06-Aug-2015

Heritage Insurance Holdings, Inc. (HRTG)

Q2 2015 Earnings Call

CORPORATE PARTICIPANTS

Bruce Thomas Lucas
Chairman & Chief Executive Officer

Stephen L. Rohde
Chief Financial Officer

OTHER PARTICIPANTS

John B. Barnidge
Sandler O'Neill & Partners LP

Matya Magnezi
SunTrust Robinson Humphrey, Inc.

Matt J. Carletti
JMP Securities LLC

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Casey J. Alexander
Gilford Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Heritage Insurance Holdings' Second Quarter 2015 Financial Results Conference Call. My name is Alison, and I'll 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. [Operator Instructions] As a reminder, this event is being recorded.

The matters discussed on this call that are forward-looking statements are based on current management expectations involving risks and uncertainties that may result in these expectations not being realized. Actual events, outcomes, and results may differ materially from what is expressed or forecasted in forward-looking statements made on this call due to numerous risks and uncertainties, included but not limited to the risks and uncertainties described in this conference call or press release issued yesterday and other filings made by the company with the Securities and Exchange Commission from time-to-time.

Forward-looking statements made during this presentation speak only as of the date on which they are made and Heritage Insurance Holdings specifically disclaims any obligation to update or revise any forward-looking statements to reflect new information, future events, or circumstances or otherwise.

Now, at this time, I would like to turn the conference over to Mr. Bruce Lucas, Chairman and Chief Executive Officer of Heritage Insurance Holdings. Please go ahead, sir.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

Thank you, and good morning to everyone joining us for the call. This is Bruce Lucas, Chairman and CEO of Heritage Insurance, and with me is Steve Rohde, our CFO. I would like to welcome all of you to our second quarter earnings call.

Before we begin the discussion of our quarter, I would like to take a moment to thank all of our employees for their commitment to our company. We had another great quarter in which we earned net operating income of $25.4 million. We have a strong business plan and our quarterly earnings results reflect our ability to execute on that plan and once again, outperformed expectations.

From a financial perspective, the quarter was solid. Our premiums written were strong, our voluntary personal lines premium in-force grew by nearly 67% year-over-year, and our voluntary commercial residential production outpaced our expectations. While we continue to assume policies from Citizens, our opt-out rates have been much higher when compared to historical take-outs and we believe that future take-outs from Citizens will be more challenging and smaller in scale.

Citizens recently filed for a rate increase, which will likely make more policies eligible under our underwriting guidelines, but it is too early to determine the impact, this proposed rate increase will have on our policy selection process. Regardless of dynamics within Citizens, we continue to have tremendous success in growing the company, as evidenced by a 37% increase in gross premiums written, as compared to the second quarter of 2014, a 114% increase in net premiums earned, as compared to the second quarter of 2014. A 30% increase in policy count, compared to the second quarter of 2014. Net income of $25.4 million, which is an increase of 166%, compared to the second quarter of 2014. Our combined ratio was 71.1% for the quarter. Shareholders' equity increased 41%, compared to the second quarter of 2014, and our return on average equity was 33.9% for the quarter.

In closing, I would like to talk about the acquisition that we announced earlier this week that I'm particularly excited about. BRC Restoration Specialists, a full-service general contractor with operations throughout Florida is our third M&A transaction and helps to fill a vital niche for our company.

BRC is a large-scale contractor that currently services several property and casualty insurers in Florida and understands our business. BRC will enable us to perform all facets of the repair, including those related to fire, mold and roofing, and they will bolster our water mitigation division by adding additional personal and resources.

The acquisition will provide better customer service by allowing our in-house contractor to work directly with the insurer to repair their home with professionalism and expediency. This will help Heritage control claim expenditures by performing the repair and reconstruction work at the appropriate price without having to pay the profit margin charged by outside vendors.

We send millions of dollars through Contractors' Alliance Network every year and we will be able to service these claims immediately. As part of the transaction, we are reorganizing Contractors' Alliance Network to include the first notice of loss, water mitigation and construction services so that all of these professionals can better work together.

Additionally, BRC's resources will be particularly helpful after a hurricane as the company can immediately respond to catastrophe claims, which should help to better serve our policyholders and control claim expenditures. The company has named John Crist, as the President of Contractors' Alliance Network to lead this exciting and innovative component of the company. And I believe that John's experience and leadership will prove invaluable in the years to come.

