chairman of the Board & CEO

Thank you, and good morning to everyone joining us for the call. This is Bruce Lucas, Chairman and CEO of Heritage Insurance, and with me is Steve Rohde, our CFO. I would like to welcome all of you to our third quarter earnings call.

Before we begin the discussion of the quarter, I would like to take a moment to thank all of our employees. Our accomplishments to date are a reflection of our exceptional employees and their commitment to our company.

We had a successful and exciting third quarter. From a financial perspective, we had an excellent quarter. Our gross written premiums increased significantly. Attrition and loss ratios remained stable, and we generated an attractive return on equity for our shareholders.

In addition to our strong financial results, we accomplished a number of things during the quarter that we believe align with our strategic vision for the company and position us for continued success in the quarters and years to come. For example, we completed the migration of policies from Sunshine State Insurance to Heritage Insurance, our retention levels are currently better-than-expected, and we have received widespread support from the agent community. The acquisition of these policies creates a better geographic spread of risk throughout the quarter.

In addition, we launched our commercial residential program last quarter and have grown the division to 10 members, which we believe is the deepest and most experienced commercial residential department in Florida. We are now fully staffed and ramping up our voluntary production.

We continue to have a tremendous year-over-year success in growing the company as evidenced by a 133% increase in gross premiums written for the third quarter of 2014 as compared with the third quarter of 2013.

Additionally, we received a 155% increase in net premiums earned for the third quarter of this year compared to the third quarter of last year, and we also had a 102% increase in policy counts compared to the prior quarter in 2013.

We are very pleased with our growth to date and have exciting plans for the company in the near future. Now for the financial results, I will turn the call over to Steve Rohde, our Chief Financial Officer. Steve?

Stephen L. Rohde*Advisory*

Thank you, Bruce, and good morning. First, I'd like to give you a few financial highlights from the third quarter. Our gross written premiums were \$86.8 million. Net income was \$10 million. Our combined ratio, as measured against gross earned premium, was 82.9%, and stockholders equity was \$231.5 million. Our policy count reached 171,700 policies at September 30, an increase of approximately 102% for the September 30, 2013. Our total in-force premium at September 30 was \$322 million, an increase of 92% over the prior year. As of September 30, approximately 68% of our policies were some Citizens takeouts, 19% from policies acquired from Sunshine State and 13% from our voluntary business. The significant increase in our policy count has fueled the growth in our gross premiums written and gross premiums earned.

In addition to an increase in in-force premium, our results were fairly impacted by significantly lower reinsurance costs as measured against gross premiums earned. Reinsurance costs were lower following the placement of our reinsurance program on June 1 due to favorable reinsurance market conditions and the issuance of a \$200 million of CAT bonds through Citrus Re as well as the improved geographic spread of risk [ph] resulting from the Sunshine State policy acquisition. Our ceded premium ratio, as measured against gross premiums earned, was 30.5% for the third quarter of 2014 compared to 47.5% for the third quarter of 2013.

Of the 17 percentage point improvement, about 12 points were related to lower reinsurance costs, and about 5 points were related to a modest 1.8% increase in our in-force premium this year from Q2 to Q3 versus a 4.2% decrease from Q2 to Q3 of 2013.

We did a small 4,000 policy takeouts from Citizens in August. This, combined with our successful efforts to retain over 95% of policies acquired from Sunshine State, focused manage our in-force premium very effectively this year during the one [ph] season resulting in a lower ceded premium ratio.

Our loss experience continues to be positive and well within our expectations. Our loss ratio, as measured against gross earned premiums, was 27.9% for the quarter and 30.3% year-to-date. The loss ratio on a reported basis was approximately 23% for the quarter and 24% for the 9 months ended September 30, with IBNR increases making up about 5 points of the loss ratio for the quarter and 6 points year-to-date.

In total, our unpaid loss and LAE reserves at September 30, 2014 were \$42 million, which included \$23.8 million of IBNR or 57% of the total loss in LAE reserves. For the quarter, our loss ratio of 27.9% was 3.8 percentage points higher than the third quarter of 2013. However, on a reported basis, excluding the impact of IBNR, this year's third quarter loss ratio was 23.1% versus 24.8% for the third quarter of 2013.

We are still a new company with limited loss development experience, and as a result, we had to rely significantly on industry experience when establishing our reserves. Because of this, we have set IBNR using management's current best estimate at the top of the indicated range. However, our loss trends as evidenced by our reported loss ratios for the quarter and for the 9 months ended September 30 as well as our actual loss development factors appear to be favorable at this time. We, however, can provide no assurances that this trend will continue.

