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Heritage Insurance Holdings, Inc. (HRTG)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Arash Soleimani

Executive Vice President, Heritage Insurance Holdings, Inc.

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

OTHER PARTICIPANTS

Matthew J. Carletti

Analyst, JMP Securities LLC

Mark Hughes

Analyst, Truist Securities, Inc.

Paul Newsome

Analyst, Piper Sandler & Co.

MANAGEMENT DISCUSSION SECTION

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. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. Please note this event is being recorded.

I'd now like to turn the conference over to Arash Soleimani, Executive Vice President at Heritage. Please go ahead, sir.

Arash Soleimani

Executive Vice President, Heritage Insurance Holdings, Inc.

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 uncertainty 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

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

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 markets 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, pre-tax 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 13 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, Heritage Insurance Holdings, Inc.

Thank you, Ernie. Good morning. The net loss for the quarter was \$16.2 million (sic) [\$16.4 million] (03:53) compared to a net loss of \$5.2 million during the prior year quarter. The primary drivers of the variance 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 are \$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're 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 timeframe, 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 A 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 convective 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 stemmed 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 the 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're now available to take your questions.

QUESTION AND ANSWER SECTION

Operator: At this time, we'll now begin the question-and-answer session. [Operator Instructions] [ph] We'll take our first question here that comes (08:28) from Matt Carletti of JMP. Please go ahead.

Matthew J. Carletti

Analyst, JMP Securities LLC

Hey. Thanks. Good morning.

Q

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Hey. Good morning.

A

Matthew J. Carletti

Analyst, JMP Securities LLC

Kirk, you mentioned a few times, I think, substantial rate working its 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?

Q

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

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.

A

Matthew J. Carletti

Analyst, JMP Securities LLC

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

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Yeah. So, we are 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 [ph] profitable (09:41) is where the focus is going to be. And then, the overall book that we have with them probably is – accounts for about 25% of the portfolio.

A

Matthew J. Carletti

Analyst, JMP Securities LLC

Okay, great. And then, I guess my last question, just a broad question, I guess probably for you, Kirk, centering around capital. Kind of how do you feel about Heritage's capital position currently, particularly given kind of the moderation in exposure currently and just how should we think about it as we go into 2022?

Q

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

Yeah. No, I think we're positioned well from a capital standpoint. One of the things we did do is we did refinance our debt in the second quarter with our core syndicate banks, which was led by Regions and BMO, which we're very great to work with. We were able to lower our cost, get more flexibility and increased our revolver by 50% there. So, we feel pretty good about that. When we look at deploying capital in the future, really the focus is on profitability. I think that there are some areas where we are going to see 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 Up North where we think that we are going to have a positive PIF growth and premium growth on top of that.

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Great. As you look forward, would you – it sounds like you clearly believe capital is at a minimum adequate. Do you foresee an 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, Heritage Insurance Holdings, Inc.

A

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

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Great. Thanks very much for the answers.

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

A

Thank you, Matt.

Operator: Our next question comes from Paul Newsome of Piper Sandler. Please go ahead.

Paul Newsome

Analyst, Piper Sandler & Co.

Q

Hey. Good morning. I was hoping you could talk a little bit more about what you're seeing from a claim class inflation perspective. Other companies are reporting, depending on their businesses, pretty high rates of severity and pretty – I guess the concern would be maybe a mid single-digit increase in rate isn't actually sufficient to overcome both the severity [ph] from the underlying cost of repairing (12:23) things plus whatever you think may or may not be happening from a weather-type deterioration perspective?

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

Yeah. No, and I would say that that inflation is very real. I think that we're seeing it also. One of the things we do 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 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 are loss cost factor substantially over the last couple of years.

Paul Newsome*Analyst, Piper Sandler & Co.*

Q

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

Ernesto Jose Garateix*Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.*

A

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

Paul Newsome*Analyst, Piper Sandler & Co.*

Q

Well, the example I used, Progressive said in their home insurance business that they're going to try to essentially deemphasize the Gulf areas, Florida and actually expand elsewhere outside of those regions. But they're only one, but they're a decent-sized [indiscernible] (14:03).

Ernesto Jose Garateix*Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.*

A

Yeah. 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*Analyst, Piper Sandler & Co.*

Q

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

Ernesto Jose Garateix*Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.*

A

Well, 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 have hit the Gulf. But we have not seen more competitors come in.

Paul Newsome*Analyst, Piper Sandler & Co.*

Q

Great. Thanks.

Ernesto Jose Garateix*Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.*

A

Got it. Thank you.

Operator: [Operator Instructions] Next question is coming from Mark Hughes with Truist. Please go ahead.

Mark Hughes

Analyst, Truist Securities, Inc.

Thank you. Good morning.

Q

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Good morning, Mark.

A

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Good morning.

A

Mark Hughes

Analyst, Truist Securities, Inc.

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

Q

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Yeah. No, we think it's going to be up next year because of the amount of rates that we have. 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 PIF count 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.

A

Mark Hughes

Analyst, Truist Securities, Inc.

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

Q

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

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.

A

Mark Hughes

Analyst, Truist Securities, Inc.

And then, how about any – I think maybe some provisions around roof issues, were there any real changes there and is that helping?

Q

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

A

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 OIR to see if there are improvements we can make going forward.

Mark Hughes

Analyst, Truist Securities, Inc.

Q

Okay. I think that was it. Appreciate it.

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

A

Thank you.

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

Thank you.

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.

Ernesto Jose Garateix

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Thank you for attending today. We hope everyone has a great weekend.

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Great. Thank you.

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

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