Now for more on the financial results, I will turn the call over to Steve Rohde, our Chief Financial Officer. Steve?

Stephen L. Rohde
Chief Financial Officer

Thank you, Bruce, and good morning. Gross premiums written for the second quarter were $135.6 million, up 37% year-over-year, resulting from $134.8 million of direct premiums written, and $0.8 million of assumed premiums written.

There are few factors that impacted premiums written for the quarter. First, the opt-out rate for our personal residential assumptions from Citizens in April and May were higher than we have historically seen. The higher opt-out rates, we've experienced recently began in February, and appear more reflective of the current environment. This translated into an 80% opt-out rate in the second quarter, compared to an average of approximately 46% in 2014.

A second contributing factor was our choice, not to do a June take-out, due to the economics of how the FHCF premium is calculated. As a result of these first two factors, personal residential policies assumed in the second quarter were approximately 3,400 policies. Also playing a role with our commercial business where we chose to not select any commercial policies during the second quarter, while receiving notification from Citizens that we had some mid-term cancellations of policies assumed during the first quarter of 2015 and the fourth quarter of 2014. This resulted in $2.3 million of unearned premium; being returned and accounted for in our financials as negative premiums written in the second quarter.

Finally, our non-renewal activity in commercial take-out policies during the quarter was higher than normal due to the exposure management that we did, as well as competitive pressures in the commercial marketplace. The market has softened since we selected our commercial policies in the fourth quarter of 2014 and the first quarter of 2015. As a result, we identified portions of that business that were no longer attractive at rates being offered by our competitors to our long-term profitability goals. It is important to remember that these policies provided significant profits for us in the past three quarters and we expect that the polices that we are retaining, will continue to contribute to profits going forward.

Our personal residential policy count increased during the quarter to 219,200 policies, an increase of approximately 2,000 policies from March 31, 2015. Our voluntary personal lines policies increased by almost 4,900 policies during the quarter.

During the quarter, we completed the first anniversary or our Sunshine State Insurance Company policy acquisition. One year later, we've retained approximately 82.4% of the policies we acquired, ahead of expectations.

Our total premiums in-force at June 30, 2015, were $510.2 million, an increase of 61% over June 30, 2014, and a 4% reduction from March 31, 2015. As a result of the exposure management that took place in commercial lines and the modest second quarter Citizens take-out. This in-force premium resulted in $127.1 million of gross premiums earned, compared to $64.1 million for the second quarter of 2014. The increase in gross premiums earned was a significant contributor to our growth in net income when compared to the previous year.

Additionally, our results were again favorably impacted by significant lower reinsurance cost as measured against gross premiums earned. As a reminder, our reinsurance treaties renew on June 1 and run through May 31. Ceded premiums earned in April and May, relate to the reinsurance treaty that was put in place the previous June.

Our ceded premium ratio was 25.4% for the second quarter of 2015, compared to 30.9% for the second quarter of 2014. The reasons for the decrease in the first two months of the quarter were two-fold.

First, last year's favorable reinsurance market conditions and the lower cost of reinsurance associated with the issuance of $200 million of catastrophe bonds by Citrus Re, as well as improved geographic spread of risk resulting from the SSIC policy acquisition.

Second, our fourth quarter of 2014 and first quarter of 2015 Citizens take-out activity had a positive impact on the ceded premium ratio. These take-outs increased gross premiums earned for April and May, without a corresponding increase in ceded premiums. The ceded premium ratio for the month of June of 2015 was approximately 34.9%, compared to 33.5% for June of 2014, following renewal of the reinsurance program.

Our June 1, 2015, we renewed our reinsurance program, which now provides $1.8 billion of coverage for a cost of approximately $177 million. Included in this cost is reinstatement premium protection, which will provide approximately $440 million of reinstatement coverage. A total of $477.5 million of coverage was provided through catastrophe bonds, approximately $690 million through the Florida Hurricane Catastrophe Fund, $566 million through private reinsurance, and a $35 million retention shared by our insurance subsidiary HPCIC, and Osprey, our captive reinsurance company. Our retention is split $15 million to HPCIC and $20 million to Osprey.

In addition to its $20 million retention at the bottom of the program, Osprey has a $5 million retention alongside the FHCF to fill a small gap between the two cat bonds, we've placed alongside the FHCF. The cost of the program as measured against in-force premium at June 30 is 34.7%. This year's program costs were in line with expectations considering the inclusion of the commercial residential book of business, which did not exist last June. And on a risk-adjusted basis, the costs were modestly down from last year.