Our expense ratio, as a percentage of gross earned premiums, was 24.5% for the quarter and 21.1% year-to-date. The \$10 million acquisition payment for the SSIC policies was capitalized in June and is being amortized in relation to the earning out of the unwritten premiums that we acquired. The amortization of the SSIC acquisition payment was approximately \$4.5 million in the quarter, which had a 5.6 percentage point impact on the expense ratio.

For the quarter, the SSIC policies produced approximately \$1.8 million in pretax earnings, taking into account the amortization of the acquisition costs, the incremental reinsurance costs and operating expenses we incurred an actual loss experience with a low for IBNR. This equates to an 87% combined ratio for the quarter. When we were analyzing the SSIC transaction back in June, one of the biggest unknown factors was the expected retention rate of the policies under uncertainties of the receivership and competitive factors in the marketplace. We lost only 900 policies or 2.7% related to the uncertainties

of the receivership. And in the 3 months following the acquisition, we have renewed over 95% of the policies that have come up for renewal. These results are far exceeding our original expectations in evaluating acquisition price.

Our combined ratio, as a percentage of gross earned premiums, was 82.9% for the third quarter and 81.6% for the 9 months ended September 30. We are very pleased with these results, especially when considering each component as our combined ratio, reinsurance, losses and expenses were in line or better than our expectations. We believe that underlying base of proper business we combined with our significant fourth quarter Citizens takeout activity thus far, especially the commercial residential business, should position us well through the coming quarters.

On the balance sheet side, stockholders equity increased to \$231.5 million compared to \$100.9 million at December 31, 2013. Our May 2014 IPO increased equity by approximately \$101 million, with retained earnings contributing \$27.4 million this year. Statutory surplus, our insurance company subsidiary at September 30, was \$124.7 million. Our invested assets at September 30 were \$251.1 million, with approximately \$215 million invested in bonds with an average credit quality of A and a duration of 4.0. Our cash position was \$102 million at September 30, which included \$50 million held in a collateral trust account to cover the reinsurance exposure of our capital reinsurance subsidiary, Osprey Re. Our total assets were \$523 million at September 30.

Over all, the third quarter was an excellent quarter for Heritage. And with that, I'll turn it back to Bruce.

Bruce Lucas

Chairman of the Board & CEO

Thank you, Steve. We will now take questions from our analysts.

Question and Answer

Operator

[Operator Instructions] And the first question comes from Mark Hughes with SunTrust.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

I wonder if you could give us your latest thoughts on what premium you are expecting from the takeouts that you've done here in the fourth quarter, once you get through the opt-out period. I'm curious what your outlook is for premium, if you could break that out by the commercial residential and the residential as well.

Bruce Lucas

Chairman of the Board & CEO

Hey, Mark, thanks for the question. It's Bruce Lucas. We can certainly give you some just rough-cut numbers in terms of what we are approved for and what we've submitted in terms of our mail-out policies. But as you know there are still knocked-out periods, et cetera, throughout the quarter so anything that we provide would be nothing more than just a guesstimate at this point. But with that, I can turn it over to Steve and he can give you some -- at least the approval numbers and the tag numbers that we have.

Stephen L. Rohde

Advisory

Okay. Through -- for the October takeout, commercial residential, we were approved for about \$95 million of premium. And then after the 30-day opt-out period, that was down to about \$78 million and we're still getting the final opt-outs in process through October 14. So those numbers are holding pretty well for us at this point. The October personal residential, we -- after the opt-out period, the 30-day opt-out period, we're at 13,500 policies and that opt-out period run through until October 21 -- so until November 21, I should say, for a late opt-out period. So we still have some time yet on that one. For the November takeout, we were allocated just over 38,000 policies from Citizens on the personal line side and when we're still on the initial opt-out period on that. And the commercial residential, we -- after the opt-out period, that, we -- about 140 policies. In December, we just received our allocation on the personal residential, we received allocation of 14,115 policies. And on the commercial residential, we received an allocation of 390 policies.

Bruce Lucas

Chairman of the Board & CEO

Now the overall premium on that, Mark, though, is such a fluctuating number because you don't know what policies will or won't opt out until you complete the process. But I think it's pretty safe to say that the total number will be well in excess of \$100 million assumed on a gross-written-premium basis annually for the quarter. If you just look at October right now, you're probably looking in the \$90 million to \$100 million range. And I would say November, you're probably looking at gross written premiums somewhere around \$50-plus million. And December still remains to be seen, but I would say probably \$25 million or so. So definitely ahead of our initial projections of where we were even last quarter and at the IPO, so we like the metrics on these policies, the profitability on them in terms of the combined ratio is running consistent with all of our past takeouts. So we feel pretty confident about where we're heading in the fourth quarter. It should be a pretty good number.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

How about...

