Heritage Insurance Holdings, Inc. [HRTG]
Third Quarter 2024 Earnings Call
Thursday, November 7, 2024, 12:00 PM Eastern Time

Officers and Speakers
Kirk Lusk; Chief Financial Officer
Ernie Garateix, Chief Executive Officer

Analysts
Mark Hughes; Truist
Paul Newsome; Piper Sandler

Presentation

Operator: Good afternoon, and welcome to the Heritage Insurance Holdings Third Quarter 2024 Earnings Conference Call. Please note, today's event is being recorded.

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

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. Good afternoon, everyone, and thank you for joining us today.

To start, our thoughts and support are with the many people who were impacted by the devastating hurricanes that affected so many communities across the Southeast. This has been a difficult storm season that has left millions with significant damage and loss. At Heritage, we are working tirelessly to support our policyholders and communities to ensure they have the necessary resources to quickly rebuild. I am especially proud of our employees from across our company who have been providing a rapid response to our valued policyholders as well as hundreds of adjusters and emergency service providers that we have in the field to support our customers daily.

To ensure we are offering the support that our policyholders expect, we track a series of metrics to ensure our operational effectiveness. As an example, at 21 days following Hurricane Milton, we received 6,352 claims, with the average wait time for policyholders calling in their claims of under one minute. We had over 230 employees throughout our footprint taking first notice of loss calls, while we also have over 200 vendors ready and responding to emergency services.

I would like to thank our employees, many of whom themselves were impacted by the hurricanes, for their incredible effort during this challenging time. Their commitment to our policyholders has been remarkable and a testament to the culture at Heritage.

While I am proud of our support to our policyholders, I am also very proud of our financial results, which clearly demonstrate the successful execution of our strategic initiatives that I laid out when I was appointed CEO of Heritage three years ago. Our initiatives have been focused on achieving rate adequacy, enhancing our underwriting discipline, and allocating capital to drive growth and returns as we strive to deliver solid financial results. Through these efforts, we have positioned Heritage to absorb a full retention loss while maintaining profitability and delivering results to our shareholders.

Looking at our third quarter results in more detail. We have achieved net income of $8.2 million, or $0.27 per share, which is a sharp improvement from the year ago third quarter, where our results produced a net loss of $7.4 million, or a 28% loss per share. Importantly, our current quarter results include approximately $48 million of hurricane losses from Debbie and Helene. On a year-to-date basis, we achieved net income of $41.2 million, or $1.35 per share, representing a strong increase from our 2023 nine-month net income of $14.4 million, or $0.55 per share. Our ability to maintain profitability in the face of significant catastrophe losses is the result of a multi-year effort where we have focused on executing our underwriting and rate adequacy initiatives.

From an underwriting perspective, we continue to strategically reduce our exposures in overconcentrated and unprofitable areas while increasing our presence in profitable geographies and products. This disciplined underwriting approach resulted in a further policy count reduction of just over 66,000 policies, or 14.2% throughout our footprint compared to the third quarter of 2023, while our premium in force increased by $80.6 million, or 6%.

As we have discussed on prior earnings calls, we expect declining policies to moderate over the next few quarters as we open territories for new business while maintaining our underwriting discipline. We have also maintained a stable indemnity-based reinsurance program at manageable costs through our policy count and exposure management initiatives while also proactively engaging with our reinsurance partners. In fact, we met with 28 of our reinsurance partners just prior to Hurricane Milton making landfall, each of whom reiterated their continued support of Heritage both near and long-term.

Turning to our rate adequacy initiatives. These efforts have resulted in significant rate increases, which are earning through our portfolio in 2024 as evidenced by our growing unearned premium balance. Looking to 2025, we anticipate an even more meaningful amount of rate to earn through our portfolio, which we expect will provide a healthy tailwind to our financial results. More importantly, we have selectively started writing personal lines business throughout our footprint as we pivot our strategy to one of controlled growth, anchored by our continued focus on risk management and stringent underwriting. This is an important change in our strategy, given that we significantly curtailed writing personal lines new business beginning in 2022.

