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Heritage Insurance Holdings, Inc. (HRTG)

Q4 2021 Earnings Call

CORPORATE PARTICIPANTS

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Ernesto Jose Garateix

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

OTHER PARTICIPANTS

Marla Backer

Analyst, Sidoti & Co. LLC

Matthew J. Carletti

Analyst, JMP Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning everyone and welcome to Heritage Insurance Holdings Fourth Quarter 2021 Financial Results Conference Call. My name is Jamie, 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 that today's event is being recorded.

At this time, I'd like to turn the conference call over to Kirk Lusk, Chief Financial Officer at Heritage. Please go ahead.

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Good morning and thank you 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 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

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

Thank you, Kirk. Good morning, everyone, and thank you for joining us today. I would like to thank our employees and our board for the continued hard work and dedication. I also would like to thank our shareholders for their continued support as we work towards delivering improving profitability and strong shareholder value for years to come.

Despite the challenges the industry faced in 2021, we returned to positive adjusted net income in the fourth quarter with strong results driven by a solid 93.2% net combined ratio, representing our first sub 100% combined ratio since the first quarter of 2020. Weather losses normalized this quarter and the impact of rate increases and underwriting enhancements has started to benefit results. While we're not pleased to take the goodwill impairment charge in the quarter, it's important to note that it's a non-cash charge with no economic impact to our business and no relation to our core underwriting and investing operations. It will not distract our team from the continued execution of our well-defined strategy to reduce volatility and generate sustainable returns on equity.

Our focus over the past year has been on improving profitability by implementing meaningful rate increases, re-underwriting our existing business and be more selective when we consider and accept new business. We also made [ph] meaningful form (00:03:29) changes, vetted out agent network to ensure that we're writing new business through our most profitable partnership, and intensified our focus on expense management. We also continue to diversify away from Florida to reduce the volatility of our book. As of the fourth quarter, Florida total insured value only accounted for 26.9% of total TIB, down from 31.3% last year. As I mentioned, rate increases benefited fourth quarter results and we expect higher rate to continue to increase our earned premiums throughout the year.

As of the fourth quarter, the total average premium per policy was up 10.1% year-over-year while we implemented even more meaningful increases in Florida, where our average premium per policy was up 15.5%. Further, our Florida TIB decreased by 3.2%, while the premium-in-force increased nominally. Our focus on rate adequacy can also be seen by looking at our premiums relative to our policy count. For example, our overall premiums-in-force increased by 8.3% year-over-year as of the fourth quarter, while policies-in-force declined by 1.7% representing a 10.0 delta. This was more pronounced in our Florida homeowners book where premium growth outpaced policy growth by 13.3 points. We will continue to aggressively take rate as appropriate throughout our portfolio. We believe the underwriting progress that we delivered in the fourth quarter represents the early innings of our underwriting profitability improvement and we're confident that our strategic initiatives will continue to move us forward in 2022 and beyond.

Given our confidence and the actions we're taking, we repurchased \$7.2 million of stock in the fourth quarter, which was accretive to tangible book value per share. I'm pleased with our progress and expect continued positive momentum in 2022 and beyond.

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

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Thank you, Ernie. Good morning. Let me begin by providing some additional detail on the driver of the net loss of \$49.5 million reported for the quarter. The primary driver was a \$60.5 million non-cash goodwill impairment that was mostly non-tax deductible and negatively impacted earnings per share by \$2.20. Adjusted net income, which excludes the impact of goodwill, was \$11.3 million or \$0.41 per share.

Management firmly believes our stock is undervalued and that the last several years of weather-related catastrophes has had an adverse impact on our stock price. With our stock trading below tangible book value at the time of the annual goodwill impairment analysis and the overall market disruption and estimated valuation multiples in the property, insurance market, we determined an impairment of a portion of our goodwill was appropriate. Importantly, we believe the fundamental performance of the business in the fourth quarter and the earnings potential for Heritage in 2022 and beyond is better reflected by our fourth quarter adjusted net income and combined ratio.

Adjusted net income of \$11.3 million for the fourth quarter of 2021 was up [ph] \$8.5 million (00:07:12) from the \$2.8 million in the prior year quarter. The year-over-year change primarily stems from current accident year weather and attritional losses, and lower general and administrative expenses, partly offset by lower favorable prior year reserve development. We instituted a number of underwriting initiatives during 2021. Those efforts allowed us to achieve a net combined ratio under 100% in the fourth quarter of 2021. But more importantly, we expect our efforts to continue benefiting underwriting results in 2022 and beyond.

With the current market disruption in both the Southeast and Northeast regions, we will be even more selective in our underwriting as we continue our focus on a diversified, profitable, and balanced portfolio. These actions include remaining focused on margin expansion, which includes rate increases, curtailing production in unprofitable areas, and tightening our underwriting standards. In addition to making positive rate and underwriting changes, we are also making form changes, which are aimed at lowering loss costs. We expect the majority of our growth will occur from rate increases instead of growth in policies in-force, and management will continue to stay focused on maintaining and improving our portfolio. In 2021, our total insured value increased 4.3% over the prior year, which reflected a 10.9% decrease in our Florida personal lines portfolio and a 10.7% increase in our personal lines outside of Florida. Over the same period, our in-force premium increased by 10.1% over the prior year. This demonstrates a positive shift in our portfolio and progress in our profit initiatives.

