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# Heritage Insurance Holdings, Inc. (HRTG)

Q2 2019 Earnings Call

## CORPORATE PARTICIPANTS

Arash Soleimani

*Executive Vice President, Heritage Insurance Holdings, Inc.*

Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

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## OTHER PARTICIPANTS

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Matthew J. Carletti

*Analyst, JMP Securities LLC*

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning and welcome to the Heritage Insurance Holdings' First (sic) [Second] (00:05) Quarter 2019 Financial Results Conference Call. My name is Cole and I will be the 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 would like to turn the conference over to Arash Soleimani, Executive Vice President at Heritage. Please go ahead, sir.

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**Arash Soleimani**

*Executive Vice President, Heritage Insurance Holdings, Inc.*

Good morning and thanks for joining us today. We invite you to visit the Investor section of our website, [investors.heritagepci.com](http://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 Bruce Lucas, our Chairman and Chief Executive Officer; and Kirk Lusk, our Chief Financial Officer.

I will now turn the call over to Bruce.

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## Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

Thank you, Arash. I would like to welcome all of you to our second quarter 2019 earnings call. Before we begin the call, I'd like to thank all of our employees for their dedication to our company. Despite severe weather losses, we had excellent second quarter operating results. We continue to execute on our diversification strategy that is designed to reduce exposure in Florida, especially in fraud prone areas like the Tri-County, while growing in other states that have less volatility.

Our ex-Florida sales are significantly accelerating across our footprint, as we launched new states and expand with strategic partners. In the Southeast, ex-Florida, new business premium increased 90% year-over-year, and 44% quarter-over-quarter. In the Northeast, new business premium increased 25% year-over-year and 35% quarter-over-quarter. In Florida, personal lines new business premium decreased 6% year-over-year, but increased 27% quarter-over-quarter. Across our entire platform, 64% of personal lines new business premium was generated outside of Florida.

We have used our ex-Florida growth to offset strategic non-renewals in the Tri-County. In the second quarter, we dropped a remarkable \$6.2 billion of total insured value, or TIV, in Florida's Tri-County year-over-year. This is a unique approach to diversifying away from the Tri-County in Florida in general that we do not believe is occurring with any of our competitors.

Although new business premiums outside of Florida and the Tri-County are significantly lower, they are more profitable because there is less fraud, litigation and reinsurance costs. Long-term, we believe our portfolio will outperform peer companies that continue to focus on top line growth versus bottom line profit.

We strongly believe that aggregation in Florida and the Tri-County will continue to cause higher loss ratios and adverse prior year reserve development across the sector. With the exception of Heritage Insurance, adverse development continues to plague the Florida market and it is our belief that it is largely related to Tri-County claims that have elevated severities.

Three years ago, we began to pull out of Tri-County and diversify away from Florida. Since then, we have evolved from a Florida company to a super-regional carrier that has 70% of our TIV outside of Florida. During this time period, our claim statistics related to the Tri-County have continually improved and we are at all-time lows for percentage of claims and lawsuits related to the Tri-County. Fewer Tri-County policies and claims means less volatility related to reserves. As a result, I'm not surprised that Heritage stands alone as the only carrier to report favorable prior year development four quarters in a row.

Our reserving philosophy is different. I've noted several times that our reserves have been the highest than the peer group, despite having lower exposures in Florida and the Tri-County and we believe we have a more conservative and accurate approach to setting loss reserves as evidenced by our consistent favorable prior year development. This was particularly an issue in the second quarter in Florida, as we had a surge in newly reported Assignment of Benefit or AOB claims in advance of the July 1st statutory reform. In particular, we received a large influx of roof-related claims for hail events in prior quarters and for one PCS event in Florida during the second quarter.

Including the Florida PCS event, which impacted multiple Southeast states in the quarter, we had a total of four PCS events that impacted our Southeast footprint. Unlike the first quarter, we did not have a single event that was

large enough to trigger re-insurance recoveries. As a result, we incurred approximately \$21.5 million of current accident quarter severe weather losses that overshadow an otherwise stellar quarter across all metrics.