Stephen L. Rohde

Advisory

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I was just going to add. In those premiums numbers, that's the gross written premium. And of course, we only booked the un-premium [ph] that just transferred to us, which generally equates to just roughly 50% of the total written premium.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

Right. But on a run rate basis, you still sustain those policies on a gross basis?

Stephen L. Rohde

Advisory

Absolutely.

Bruce Lucas

Chairman of the Board & CEO

Yes.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

The commercial residential, can you talk about how the trends have been lately in your voluntary business?

Bruce Lucas

Chairman of the Board & CEO

Pretty encouraging through the first month of the act of writing on the voluntary side. We've written about \$1.6 million in premium. We are now fully ramped up and writing throughout the state, and volume has definitely picked up for us. It looks pretty good right now. We're definitely trending ahead of expectations there as well.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc., Research Division

And any -- the losses seemed like they're coming in pretty well. Can you kind of frame that up in terms of frequency, severity? How much is having your own water mitigation capacity making a difference in terms of the losses?

Stephen L. Rohde

Advisory

Sure. Our -- when you look at our frequency and severity, this is measured against all our claims reported. So an improved claims close without payment. But our frequency for the year is running 5.1% and the average severity is just above \$9,000. And so the -- and that's been fairly consistent through the year. We feel the water mitigation company we acquired in operations is having an impact on our loss ratio already. But I would suggest that some of the -- just from the -- doing it ourselves as opposed to having somebody else doing it is probably improving our loss ratio by a couple of points. And then that's not taking into account that we think it also improves the overall scope of the loss by reducing the creep [ph] that comes in a lot of the claims, and that would be on top of the 2- to 3-point improvement on the -- just from the cost standpoint itself.

Operator

And the next question comes from Matt Carletti with JMP Securities.

Christine Amanda Worley

JMP Securities LLC, Research Division

It's actually Christine Worley for Matt. Just wanted to turn back to the Citizens takeouts on the personal residential side. As you stated, your appetite now -- you're a bit ahead of where you thought you'd be at the IPO, what have you sort of seen that has changed your appetite between now and then?

Bruce Lucas

Chairman of the Board & CEO

I wouldn't say that there's a change in appetite. I just think we came in with very conservative numbers. It's always better to under-promise and over-deliver. We have not changed our underwriting guidelines. We have not changed the policy selection criteria that we normally used. There's just some pretty good policies there and we wanted to be conservative on our forward projections at the IPO.

Operator

And the next question comes from John Barnett [ph] with Sandler O'Neill.

Unknown Analyst

I have a couple of questions. The soft -- there's been a soft reinsurance environment. As we look out to next year, how much of the savings on the price per unit basis are you expecting?

Bruce Lucas

Chairman of the Board & CEO

Well, we don't know really where things are going to trend until we see the 1/1 renewals with the rest of the market. That will give you a good indication of where the market's headed. I hate to speculate what your reinsurers are going to charge or not, but I can tell you that we're hearing that rates are going down. We're hearing probably 5 to 10 points across the board, but we really won't have a good indication of what that's going to be until we see what 1/1 renewals come in at.

Unknown Analyst

Okay. And then just one other question. As I look at your policy acquisition ratio, it has increased in the last couple of quarters and I know you mentioned it's partially due to the increase in new renewal policies. Where should we see that ratio kind of settle in, in that?

Stephen L. Rohde

Advisory

Okay. This is Steve Rohde. I think on our ongoing ratio or expense ratio, it means gross earned premiums, is in the 22% to 23% range right now, about 22.5%, naturally. When you have no benefits during the takeouts -- in the takeouts, as you know, we did not pay any ceding commission to or absorption costs to take those policies out, so we do get the benefit from that. Likewise this quarter, we have an amortization of the Sunshine State acquisition cost that impacted our expense ratio. But I think on a going forward basis, we're running about 22.7%. Our G&A expense as a percentage of premium keep going down. For the third quarter, they're about 9% of premium and last year, in June 15, they're about 12% so we have about 3-point improvement there just from the economy of scale basically. And our variable expenses on a go-forward basis excluding any impact from takeouts is about 13.8%.

Operator

And as there are no more questions at the present time, I would like to turn the conference back over to Mr. Lucas for any closing comments.

Bruce Lucas

Chairman of the Board & CEO

I just wanted to say thank you for everyone for your participation in the call and your interest in Heritage, and we look forward to speaking with you in the next quarter.

Operator

Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect. Have a nice day.

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