Heritage Insurance Holdings, Inc. [HRTG]
Q1 2024 Earnings Conference Call
May 2, 2024, 9:00 AM ET.

Company Participants:
Ernie Garateix, Chief Executive Officer
Kirk Lusk, Chief Financial Officer

Analysts:
Maxwell Fischer, Truist
Mark Hughes, Truist

Presentation

Operator: Good morning, and welcome to the Heritage Insurance Holdings First Quarter 2024 Earnings Conference Call. (Operator Instructions). Following the presentation, we will conduct a question-and-answer session. (Operator Instructions). This call is being recorded on Thursday, May 2, 2024.

I would now like to turn the conference over to Kirk Lusk, Chief Financial Officer for the company.

Kirk Lusk: 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.

Ernie Garateix: Thank you, Kirk, and thank you all for joining us today. I will provide some highlights of our first quarter performance, discuss our progress in achieving key objectives, and offer insights into our strategic initiatives. Following my remarks, Kirk will provide details on key financial performance metrics, after which we will open the call for Q&A.

I am pleased to report a solid start to 2024 with a first quarter net income of 14.2 million, which is a slight increase from the 14 million reported in the same period last year. This improvement primarily reflects the success of our ongoing strategic initiatives aimed at achieving rate adequacy, underwriting discipline and capital allocation. We've expanded our portfolio where rates are adequate and where we have modest concentration, while reducing our exposures, where either rates are inadequate, or we have over-concentration.

We've continued to receive approval from our regulators to take rate where indicated. These actions represent the key strategic objectives that have been implemented over the past 2 years. While our exposure management initiatives have intentionally reduced our policies in force, premiums in force have increased for each of the last 9 consecutive quarters. In force premiums at Q1 2024 was 1.4 billion, a 6.2% increase over the first quarter of 2023.

The costs associated with writing property insurance in recent years has increased materially due to more frequent and severe weather, excessive claim litigation in Florida, higher reinsurance costs, and general inflationary impacts on the cost to repair properties. As such, our rate need has escalated over the last several years. We sought and were approved for rate increases that were substantial in certain geographic areas, and those new rates are being earned over the life of the associated policies.

For 2024, we anticipate higher gross premiums driven by rates approved in 2022, 2023 and 2024, as the associated premiums are earned, for geographies where rates are becoming more adequate, we would therefore expect the percentage increase to rates to be smaller than recent years.

Even with the opportunistic growth in certain lines of business and geographies, we have maintained a balanced and diversified portfolio with no single state representing more than 26.7% of the company's total insured value. This strategic diversification helps mitigate risks and stabilize our earnings across various geographic regions.

The decrease in our policies in force has been intentional, driven by our strategic initiatives to get adequate rate, non-renew unprofitable policies to the extent permitted by individual state requirements, reduced concentrations and fine-tune our distribution network. These activities achieve the intended impact and now puts us in position that policy count is no longer expected to decline at the same rate we experienced over the past few years.

We are pleased to announce that we have finalized our catastrophe XOL reinsurance program for 2024, 2025, earlier than in previous years, reflecting our commitment to our reinsurance partners and their corresponding commitment to our strategy. This year's program includes a new Southeast-only catastrophe bond providing a limit of $100 million. The inclusion of catastrophe bonds is an important element of our risk transfer program. Because it includes the capital markets as a supplier of reinsurance, contracts are multiyear and the reinsurance we secure is fully collateralized.

As we continue to navigate forward, our focus remains steadfast on enhancing shareholder value, disciplined capital management and strategic growth initiatives. The challenges of the litigated claims environment in Florida continues to be noteworthy. But with targeted underwriting and rate actions, as well as legislative actions taken to reduce the influence of claims abuse and one-way attorney fees, we believe we are positioned to successfully return to a policy count growth trajectory.

Before I turn the call over to Kirk, I want to reaffirm our commitment to navigating the complexities of our market with a strategic focus that prioritizes long-term profitability and driving shareholder value. We are optimistic about the benefits of recent legislative changes in Florida, and remain adaptable in our strategies to ensure sustained positive outcomes.

Now, let me turn things over to Kirk for a detailed review of our financial performance this quarter.

Kirk Lusk: Thank you, Ernie. Good morning, everyone. As Ernie highlighted, we began 2024 on a strong note with first quarter net income of 14.2 million or 47 cents per diluted share. This result represents an improvement in our net income over the prior year, driven by an 8% increase in net premiums earned and a notable rise in investment income.

Additionally, it is important to note that the decrease in earnings per share was influenced by higher average weighted number of shares outstanding due to the equity issuance and stock grants, net of forfeitures.

Our gross premiums written this quarter were 356.7 million, a 14.9% increase from the prior-year quarter, reflecting our strategic focus on enhancing our product offerings and expanding into profitable segments. Gross premiums earned followed suit, rising to 341.4 million, up 7.7% from the prior quarter.

Net premiums earned increased by 8.1%, reflecting the increase in gross earned premiums outpacing the increase in ceded premiums. We expect an improvement in our ceded premium ratio going forward, and for the growth in net premiums earned to accelerate throughout 2024.

Total revenue for the quarter reached 191.3 million, marking an 8.1% increase compared to 176.9 million in the prior-year quarter. This increase in revenue is bolstered by our hard net earned premiums and an increase in net investment income, which rose due to our positioning and its current yield curve opportunity.