It is worth noting that the vast majority of this loss is related to incurred but not reported or IBNR versus paid claims and this approach is consistent with our reserving philosophy. If these claims are truly related to a surge in AOB and/or do not develop, we will potentially have a significant amount of IBNR to release in future quarters. However, until and if that occurs, it is prudent to establish sufficient reserves now rather than incur adverse development later.

Moving on to capital management, we repurchased \$2.3 million of common stock at a discount to book value. We have been stockpiling free cash at the holding company and will be opportunistic and intend to retire additional shares in 2019, as long as our share price is full of fair value.

I will now turn the call over to Kirk to provide more details on our financials.

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## Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

Thank you, Bruce. Good morning. Net income for the quarter was \$700,000 and was down from \$2.4 million reported during the second quarter of 2018. As announced in our July 18th press release, weather losses during the second quarter of 2019 were the main driver of the year-over-year variance.

Gross written premiums for the quarter were \$255 million, which was down from \$264 million for the second quarter of 2018. The drop in the second quarter reflects that continued derisking in the Tri-County region of Florida. In-force premium reductions in the Tri-County area for the second quarter of 2019 was one of the largest in-force reduction since the derisking began in 2016. In-force premiums in the Tri-County area decreased by over \$35 million year-over-year and by over \$23 million in the second quarter of 2019 alone. Largely offsetting the significant reduction in the Tri-County, in-force premiums' year-over-year outside of the Tri-County area grew by over \$25 million.

We anticipate that our growth outside of the Tri-County area will continue and accelerate as we direct our marketing efforts outside that region and continue to evaluate our exposure in the Tri-County area. Despite the significant amount of de-risking, gross earned premiums are relatively flat from the prior year quarter.

Ceded earned premiums are down year-over-year by 3.2% and down 2.5% from the first quarter of 2019. The decrease reflects NBIC-related synergy savings on the cat XOL reinsurance tree and also the June 1, 2018 reduction of NBIC's gross quota share contract from 18.8% to 8% and the June 1, 2019 elimination of the gross quota share, which was partially offset by an increase in the NBIC net quota share last December from 49.5% to 52% and increases in other reinsurance structures.

2019 second quarter net earned premiums were up 2.6% from the second quarter of 2018, reflecting the slight reductions in the gross earned premium, which was more than offset by the decrease in ceded premiums earned just mentioned.

Losses in LAE were up 12.6% or \$8.3 million from the prior year quarter. The net loss ratio was 65.1% for the second quarter of 2019, compared to 59.3% for the second quarter of 2018. Current accident quarter hail and non-catastrophe weather losses from multiple events impacted the net loss ratio for the quarter by 18.8 points and for the year-over-year loss ratio variance by 10.4 points. The remainder of the variance is attributable to the change in loss development and reduced activity in our vertically integrated Contractors Alliance Network.

Policy acquisition costs were up \$7.7 million, predominantly due to the expiration of the purchase accounting benefit obtained during the first half of 2018 and reduced ceding commissions associated with changes to our quota share reinsurance programs.

General and administrative costs were down \$6 million from \$24.4 million at second quarter 2018 to \$18.4 million at the second quarter of 2019, and relatively flat from the first quarter of 2019. The reduction from the prior year quarter is predominantly due to acquisition and integration expenses incurred in 2018, which was partially offset by a ceding commission reduction.

The combined ratio for the quarter as a percentage of net premiums earned was 105%, which is up from the 98.7% as of the second quarter 2018. The increase reflects the weather losses previously discussed with a relatively flat expense ratio. Shareholder's equity at June 30, 2018 increased to \$438.9 million from \$435 million at the end of the first quarter 2019. The change predominantly reflects the net income for the quarter and the tax affected net unrealized gains on investments, partially offset by dividends to shareholders and stock buybacks.

Book value per share is \$14.99, up from \$14.78 at the end of Q1 and \$14.43 at year-end. Total cash plus invested assets increased \$62 million from year-end, mostly driven by the receipt of reinsurance recoverables related to hurricane claims. Total Assets are \$1.9 billion at the end of Q2.

Bruce and I are now available to take your questions.