Our loss ratio was measured against gross premiums earned was 26.7% for the quarter, compared to 30% for the second quarter of 2014 due to the continued benefit of our commercial residential business, as this line of business historically for the industry has had a very low non-catastrophe loss ratio. Our experience to-date has been excellent. Through three quarters, our reported loss ratio for commercial residential is in the low single-digits.

During the quarter, we increased IBNR by $5.2 million to $39.5 million. IBNR represented approximately 56% of our total loss reserves at June 30, a level consistent with the previous quarters and accounted for 4.1 points of the loss ratio. Our expense ratio, as a percentage of gross earned premiums, was 19% for the quarter, the same as the second quarter of 2014.

The final amortization of the Sunshine State policy acquisition cost of $550,000 occurred in the second quarter, which represented 0.4 points of expense ratio. Our expense ratios for the second quarters of both 2015 and 2014 were favorably impacted by assumed earned premium from the Citizens take-outs, in which there were no acquisition expenses. This improved the Q2 expense ratios for 2015 and 2014 by approximately 3.7 points and 4.2 points respectively. Our combined ratio as a percentage of gross premiums earned were was 71.1% for the quarter, compared to 79.9% for the second quarter of 2014.

We are very pleased with these results, despite some challenges on the revenue side, it was another excellent quarter for us, especially considering each component of our combined ratio reinsurance, losses and expenses were in line or better than our expectations. We believe this underlying base of profitable business, representing $510 million of in-force premium positions us well for the coming quarters.

On the balance sheet side, stockholders equity increased to $312.1 million, compared to $255.1 million at December 31, 2014. Statutory surplus in our insurance company subsidiary at June 30, was $200.3 million, an increase of $6.2 million for the quarter. Our invested assets at June 30 were $438 million, approximately $398 million invested in bonds, with an average credit quality of A, and a duration of 4.1.

Our cash position was $132 million, and our total assets were $854 million at June 30. Overall, we had another excellent quarter, one we're very proud of.

With that, Bruce and I are now available to take your questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And our first question comes from John Barnidge from Sandler O'Neill. Please go ahead.

John B. Barnidge
Sandler O'Neill & Partners LP

Q

Good morning, and thanks for having the call. I had a quick question. Now that we're in the later innings of the Citizens take-outs. How should we think about geographic expansion for the company, because that seems to be the next leg for growth?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

John, this is Bruce. I don't know that we are in the later innings of the take-outs of Citizens or not. All we can say is that lately the opt-out rates have been higher than normal. I don't know if that's a trend that's going to continue or not. We did not do a take-out in June, because we wanted to manage our reinsurance costs likewise we do not have one plan for August, again because we're just watching our true-up mechanism under our reinsurance program. We still think that there are good opportunities at Citizens. We are getting good production out of the take-out process. And we have been focused ongoing multi-state now for about a year.

We did our due diligence and filed in four states recently. That is something that we believe is more of a 2016 story by the time we get licensed and get our systems up and running in those new states. We are looking at filing in a few more additional states and we are looking at some M&A opportunities that are outside of Florida. We do think it'll be growing portion of our business especially as we progress into 2016.

John B. Barnidge
Sandler O'Neill & Partners LP

Q

And a follow-up to that and one other question, if I may. You mentioned M&A, how large a transaction could you – do you anticipate that you could currently handle with your current capital?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

I would say at the top-end current capital wise, we could do a transaction that is $125 million to $150 million-ish.

John B. Barnidge
Sandler O'Neill & Partners LP

Q

Okay.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

It'd be a rough ballpark estimate.

John B. Barnidge
Sandler O'Neill & Partners LP

Q

That's great. Thank you. And then your recent acquisition just further integrates you on the vertical integration that you guys have. Over time, how much savings do you think that could be on a loss ratio basis, I mean how much do you feel like you're paying out in profit to contractor versus the cost on an annual basis?