Over this period of time, we have been growing our top line through organic growth in our commercial and residential portfolio and our E&S products, combined with the rate action that we have taken in our personal lines portfolio. Additionally, recent legislative changes in Florida are having a positive impact on the economics of writing new profitable business in the state. In fact, we believe Hurricane Milton will further demonstrate that the legislative changes will mitigate frivolous lawsuits, shorten the claim closure cycle and bring more reinsurers back to the market. Taken together, we expect our improved rate to continue to earn in through 2025, the headwind from our policy reduction efforts to mitigate through the first half of 2025 and our new business production to continue to ramp up through the year ahead. We believe we have the foundation in place to deliver solid, profitable growth in 2025 as we execute our controlled growth strategy.

Our E&S business has been a growth lever for Heritage, as in force premiums grew nearly $25 million, or 116%, as compared to the year ago third quarter as we continue to write this business in California, Florida and South Carolina. What makes this business so attractive is that we can more nimbly adjust our rates and coverages to the changing dynamics state by state to ensure we continue to earn appropriate risk-adjusted returns.

Looking forward, we plan to continue to evaluate more states for E&S opportunities as we focus on our controlled growth strategy. Importantly, we remain resolute in maintaining a balanced and diversified portfolio as no single state represents over 30% of our total insured value. This selective diversification helps reduce performance volatility and ensures our long-term stability, which we believe will be reflected in the value of our company over time.

We remain committed to maintaining our focus on disciplined growth, operational excellence and effective capital management. Importantly, our strategic initiatives are yielding the positive results as evidenced by our ability to remain profitable through a challenging cap season. Looking forward, I remain optimistic as we pivot to our controlled growth strategy designed to prudently accelerate premium growth while maintaining our margins.

To conclude, I would like to reiterate our dedication to navigating the complexities of the market with a strategic focus that prioritizes long-term profitability and shareholder value, driven by our dedicated workforce.

Kirk, over to you.

Kirk Lusk: Thank you, Ernie, and good afternoon, everyone.

As Ernie highlighted, our results this quarter reflect the success of our strategic initiatives. Starting with our financial highlights. We reported net income of $8.2 million, or $0.27 per diluted share, compared to a net loss of $7.4 million, or a loss of $0.28 per diluted share in the prior year quarter. The increase in net income was driven by the positive impact of our rate actions, our underwriting actions and our targeted exposure management taken over the last several years, which continue to favorably impact our results.

Demonstrating the improvement to the portfolio and to put that into context, in the third quarter of 2022, with Hurricane Ian, we incurred a full $40 million retention loss and reported a net loss in the quarter of $48 million. In 2023, with the Maui fires and Hurricane Idalia, we also had $40 million of cat losses and reported a $7 million net loss in the quarter while this year, we sustained $48 million of cat losses in the quarter with Hurricanes Debbie and Helene and reported net income of $8 million.

Our total revenues for the quarter were $211.9 million, up 13.7% from $186.3 million in the prior year quarter. This increase was driven by the increase in net earned premiums and investment income. Gross premiums earned rose to $354.2 million, up 5.1% from $337 million in the prior year quarter, reflecting our strategic focus on rate adequacy and organic growth in our commercial and residential line. Net premiums earned increased to $198.8 million, up 12.6% from $176.6 million in the prior year quarter as the growth in gross premiums earned outpaced the increase in seeded premiums.

Our strategic focus on expanding profitable products and markets includes the organic growth of our commercial and residential business, for which we selectively increased the premium in force by 23.6% compared to the third quarter of 2023, while the total insured value only increased by 9.5%. The commercial and residential business tends to have lower attritional losses while generating material higher average premiums. This segment now accounts for 21.4% of our total in force premium, compared to 18.4% in the prior year period.

Overall, we are in a strong financial position and backed by a $1.3 billion reinsurance tower for the Southeast. We experienced hurricanes Debbie and Helene during the third quarter with a combined loss of $48.7 million, with Debbie being a much smaller storm. We expect gross losses from Hurricane Milton to possibly reach into the third layer of our reinsurance tower, which starts at $450 million and goes to $914 million. We continue to maintain a robust level of reinsurance coverage through year-end 2024 while the strategic actions we have taken over the last three years have helped to mitigate our losses from significant events like the three recent hurricanes.