## QUESTION AND ANSWER SECTION

**Operator:** We will now begin the question-and-answer session. [Operator Instructions] And our first question today comes from Mark Hughes with SunTrust. Please go ahead.

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Yeah. Thank you. Good morning. On the ceded premiums line, it's about \$116 million this quarter. How should we think about that for Q3 when we get the full run rate on the new Florida reinsurance treaty?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. When you look at that – yeah, that only reflects like one month of the reduction, so we will get a little bit more of a reduction and it won't be – you can't extrapolate fully there the reduction multiply times three. But we think that – when you look at the quarter-over-quarter reduction from Q1 to Q2, we're going to have about that same type of magnitude in the third quarter going forward.

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Okay. Then how about the G&A expense? It's been a little bit volatile. Is this \$18 million, \$19 million, is that a good number or how should we think about that?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. I think that probably is going to tick up a little bit as we look at some of the initiatives we have both on the growth and on the claims side. So, the claims side will actually move over to the loss dollars, but some of the activity we're going to incur. So, I would look at that going up slightly.

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Okay. And then the AOB, you talked about the surge in filings in 2Q. Was that captured in your 2Q loss ratio? Is that going to have a spillover into Q3 on losses?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

No. So, it is captured in 2Q, Mark. We along with everyone else saw the surge in AOB as they were racing to get their AOBs in before the 7/1 deadline. So, there was a big ramp up out there in the market trying to recruit insureds to participate in the scam. So, we saw that increase. A lot of that we saw was related to hail and other miscellaneous wind events. We have a hard time getting the AOB contractor to tell us exactly when these losses happened, because they don't know. And so, those losses were captured in that \$21.3 million or \$21.5 million severe weather number that we put out. The vast majority of the losses are IBNR.

When you see an increase in claim activity like that, unfortunately, you have to reserve for it like that's your latest trend. So, we put up significant reserves and we'd rather be wrong about the reserves and have favorable development going forward like we've been doing in the past four quarters. But we can't change our reserving philosophy quarter-over-quarter. One quarter does not a trend make, so these things don't develop and we should have a lot of reserves to release, but until and if that happens, we have to make sure that we're doing things according to our standard reserving protocols.

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

I'll ask one more modeling question, and I apologize for that. But when you think about your underlying loss ratio this quarter, you clearly called out that was 19 points from the severe weather. If we think of on a go forward basis, do we just strip out the 19 points and then make some assumptions about cats or what have you, or would you say we ought to keep in some additional buffer for normal weather volatility?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

I mean, there should be a little bit of a buffer for normal weather volatility in especially 2Q and going into 3Q, because those are the rainy months. But what we saw this quarter was I think we had four separate PCS events. Four of them hit our Southeast book ex-Florida, one of them hit directly in Florida. That's kind of unusual. But we put up a lot of reserves on those. So, like I said before, hopefully, we've overshot it, but we won't know for another year, to be honest with you.

But you're always going to have a little bit of weather volatility. I mean, as we expand our footprint, you're going to get more frequency events. But over the long haul, with reinsurance synergies, lower fraud costs, lower claim costs, it should more than balance out and should be pretty accretive to the bottom line as we continue with the business plan.

Mark Hughes

*Analyst, SunTrust Robinson Humphrey, Inc.*

Thank you.

Q

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

Thank you, Mark.

A

**Operator:** And our next question comes from Christopher Campbell with KBW. Please go ahead.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Hi. Yes. Good morning. Congrats on the quarter.

Q

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

Thank you.

A

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

I guess, my first question is on the core loss ratio increase. Look, I'm assuming most of that is the storm-related income rolling off. Was there anything else that drove that increase as well, that we should be thinking about as we model that forward?

Q

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

Well, the core loss ratio is impacted by higher reserves, especially in the quarter. I mean, we massively increased current accident quarter IBNR to encapsulate the surge in claims that we had. So, it's that factor. In addition, we've just generally noted across Florida that the environment for claims abuses is getting worse. I really can't say that I've seen it improving. And so, this goes to the heart of why we have been making this pivot for the last three years to diversify away from Florida.