Stephen L. Rohde
Chief Financial Officer

A

John, this is Steve. Our CAN operations has been improving our loss ratio by about 1.5 points on our loss ratio. We anticipate that with the BRC acquisition that will push it above the 2% savings on our loss ratio. And if we can leverage BRC more, it'll obviously improve it more. And that's just on the savings side. We also have the opportunity to reduce, what we call the loss ratio creep that again the quicker the scope of loss, stays smaller. And the more penetration we can get, our people in quicker and avoiding the public adjusters and the lawyers and such reduces the overall size of severity. As an example, right now, when our people get in with CAN and water losses, the average loss is about $6,000 and when someone else comes in first, the average loss is about $12,000, so that's what savings in addition to the 0.5 points to maybe upto 2.5 points with integration of BRC.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, I think, and this is Bruce. I think that the addition of BRC is going to be meaningful. And, we're adding about 50 people to 60 people that are essentially in arm of our claims department, these individuals currently service Florida based Property & Casualty Insurance Company now. So, they really understand the business, they understand policy forms, they know the importance of getting out to the scene quickly. They're licensed bonded, they can do all aspects of the repair work, and we're sending millions of dollars a year through our Contractors' Alliance Network. And we're able to harvest all of those profits that we are currently sending out to third-parties, and additionally having another 50 people to 60 people in the field, helping us to work with policyholders at the time of loss to capture that work, should improve the penetration ratio that we're getting on our claims, which again will help to lower our gross loss ratio.

So, this is a home run for us on the AOP [All Other Perils] side, on the catastrophe side, this is a hedge that I really don't think anyone else in the business has, maybe People's Trust to a certain extent. But we're able to now dispatch our professionals out into the field immediately to do repair work et cetera that keeps the dollar in the door. It's a good hedge on our reinsurance retention, and it should help to control our catastrophe losses, which would be a positive message for our reinsurance pricing and our program going forward.

John B. Barnidge
Sandler O'Neill & Partners LP

Q

Great. Thank you very much.

Operator: The next question comes from Mark Hughes from SunTrust. Please, go ahead.

Matya Magnezi
SunTrust Robinson Humphrey, Inc.

Q

Hi, this is actually Matya on for Mark. You mentioned that you're not doing a take-out in July or August. Can you just discuss how the take-out prospects are shaping up for the fall?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Well, we actually are doing one in July. It's in process right now. The opt-out process is in its last two weeks. We had selected 18,000 policies in July and at this point, there's 8,000 policies remaining that have not yet opted-out. So we just have two weeks to go on that. And then we've done an approved for our September take-out for up to 40,000 policies and we've just gone through our selection process and that we do anticipate selecting close to 40,000 policies. But again, we don't – opt-out rate is going to be on those.

Matya Magnezi
SunTrust Robinson Humphrey, Inc.

Q

Right. Okay.

Stephen L. Rohde
Chief Financial Officer

A

And the part of the reason that we're not really sure what the opt-out rate is going to be going forward is, we've done smaller scale take-outs with smaller population sizes. And so we don't know that's just a reflection of the policies that we happen to take or if it's more in endemic of higher opt-out rates into the future.

Matya Magnezi
SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you. And then could you just give a little more detail on competition in commercial?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah. So commercial residential line, just like the personal line side, I mean the rates have been a little soft here in Florida. What we have really seen more than anything are the excess and surplus line carriers coming into the state and trying to take really high TIV policies. Now, we had some of that business from our Citizens assumption. I don't think we have a lot of that business now, which is fine with us and there is a lot of additional reinsurance costs that are associated with those policies, but the E&S carriers came in and were looking for large premiums, large TIV, because their spread of risk throughout the U.S. is radically different than ours, which is more Florida centric.

So, they were able to take some of the large TIV structures at a lower premium than we were willing to go to. So we had to make a decision. Do we want to keep that business, really at a combined ratio that did not make sense to us, or do we want to let that business go therefore we don't have to buy the reinsurance on it, and focus really more on the core aspects of the commercial residential program, which are incredibly profitable for us. So E&S really is working on the higher TIV policies is what we've noticed. And I think that's been the lion's share of the premium that we let go in that division.

Stephen L. Rohde
Chief Financial Officer

A

To add some to that. The policies that came up for renewal, that we did not renew, had an average premium of about $70,000 and the one that we did renew, had an average premium of about $32,000.

And then I mentioned, we had some mid-term cancellations, and this again with policies that were taken by E&S carriers mid-term. And those were the really large ones that having an average premium of $173,000. So we're going back. What's remaining is kind of the – our bread and butter would have been and what is more in line with what our voluntary policies are.