Our net investment income inclusive of realized gains, losses and impairment for the quarter was $9.8 million, an increase of 42% from $6.9 million in the prior year quarter. This increase reflects our actions to align the investments with the yield curve while maintaining a high-quality portfolio of short-duration assets.

The net loss ratio for the quarter improved to 65.4%, an improvement of 9 points from the 74.4% in the same quarter last year, reflecting higher net premiums earned, coupled with slightly lowered net losses and LAE. The reduction in net losses and LAE was driven primarily by a reduction of attritional losses, which was partially offset by higher weather losses and adverse development.

Net weather losses for the current extant quarter were $63 million, an increase of $11.4 million from $51.6 million in the prior year quarter. Catastrophe losses in the quarter were $48.7 million, compared to $40.1 million in the prior year quarter. Other weather losses totaled $14.3 million, an increase in the prior year quarter amount of $11.5 million. Additionally, the net loss ratio was impacted by net unfavorable loss development of $6.3 million during the third quarter of 2024, compared to net unfavorable loss development of $800,000 in the third quarter of 2023.

We have continued to see favorable trends in the current year loss cost attributable to the legislative changes made in Florida and the improvements in our underlining portfolio across all 16 states in which we conduct business. We continue to evaluate each state on an ongoing basis to make adjustments as necessary to maintain rate adequacy and improved underwriting results.

Our net expense ratio for the quarter was 35.2%, a decrease of 1.2 points from 36.4% in the prior year's quarter. The decrease was driven primarily by the increase in net premiums earned, which offset higher policy acquisition costs. The net combined ratio for the quarter was 100.6%, down 10.2 points from 110.8% in the prior year quarter, driven by the lower net loss ratio and lower net expense ratio.

Turning to our balance sheet. We ended the quarter with total assets of $2.4 billion and shareholders equity of $279.3 million. Our book value per share increased to $9.10, up 61.1% from $5.65 in the prior year quarter. The increase from the comparable quarter of 2023 is primarily attributable to net income as well as a reduction in unrealized losses on the company's fixed income securities portfolio. The remaining unrealized losses are attributable to interest rates and not to credit risk. The reduction in unrealized losses is correspondingly driven by the recent decline in interest rates. We expect unrealized losses will continue to decline as bonds mature, but recognize that changing interest rates will impact unrealized losses or gains.

The average rating of our portfolio is AA-, with a duration of 3.19 years as we have extended the portfolio's duration to take advantage of higher yields further out on the yield curve while still maintaining a short duration, high credit quality portfolio.

Our annualized return on equity for the quarter was 12.2%, an improvement of 31.2 points from a negative 19% in the prior year quarter, reflecting our improved profitability and effective capital management. In terms of capital management, our board of directors has decided to continue the suspension of the quarterly dividend. This decision aligns with our strategy to support our long-term growth initiatives with related robust returns on equity. We will continue to evaluate our dividend distribution and stock repurchase strategies on a quarterly basis.

Looking ahead, we remain focused on executing our strategic initiatives aimed at driving shareholder value. We believe that our proactive approach to managing exposure, enhancing rate adequacy and investing in technology and infrastructure will position us well for continued success. Lastly, we are excited to embark on the next phase of our strategic initiatives as we initiate our controlled growth strategy and begin writing personal lines policies in the Southeast and Northeast. We expect these to have a positive impact on our earnings as we look to the year ahead.

Thank you for your time today. Operator, we are now ready for questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. The first question today comes from Mark Hughes with Truist.

Mark Hughes: The loss ratio, excluding the weather, excluding the cat, was really striking, and particularly when you take into account the prior year development. You talked quite a bit on the call about the initiatives that you've undertaken to help achieve that and the regulatory help.