A

And to be honest with you, you can do AOB reform and you can change the format of the fraud, but the fraud will continue. And I just don't see it really ever going away, particularly in the Tri-County, Orange and Osceola or two other big ones. We just got to hit it with rate, which we were doing. We're getting about an average of 14-plus-percent rate increases across our personal line platform in Florida. And that's in response to the higher loss cost that we're seeing across the board.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Got it. And post-AOB reform, I mean, I know you guys are only like a month in, I mean, are you seeing like any like drop in litigation or anything like that on the Florida book? I mean, has there been a noticeable improvement in...

Q

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Well, you...

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

... [indiscernible] (18:18) like operational claims metrics?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. So, you're right. It has been – it is pretty early and I can tell you that what our stats tell us is, on litigation, we actually saw, I'd say, pretty consistent levels in July, because you have a lot of AOB claims that were, say, from first quarter or second quarter. They didn't get the exact amount of money that they were looking for, and so they end up filing suit. And because those AOBs are pre-7/1, they are covered – they are not covered by the new statute. So, we haven't really seen that tail off as much, because there's a bit of a lag there. Last half of July was lower than the first half, I can tell you that.

And in terms of AOBs that we have seen since July 1st, yeah, we've seen a pretty sharp decline. And of the ones that have, that were filed with us, I think in total we had a few hundred AOBs, which really isn't that much. And only about 30 or 40 of them even attempted to comply with the new statute. So, they were summarily rejected. So, we've seen a pretty big drop off in the amount of AOB activity on front-end claims in the month of July.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Okay, guys. And there is no other area that like they're being creative – they plan as far as being creative about like trying to open up new areas for?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. They are. And I won't mention them on the call, but they – we have different lawyers trying different strategies to try to circumvent the AOB statute. And so, we're on top of those issues as well. But that kind of goes to my point, you can't stop the fraud in certain areas of Florida. You can't stop it. There's – it will find a way to creep into your numbers through one mechanism or another. It is there, it is not going away. We've noticed it getting worse every year of our operation, which is why we've so steadfastly been derisking out of those areas and growing outside of Florida. The only way to stop a fraud is to not have the actual exposure.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Okay. Thanks. And then, can you give us color, I mean, I know you guys aren't interested in M&A in Florida, but has like the environment like post reinsurance rate increases for competitors who took higher rate increases than you guys did, has that changed like the outlook of sellers and are you seeing more companies down there willing to entertain offers?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A



Well, that's a really good question. We've kind of led the market on the M&A front. We are not interested in M&A in Florida, but I can tell you that there are several companies that are teasing potential sale to prospective buyers. We're just not seeing the buyers coming for those companies. I mean, they're generally smaller in scale, they have a lot of Tri-County business. You've got to get in the reserves. They don't have the reinsurance leverage that the bigger carriers have. We're really not seeing any activity. The only activity I'm aware of is one company that I believe acquired a book of business from another within Florida, but I don't think they actually took on the entity itself.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Got it. And will there be like – will there be a price like if something was trading at like our large price to book discount, would there be a discount at which like you might get like – Florida might look more attractive if like you could get something for like 70% a book?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Maybe. I mean, I'm never going to say no. But for us, we need to find – let's just say that hypothetical was there, we would need to find a company that has our reserving philosophy, and I can just tell you that nobody has that. And that's the reason we're the only carrier that is being reporting favorable prior year development every quarter. I'm not really looking to inherit somebody else's headaches. We're diversifying the company away from Florida. That is our business plan. It's different than everyone else in this market. We're going to stick to it. It is working for us. We've seen it in our operating profit over the last several years. It has been very strong. We're going to have frequency events, more of them as we expand outside of Florida. But in general, we just find incredibly stable claim markets environments outside of the State of Florida, particularly outside of Tri-County, Orange and Osceola.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Got it. And then, as you diversify outside of Florida, what are the ROEs like? I mean, Florida have like pretty large premiums and it's like a very volatile market, but usually pretty high ROEs. Now as you expand outside of Florida, right, are you expecting those to compress? And then just thinking at the high level about valuation, right, I'm thinking like price to book as a function of future ROE, if you're standing outside of Florida, how does your competitor set change whereas most people will throw you in with the other four Floridians, does your competitive set change? And should we be thinking about the valuation any differently as you become a super-regional versus a predominantly Florida-carrier?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Well, really good question. So, I would say, no that the ROEs are not compressing as we expand outside of Florida and there are several reasons for that. First, we have lower claim experiences outside of Florida. It's way more stable, there's less fraud, there's just – lawsuits just don't exist, PAs just don't exist. We don't see them in our books. We're not in Louisiana, we're not in Texas where you see the stuff. We've purposely removed ourselves from those markets. The markets that we're in are very, very stable. They have higher retention ratios and we are also – so that's the first reason.