Matya Magnezi
SunTrust Robinson Humphrey, Inc.

Q

Got it. Okay. Well, thank you. Thanks for taking my questions.

Operator: Our next question comes from Matt Carletti from JMP Securities. Please go ahead.

Matt J. Carletti
JMP Securities LLC

Q

Hey good morning. Just wanted to ask a question following-up on some of the discussions about your in-house claims litigation – I'm sorry, claims management, and just given in late July, I believe there is a lot of rain, particularly you're guys as part of Florida. And I just curious, what you guys have seen, has there been an uptick in claims and if so, have you been able to address that mostly with your in-house claim adjusters and how do you feel about the result there?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yes. Our loss ratio has ticked up a bit. I really saw a little bit in June, as well as in July weather related, still a lot of water claims as well as water roof losses. And our penetration, about 35% of our claims are being handled by our in-house people. We would like that to be higher, it's still a challenge down in South Florida and if you get the penetration because of the culture, the PAs and the lawyers and so forth, but again our loss ratio is not gotten out of hand, it's just spiked up a bit.

Matt J. Carletti
JMP Securities LLC

Q

Yeah. I actually cover...?

Stephen L. Rohde
Chief Financial Officer

A

Yes, we always see that in the summer months. It's the same every single year. It's May, June, and July are the wettest months in Florida. So, you always see an uptick in loss ratios for those three months that's because it's the rainy season down here. We also get a lot of claims that are reported and that are flood related, which we don't cover. And so, you have to kind of sort through those claims as well and make sure that while total claims coming in maybe higher in those three months, a lot of those claims won't be covered simply because we don't cover the flood payroll.

Matt J. Carletti
JMP Securities LLC
Q

Okay. So would you say that seasonally adjusted or say, looking year-over-year as opposed to sequentially, it's maybe more normal?

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Yeah, I think so, and probably a couple of points higher than what we had earlier in the year.

Matt J. Carletti
JMP Securities LLC
Q

Okay. Thanks.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Again, it's not significantly higher.

Matt J. Carletti
JMP Securities LLC
Q

Okay, well. Thank you for the color and best of luck.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Thank you.

Stephen L. Rohde
Chief Financial Officer
A

Thanks.

Operator: Our next question comes from Arash Soleimani from KBW. Please go ahead.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Thanks. Good morning.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Good morning.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Had a couple of questions. I just wanted to confirm. So in-force premiums this quarter were $510 million, so it looks like they declined sequentially from last quarter, is that correct?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yes, last quarter we had.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

[ph] looks like 1Q (28:06).

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, into 1Q we were at $533 million, now we're at $510 million and the drop was all in commercial, personal lines is basically the same at $423 million.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

So the – and that drop was in commercial, was that all within the assumed commercial book?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yes, the voluntary actually increased by $7 million, so sales were again strong in the second quarter for commercial voluntary. Personal voluntary is sold – we started in fourth quarter of 2014, it was $6 million, first quarter was $6 million and then the second quarter was $7 million. So it's continued strong pace but it was all in the exposure management took place in the commercial take-out business, again due to the softening in the prices and that's just not willing to go down to meet the prices that the E&S carriers are offering.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. And I guess the other question is in terms of your shelf registration, is there anything to read into that in terms of needing capital for growth in two of the other states, I mean it seemed like you mentioned you could do something over a $100 million in terms of M&A without raising capital. So, I just wanted to just get a sense of how necessary the capital raise would actually be to fund your growth?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah. I think that's a great question. This is Bruce. And I've already had several enquiries this morning about it. And I think there's a – maybe some perception out there, that we're about to do an equity offering. Let me just tell you, that is not the case.

The shelf registration filing is just a corporate housekeeping filing that we put in place. We have no intention of raising any securities, pursuant to that registration statement anytime soon. We do not need to raise equity at this point in time, that's just something that we had to get in place, following our one-year IPO anniversary. So, I really wouldn't read anything into that at this point in time. It's just cleaning up some general housekeeping that we have to do, getting that registration in place.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

All right. Should we still think of commercial residential is becoming a growing part of your overall premiums, or is that something that is unlikely in the near-term, because of some of the Citizens' challenges, or what's the right way to think of the mix of business?