Gross premiums written declined 1.2% overall year-over-year and declined 17.8% in Florida, reflecting our intentional exposure management and re-underwriting efforts. In our 15 other states, gross premiums grew by 16.7% in the fourth quarter of 2021 compared to the prior year. The average rate increase over the prior year period is over 10%. Net premiums earned increase by 5.6% year-over-year, reflecting an increase in gross premiums earned of \$28.2 million that outpaced a \$19.8 million increase in ceded premium.

Losses for the quarter were down \$7.6 million year-over-year due to lower weather losses and an improvement in attritional losses, which were partially offset by lower favorable development. Losses this year were also impacted by both social and economic inflation, which we will continue to evaluate and incorporate into our rates and our inflation guard factors.

The net combined ratio of 93.2% is down 15.5 points compared to 108.7% for the fourth quarter of 2020. Even with a higher ceded premium ratio, our net loss ratio improved by 8.5 points and our expense ratio improved by 7 points. While fewer weather losses contribute to the improvement in the loss ratio, the shift in our book of business geographically, the rate increases, and the underwriting changes for new and existing businesses contribute to the lower net loss ratio.

Our net expense ratio also improved to 31.3% in the fourth quarter and 34.7% for the full year of 2021, which represented a 3.8 point improvement from the full year 2020.

Shareholder equity decreased by \$62 million for the quarter or \$2.38 per share, of which \$2.26 was related to the goodwill impairment. Management took the opportunity to purchase 1.1 million shares during the fourth quarter at an average price of \$6.42. For the full year, we purchased 1.3 million shares for an average price of \$6.52 per share. Also, at the end of the fourth quarter, the board approved a new \$25 million repurchase authorization for 2022. At year-end, the company had \$26 million of cash at the holding company, in addition we continue our commitment to returning value to shareholders.

We believe the favorable improvements in the net combined ratio indicate that the fundamentals of the company are trending favorably. As such, we expect to continue to see positive results from these profit initiatives. We're now available to take your questions.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. [Operator Instructions] And our first question today comes from Marla Backer from Sidoti. Please go ahead with your question.

Marla Backer

Analyst, Sidoti & Co. LLC

Q

Thank you. So, I'm just looking for a little bit more color here in terms of seeing how these trends continue in future quarters. Can you give us a little bit more color on the diversification? Obviously, as you pointed out in your prepared remarks, Florida policies as a percent of total insured value that's down. Do you have a target number of where you want that to be? And in terms of – you did comment on growth being driven primarily by rate increases, but I think embedded in that is also new business writing in states outside of Florida. Can you give us a little bit of color whether you're thinking of opening new states?

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

Okay. At this point, no, we are not contemplating opening new states, although we continue to evaluate that based upon current needs in the market. When you look at our PIP growth and where are kind of where we position ourselves going forward, the Florida market when we look at the percentage that we have there, we're actually comfortable with that. I think the – when you look at the growth, it's predominantly going to be in the Mid-Atlantic states and the Northeast. Hawaii is also starting to tick up well for us due to the implementation of an HO3 product out there. So, I think that the balance of the portfolio we're pretty comfortable with. And I would be surprised if it moves more than a couple of points if anything probably the Northeast and the Mid-Atlantic will grow faster than Florida. Florida if it does grow, it will be through rate increases as opposed to PIF growth.

Marla Backer

Analyst, Sidoti & Co. LLC

Q

Got it. And just could you remind us of when you generally implement rate increases in Florida each year and what the process there is?

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

It's typically done very early in the year. For the HO3 product, we do continue to evaluate, we do quarterly reserve reviews and indications. And so we continually look at that and take rate whenever needed and wherever it's available. But typically those are slated more towards the early part of the year.

Marla Backer

Analyst, Sidoti & Co. LLC

Q

Thanks so much.

Operator: [Operator Instructions] And we do have an additional question. This comes from Matt Carletti from JMP. Please go ahead with your question.

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Hey, thanks. Good morning. I had a couple of questions. First one is just a quick numbers one, what was the favorable development in the quarter. The press release referenced just a lower level of favorable. But can you provide the number?

Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

A

Yeah. It's just under \$600,000 to about \$500,000 for the quarter.

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Okay. Great. And then can you just talk a little bit about particularly the growth outside of Florida kind of how the partnerships – some of the partnerships you've announced over the past couple of years are going and contributing to that?

Ernesto Jose Garateix

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

A

Yeah. So, this is Ernie. So, those partnerships continue to provide benefits for us. We're very happy with those partnerships. We've been very upfront with the partners in planning out the growth together with them. So, that is a mutual win-win for both sides. So, we're very happy about those. And obviously those have been focused outside of Florida, the Northeast and other than Florida in the Southeast states.

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Great. Thanks very much.

Ernesto Jose Garateix

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

A

Thank you.

Operator: And ladies and gentlemen, I'm showing no additional questions. I'd like to turn the floor back over to management for any closing remarks.

Ernesto Jose Garateix

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

We'd like to thank everybody for joining the call today and wish everyone a great day. Thank you.

Operator: And ladies and gentlemen, with that we'll conclude today's conference call and presentation. Thank you for joining. You may now disconnect your lines.

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