The second reason that we don't believe that ROEs are compressing, in fact, we think they're accelerating is, because we're getting significant reinsurance synergies as we expand the footprint away from Florida. The

reinsurance costs that we have in Florida are significantly higher than ex-Florida. And so, more concentrations outside of Florida, particularly where our books lie in the Southeast, it's more of an inland book, not a coastal book like some of our peer companies. And we're picking up tremendous reinsurance synergies that are helping the bottom line and you get rid of the fraud and the fluctuations in IBNR and those things are very, very positive for the company.

In terms of part B of your question, which is the competitive landscape, yeah we're going head-to-head with more of the major carriers. There's no doubt about that. We do see some of the Florida peers in our states. There's one in particular that we see a lot, but we are focused more on the inland book versus the coastal book and a lot of these states that I think is a differentiator. But we are going up against companies like Travelers, and big household names that you would normally see, but we're growing at a remarkable pace outside of Florida, well in excess of what we had modeled. And so our strategy is working and we are gaining traction in the market shares we moved the footprint away from Florida.

Christopher Campbell

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Okay. Great Well, thanks for all the answers. Best of luck on the third quarter.

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

All right. Thank you, Chris.

**Operator:** And our next question comes from Matt Carletti with JPM (sic) [JMP] (25:52). Please go ahead.

Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

Hey, thanks. Matt Carletti at JMP. A few questions. Bruce, I was hoping, you could just back on the weather losses real quick. Can you give us the rough split of what were Florida events and what were ex-Florida events? I know you mentioned North Carolina as the biggest one, but kind of how that's split up?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. I think the most of it was related to Florida was related to the AOB claims that we got in the quarter. I don't know that I have that split in front of me, I'm kind of looking at the screens now, but we have a much bigger portfolio in Florida than we do in North Carolina. And so, although Georgia, Alabama and North Carolina got pounded pretty hard by these PCS events, I would say that the majority of the loss came out of Florida.

Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

Okay. And then, sticking on kind of ex-Florida, can you talk a little bit about – now, you've added some new partnerships with other larger national companies. How are those coming along and are you pleased with what you've seen so far?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. They're actually going very well. So, the three main large partnerships that we have are GEICO, National General and Safeco. So, those are the three kind of more national carriers [indiscernible] (27:11) that we're partnered up with. I can tell you that relationships there with all three companies has been fantastic. It is helping us with our growth, no doubt about it. We're looking to expand that relationship in the new markets and products, especially here in the second half of the year. So I would never give actual data about any of those three carriers, that's something – that we feel is proprietary and we would need their consent to release, but the relationships have definitely outperformed what our expectations were.

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Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

Okay. Great. Thanks. And just one quick numbers question on the investment portfolio. With the pullback in rates here, what's the new money yield and what's the book yield?

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Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

A

We are – our yield is about 2.84%, duration is 3.49.

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Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

And that's book yield?

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Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

A

Yeah.

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Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

And then what's new money rate?

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Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

A

I don't have the new money rate.

[indiscernible] (28:19)

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Matthew J. Carletti

*Analyst, JMP Securities LLC*

Q

Okay. All right. Thanks a lot.

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Kirk Howard Lusk

*Chief Financial Officer, Heritage Insurance Holdings, Inc.*

A

All right. Thank you, Matt.

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**Operator:** [Operator Instructions] And our next question comes from John Barnidge with Sandler O'Neill. Please go ahead.