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

It's still growing every month, in fact, it's internally outpacing our models. And we're doing pretty well on the voluntary side and we're doing over roughly $2 million a month in new business. And we've been a little conservative on the underwriting front, up until recently, because we really wanted to watch the reinsurance costs going into wind season. It's still a growing component of our company. We've got the – in my opinion, I'm pretty sure this is accurate. We've got the deepest commercial residential department in the state of Florida. So, we have the resources there, we've got the operating system built out, good relationship with the agents. We're getting great premium. The loss ratios there are just phenomenal. So, it's a growing part of the company and it will continue to be growing part of the company.

Stephen L. Rohde
Chief Financial Officer A

Yeah. It's about a 1,000 policies that have not yet come up for renewal on take-out policies. So there might be some continued pressure on that, but what's remaining has an average premium of $30,000. So again it wouldn't have the large towers that it was attractive to the E&S market. So we should see a better renewal rate on that. I did some calculating that, adjusting for the exposure management side of it, the renewal rate has been running about 75% on the pickup business, again we factored out some of these policies that we, we basically knew we're going to lose. Our model had anticipated about an 80% renewal rate. So again now the large policies are gone, I would anticipate, it would be close to that 80% renewal on the take-out business. And then as Bruce mentioned, we're adding close to $2 million a quarter on the voluntary side.

Arash Soleimani
Keefe, Bruyette & Woods, Inc. Q

Okay. So should we – should we – for the third quarter, does it look like in-force premiums, should we expect them to be up in the third quarter or could that be pressured again sequentially?

Stephen L. Rohde
Chief Financial Officer A

There aren't as many renewals in the take-out business in the third quarter for Citizens, but in July there, we did have some additional premium go off, so I would suggest, it'll be kind of flat. I don't think, it'll be up or down.

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

Yeah.

Arash Soleimani
Keefe, Bruyette & Woods, Inc. Q

Okay.

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

I think the big movement that we've had on the commercial residential took place really in the second quarter. And we had to make the call, on these huge TIV structures obviously, there are some risk on those, you have got to buy back alternative reinsurance, risk reinsurance and then regular excessive loss reinsurance fund, and you look at that risk profile and say, as long as you're making a certain profit margin, you're very comfortable with that line of business.

And some of the E&S growth were just simply too low for us, and we had to make the call, either we retain that business and buy the reinsurance on it, and going forward it's really not a great policy to have or we simply let that go and let the E&S players take it, and that's the decision we made. Most of those big towers are now through our portfolio. So we think that, that was kind of the big erosion event so to speak that took place. Going forward, it's more the garden style, commercial residential structures that we have. And that's like Steve mentioned earlier, that's our bread and butter.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

All right. Can you remind me, what was the in-force premium for commercial residential 1Q versus 2Q?

Stephen L. Rohde
Chief Financial Officer
A

Okay. 1Q was a $110 million and 2Q is $87.3 million.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay. And then, on the reinsurance side, so you said the $177 million, that includes the [ph] RPP (34:52) right?

Stephen L. Rohde
Chief Financial Officer
A

Yes, it does.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

It does, okay.

Stephen L. Rohde
Chief Financial Officer
A

It does.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

And you mentioned 34.7% as the ceded premium ratio, so is that something that – does that – do you guys also cede for federal flood?

Stephen L. Rohde
Chief Financial Officer
A

No.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

No.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

We don't offer any flood coverage whatsoever.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay, okay. So that 34.7% should be basically the run rate for this year. But if you guys are able to get some growth in, I mean, would it be fair to expect that 34.7% to decline over the next few quarters?

Stephen L. Rohde
Chief Financial Officer
A

Yes. That would be our desire certainly.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay. And just to make sure I'm clear, the retention, did you say the total retention is $35 million and how much of that is from Osprey, and how of that is from the Statutory subsidiary?

Stephen L. Rohde
Chief Financial Officer
A

Yeah. $15 million is from our Statutory Insurance subsidiary, and $20 million from Osprey, our captive.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

And was the decision to increase the overall retention from last year, was that – I guess what drove that decision? I mean, I know part of it is just that you're bigger, but was there anything else?

Stephen L. Rohde
Chief Financial Officer
A

That's the reason, our surplus now is $200 million, up substantially from where it was last year as well as our capital position at the holding company.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay. So that's just a function of the size is, so the 1 in 100 PML, would that be roughly then the $35 million?

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

No, $35 million was the total retention that we have on the program. When you look at both, HPCICs, primary retention, and then the lower level risk that is shared with Osprey, our captive reinsurer.