Losses and loss adjustment expenses were 102 million for the quarter, compared to 97.5 million in the first quarter of 2023. The net loss ratio improved to 56.9%, down from 58.7% the prior-year quarter, even with higher weather related losses of 5.6 million and unfavorable loss development of 6.7 million compared to favorable development of 1.5 million in the prior quarter.

The improvement in the loss ratio, which included a reduction of attritional losses, highlights the positive impact on our rate actions as well as what we believe is a better performing portfolio, driven by the [various] strategic underwriting changes made over the past 2 years.

The net expense ratio saw a slight increase to 37.1%, primarily due to a reduction in ceding commissions from our net quota share contract. This will have the most impact in the first quarter, since it is the result of contracts that were run off in 2023.

Our net combined ratio improved slightly to 94%, reflecting improvements in the loss ratio driven by the strategic initiatives Ernie and I have discussed.

Turning to our balance sheet, the book value per share has risen to $7.67, an increase of 26.8% compared to the prior-year quarter. This growth in book value is primarily driven by net income and a reduction in unrealized losses on our fixed income securities.

Our financial strength is further evidence by our cash reserves which exceed 380 million in cash and cash equivalents, providing us with substantial liquidity to meet our operational needs.

Importantly, as of the closing price on March 30, 2024, we have met the threshold necessary to qualify for inclusion in the Russell 2000 Index. While formal inclusion will be confirmed in the coming updates from the index, meeting the threshold is a testament to our financial health and market valuation.

The Board of Directors continues to evaluate our dividend distribution and stock repurchase strategies. As part of this prudent capital management approach, our Board has decided to continue the suspension of the quarterly dividend to further strengthen our financial position and support strategic growth initiatives.

In conclusion, our financial results for the first quarter of 2024 demonstrate the effectiveness of our strategic initiatives and our ability to adapt to market conditions. We remain committed to driving shareholder value and ensuring the long-term sustainability of our operations.

Thank you. We are now ready for your questions.

Questions and Answers

Operator: Thank you. And ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions). Maxwell Fischer from Truist.

Maxwell Fischer: I don’t know if this was answered, but different sources have been modeling a more active storm season this year. What is your internal model setting? And do you think the rate and the rate adequacy in Florida is there?

Ernie Garateix: Okay. Yes, we're hearing that there is a slight uptick as far as the possibilities. There's always the issue as far as whether it's going to make landfall or not. Our internal models actually show like slight increase, not quite to the extent of some of the others.

As far as the rate adequacy in Florida, that is looking extremely positive. I think that a lot of the rate actions that we've taken over the last several years, including the underwriting activities, have really kind of fine-tuned the portfolio. The legislative changes that occurred, I would say, we are cautiously optimistic -- and I'm sure you've heard that term before -- about kind of what we're seeing there. But right now, it looks like it is having the desired effect. So overall, it's looking pretty good.

Maxwell Fischer: Yes, that's helpful. And then secondly, not big numbers here, but the policy acquisition cost ticked up a bit in the quarter. Looks like it was running in the mid-12% in 2024. What should we expect the run rate to be in -- or sorry, that was in 2023. What should we expect the run rate to be in 2024?

Ernie Garateix: In 2024, post-acquisition costs, I think you're going to see go back to closer to the historic norm, simply from the standpoint of we had about $3 million worth of reduced ceding commissions in the first quarter. That had to do with some runoff of the last year's quota share, and so it'll actually go more into the norm going forward.

Maxwell Fischer: Thank you. That's all for me.

Operator: Mark Hughes from Truist.

Mark Hughes: I just jumped on the call, so I apologize. But did you make any commentary just regarding your kind of posture around top line growth? How do you view adequacy of pricing at this point? And are we at a juncture where you can feel better about adding to the top line? And of course, that takes into account capital considerations that you might be able to -- if you've already commented, leave that one go, but any elaboration would be appreciated.

Ernie Garateix: No, no, we can make a comment on that. So I think we've been taking rate over the past 2 years. We're much more comfortable in specific geographic areas and where that rate adequacy is, and then looking to grow that top line. Very specifically, I would say since we are a super-regional carrier, there are other areas that we're still focusing on getting some more rate. But I would say overall, as you look into 2024 and going forward, right, that the rate adequacy in specific regions that we are focusing on to grow that top line through policy counts, you'll see that coming through.

Kirk Lusk: In addition, I have one other comment I'd like to -- or two other comments. One is when you look at our non-regulated cash, as far as how we're sitting for growth, we do have over $50 million worth of non-regulated cash in the entities that we can push down, and utilize that for growth opportunities in the future where we see fit. The other comment I think we always make in that type of stuff is due to seasonality and the winter storms in the Northeast. Typically, the first quarter is our worst quarter.

Mark Hughes: Understood. And then did you touch on the take-outs, whether take-outs would be of interest to you at all?

Ernie Garateix: So we always do our due diligence and look at the takeout. I think right now, we're pretty optimistic with the rate adequacy we're seeing in certain regions that are going through organic growth with our value partners and the agents, is a better opportunity for us. But that doesn't mean we won't be considering the take-outs at all; it'll be something that we do as part of our due diligence every quarter.

Mark Hughes: Understood. Thank you very much.

Operator: (Operator Instructions). There are no further questions at this time. Now, ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to management team for final remarks.

Ernie Garateix: I'd like to take this opportunity to thank all our employees for their dedication, as well as shareholders, our reinsurance partners and agents for their continued support. I appreciate everybody joining the call today, and hope everyone has a great day.

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