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

Q

Thanks. Growth premiums written gross – sorry, gross premiums written growth has decelerated every quarter since 2Q 2018. I know it's a real positive, the risk reduction in Tri-County, but as we look forward, when should we expect that risk reduction eventually turns to growth, given the real strong growth you're having in the expansion states and partnerships?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Well, the derisk that we had in the second quarter was the largest in the company's history. And we did that in advance of reinsurance season. To be honest with you, we just didn't want to have all that TIV on our books during one season and pay the cap premium for it. So, there's a lot of factors – it's a great question, there's a lot of factors that kind of go into play. We saw positive growth in the first quarter. Second quarter was the largest derisk in the company's history, as mentioned, yet our in-force premium went down less than 1% year-over-year. So, it was very negligible, but that was a targeted reduction.

As we're seeing acceleration in the ex-Florida states, which has been incredibly strong, we do think that, plus rate increases moves us into positive growth trajectory, moving forward. But 2Q, because of the derisk for the reinsurance purposes, was a big offset to that tremendous growth we had in second quarter.

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

Q

Is the derisking completed? Or maybe ask it another way, the \$6.2 billion in TIV reduced during the quarter, how much on a percent basis does that represent of the current Tri-County exposure?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

It's a good question. [indiscernible] (30:14) hold up TIV metrics here. We'll try to give you that number. But I can tell you kind of rough numbers. We're going to derisk more and that is our trend. So, investors that like less fraud, volatility and adverse development, I mean, this is how we get there. There is more policy derisking that will take place. We're not writing any business down there at all for personal lines. So, you can bank every year on at least 15% to 20% of those policies disappearing just from natural attrition.

We have been very focused on commercial residential in the Tri-County. We've noticed that there are some companies that are still underwriting those exposures. And what we believe is an insufficient rate. So, we have done a lot of derisking in commercial residential, particularly in [indiscernible] (31:08) where we do not believe that market rates are sufficient to cover the cat load and the attritional loss ratios that you have for that book.

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

Q

Okay. You mentioned you've got no interest in Florida M&A really. Do you have interest in M&A outside of Florida? And if so, what geographies or lines of business?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Yeah. Another great question. Yes, we would look at M&A outside of Florida. It is not our focus. We were focused on Zephyr and Narragansett Bay. Those were the two targets. We closed on both transactions. We are not actively pursuing any M&A in the market right now. But if we did look at M&A, it would have to be outside of Florida unless there was just some crazy deal out there that made a lot of sense to us.

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

Q

All right. And I think this will be my last question. You're getting a – it sounded like a 14.9% earn rate increase on your Florida book. But can you like dimension what your claims inflation level is? I'm just trying to triangulate how long we should be thinking about underlying margin deterioration prospectively?

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Well, a lot of that depends on severe weather and a lot of that depends on how much favorable or unfavorable development we have in the book. I can just tell you that loss costs in Florida are elevated versus a year ago versus two years ago. And that is really related to the unique fraud mechanisms that are in place in Florida with or without AOB, you see it. So, there is going to be some loss cost inflation in the portfolio, offset by the rate increases. If the lost cost weren't here, we wouldn't be able to get 14.9%. And that rate increase is really targeted at Tri-County, where the average rate increase is 25% on that filing.

So, you take a statewide average of roughly 15%, but 25% is going into three counties. It shows you that the loss cost inflation ex-Tri-County isn't really that high. It's the Tri-County portfolio, which is why I mentioned in my comments earlier that we believe a lot of the adverse development occurring in the market right now is happening as related to – or in connection with Tri-County exposures.

John Bakewell Barnidge

*Analyst, Sandler O'Neill & Partners LP*

Q

Great. Thanks for the answers and good luck.

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

A

Great. Thank you, John.

**Operator:** And this will conclude our question-and-answer session. I'd like to turn the conference back over to Bruce Lucas for any closing remarks.

Bruce Thomas Lucas

*Chairman & Chief Executive Officer, Heritage Insurance Holdings, Inc.*

I would just like to thank everyone for participating in our 2Q earnings call.

**Operator:** The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines, and have a good day.

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