Stephen L. Rohde
Chief Financial Officer
A

We bought the $1.8 billion. In our 1 in 100. PML is about a little over $1.5 billion.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay, okay. Let me see if I have anything else that, okay, and what was that the GAAP loss ratio on commercial residential, split the calendar year GAAP?

Stephen L. Rohde
Chief Financial Officer
A

Counting IBNR would be about 3%, 4%.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

So that sounds much lower than, I guess what you guys had anticipated in the past clearly.

Stephen L. Rohde
Chief Financial Officer
A

Yes.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

I thought before the thought was that it would be in the 10% range, so is that?

Stephen L. Rohde
Chief Financial Officer
A

Yeah. It's performing extremely well. Our reported loss ratio was just between – in less than 1% and very few claims reported, nothing was any large severity. So it's performing much better than anticipated.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Yeah. It's a great book of business.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

So it's – sorry?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

And that's why we want to make sure that we're protecting the really good policies and some of these higher risk ones, larger TIVs where the premium isn't there. We just don't want an appetite for that when there is plenty of business out there that meets the current underwriting criteria that we have in place now.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. So is that – is 3%, I mean the right run rate to think about on a – again, a calendar year GAAP loss ratio with IBNR is that?

Stephen L. Rohde
Chief Financial Officer

A

It maybe a little low, but I think 5% to 6% is not unreasonable.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. And did the loss ratios, is there a change once the policies renew, I mean, is there a change in coverage once the Citizens' policies renew in terms of having to provide more cover, that could impact that loss ratio?

Stephen L. Rohde
Chief Financial Officer

A

Nothing significant. No.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. And is 30% still kind of the right run rate for the personal residential policies?

Stephen L. Rohde
Chief Financial Officer

A

Yes.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. And from the recent acquisition, do you guys have any amortization or anything that's going to hit the expense ratio?

Stephen L. Rohde
Chief Financial Officer

A

No.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

No. Okay.

Stephen L. Rohde
Chief Financial Officer
A

It'll go to goodwill and it'll – and the earnings will support the goodwill that we look toward this acquisition.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay. All right. Thank you very much for the answers.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Thank you.

Operator: Our next question comes from Casey Alexander from Gilford Securities. Please go ahead.

Casey J. Alexander
Gilford Securities, Inc.
Q

Hi, good morning. Thank you for taking my questions.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Good morning.

Casey J. Alexander
Gilford Securities, Inc.
Q

Do you intend to put out an 8-K on the reinsurance program because sometimes I read better than I hear?

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

I don't think so.

Stephen L. Rohde
Chief Financial Officer
A

Yeah. We weren't planning on and it's normal course of business.

Casey J. Alexander
Gilford Securities, Inc.
Q

Okay. The reinsurance program, I don't think, did you say exactly what based upon the approved OIR models. You're reinsurance program is good for one in how many years storm?

Stephen L. Rohde
Chief Financial Officer
A

Approximately 115.

Casey J. Alexander
Gilford Securities, Inc.

Q

One in 115. All right. And then if I...

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

And Casey, that really also depends on which OIR approved model you look at, right. The result is probably lower if you look at RMS, and if you use Florida Public Model, god it could be massively higher than that. It just – you have to ask what model are you using, because the models are vastly different from one other.

Stephen L. Rohde
Chief Financial Officer

A

We use the AIR model for dollar modeling and pricing work.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah. And I think a lot of companies that report they – why you see such a high return period. Let's just say they had a 200 plus year return period. They're using the Florida Public Model as a standard for putting that information out there, but when they actually buy the reinsurance, they're probably using AIR or RMS. And so the results are not even close to using the Florida Public Model.

Casey J. Alexander
Gilford Securities, Inc.

Q

Okay. And if I understood it correctly, we should be allocating about $44 million per quarter to ceded reinsurance premiums?

Stephen L. Rohde
Chief Financial Officer

A

And do the math that $177 million divided by 4, that sounds like $44 million.

Casey J. Alexander
Gilford Securities, Inc.

Q

Okay, that's I got it right. Okay, great, thanks. Thanks for taking my questions.

Stephen L. Rohde
Chief Financial Officer

A

Thanks, Casey.

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

Bruce Thomas Lucas
Chairman & Chief Executive Officer

I would like to thank, everyone, for their participation in our second quarter call.

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