Is this level sustainable? Is this a new normal? How much of this was just a pretty good quarter aside from the major events. Or is this the starting point that we think about other factors that might drive it going ahead?

Kirk Lusk: Yes. Mark, thank you. Great question. I think it's a little of both. I mean, but when you look at it, I mean, it was typically -- the third quarter was a pretty good quarter, followed by the fourth quarter, which is typically our best quarter in the year. But we are seeing some very favorable trends on the attritional loss ratio.

The underwriting actions we've taken, the rating actions we've taken over the last several years on top of the legislative reforms are having a very favorable impact on our results. So we think that there is a bit of favorability in the third quarter, but it is more close to a new norm, I think, as we go forward as far as how we're looking at it from a profitability standpoint.

Mark Hughes: Right. Okay. So you talked about the rate momentum as you earn that, or continue to earn that through. How much more of a tailwind is there? You've taken a lot of rate actions. And considering the trajectory of those and how much has already been earned through, where are we in that process of having it flow through the P&L?

Ernie Garateix: Yes. Mark, this is Ernie. So there's quite a bit still to come in 2025 that we plan for. But the one thing I'll make a comment about is we're always looking in each of the geographies and products to make sure they're rate adequate. So that's always going to be an ongoing effort.

And again, we've said this over the earnings calls, we're going to aim to be profitable in every single state in which we do business and under the products that we offer there. So there's a constantly looking at those rate adequacy products to make sure they are adding to the bottom line.

Kirk Lusk: Yes. And Mark, to get an idea just as far as the tailwind, we are expecting more earned rate coming through in '25 than we had in '24.

Mark Hughes: Right, more on an absolute basis coming through in '25.

Kirk Lusk: Correct.

Mark Hughes: Right. Not necessarily a rate of change, but just on an absolute basis?

Kirk Lusk: Correct. Yes.

Mark Hughes: Yes. Okay. And then what do you see as the more attractive geographies at this point? You've got a lot to choose from, seemingly. How do you view Florida versus the Northeast or other markets?

Ernie Garateix: So we do think that Florida, again, with a lot of legislative changes and the rate adequacy is attractive to us. But again, we look at the Northeast as well. The Northeast has been taking rate in New York, New Jersey and other states up there. So those are getting closer to rate adequacy, and then looking at doing some -- running some more business up there. But again, the overall theme is looking at rate adequacy and having a managed, diversified portfolio across. And that gives us plenty of options.

Operator: The next question comes from Paul Newsome with Piper Sandler.

Paul Newsome: Congrats on the quarter. Was hoping you could give us a little bit more details on the reserve development, just, actually, your sources. It's a little bit, I think, sometimes in contrast with the fact that it looks like the tort reform should -- maybe reserves go the other way, potentially. But anyways, additional color would be fantastic on that.

Kirk Lusk: Yes. Appreciate that. And that actually has to do with Irma, which, I mean, again, we only have a couple hundred claims remaining to basically get that thing completely settled. However, just due to the legal environment that those fall under, that there is some volatility still associated with some of those. So that is really the biggest driver of that. That actually is almost all of it, is just Hurricane Irma.

Paul Newsome: Is there any concern or should we be watching for any potential reinstatement premiums related to Milton if it creeps into certain layers?

Kirk Lusk: Yes. We've actually already included that in the latest estimate there as far as when we indicated the -- we anticipated about $57 million for Milton, that type of stuff. That included the retention and then plus reinstatement premiums.

Paul Newsome: And then finally also, are there any potential for unrelated claim management fees related to the hurricanes that become [indiscernible] in the fourth quarter?

Kirk Lusk: Say again? Can you repeat that, Paul? The claim management fee?

Paul Newsome: Sometimes the other income includes revenues that are gained off of management claims that, essentially, you're doing it for the reinsures. It can be a little bit of an offset. Is there anything in there potentially for the fourth quarter?

Kirk Lusk: Yes. Yes. Paul, good question on that. I mean, there could be some. But it's not going to be material.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over for any closing remarks.

Ernie Garateix: Thank you again for joining the call today. We hope everyone has a great afternoon.

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