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Heritage Insurance Holdings, Inc. (HRTG)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

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Bruce Thomas Lucas
Chairman & Chief Executive Officer

Steven Martindale
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Stephen L. Rohde
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OTHER PARTICIPANTS

Mark Douglas Hughes
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Arash Soleimani
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Matthew J. Carletti
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Michael D. Zaremski
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Heritage Insurance Holdings Second Quarter 2016 Financial Results Conference Call. My name is Andrew, and I will be the operator today. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. Please note this event is being recorded. [Operator Instructions] .

I would now like to turn the conference over to Melanie Skijus. Please go ahead.

Melanie Skijus
Director-Investor Relations, Heritage Insurance Holdings, Inc.

Good morning. The second quarter earnings release can be found in the Investors section of heritagepci.com. The earnings call will be archived and available for replay. Today's call may contain forward-looking statements. These statements which we undertake no obligation to update, represent our current judgment, and are subject to risk, assumptions and uncertainties. For a description of 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 and other fillings made with the SEC from time to time.

With us on the call today are Bruce Lucas, Chairman and CEO; Steve Martindale, Chief Financial Officer; and Steve Rohde, Former CFO and Current Financial Consultant to the company.

I'll now turn the call over to Bruce.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

Thank you, Melanie. I would like to welcome all of you to our second quarter 2016 earnings call. Before we begin a discussion of the quarterly results, I'd like to take a moment to thank all of our employees for their dedication and commitment to our company. We are growing the company while maintaining the highest levels of service and response to our policyholders and these achievements are made possible by the concerted effort of all of our employees.

I'm happy to report we saw a significant rebound in the second quarter as losses were lower and weather was more mild relative to the first quarter. Net income increased 147% compared to the first quarter and return on equity was 20.2% for the quarter. Our voluntary production in Florida and Hawaii has been stable and our production in North Carolina continues to expand. Importantly, production in our new states led by North Carolina currently accounts for roughly half of all new business written.

In North Carolina, our average insurance score is above 800. This insurance score is significantly better than the state average and reflects the attractive risk profile of the policies we are writing. Our North Carolina initiative is an important step in our diversified business plan, and we recently launched operations in South Carolina, which is our fourth state in which we write business. In addition, we have licenses in Georgia, Mississippi and Alabama. We are working on several new state applications and we plan to continue our growth outside of Florida.

With respect to our acquisition of Zephyr Insurance, the transition to-date has been seamless and we continue to be impressed by the management team in Hawaii. Tropical storm Darby was a relatively benign storm and Zephyr did not incur any losses. As a reminder, Zephyr does not have any exposure to named storms unless there is a hurricane watch or warning in place at the time of the loss.

I would like to provide a few highlights from the second quarter of 2016. Gross premiums written increased 31% year-over-year to $177 million. Gross premiums earned increased 29% year-over-year to $164 million. Policy count increased 49% year-over-year to 331,000 policies. Net income was $18.4 million, a 147% increase compared to the first quarter of 2016. We repurchased 527,989 shares of common stock for a total of $6.9 million in the second quarter. Business in North Carolina continue to ramp up with over 2,300 policies and roughly $2.8 million in premium written through June 30.

During the quarter, we placed our 2016-2017 reinsurance program and have roughly $3 billion in catastrophe reinsurance protection. This level of reinsurance reflects the company's conservative approach to risk management and our focus on protecting both our policyholders and stockholders against the peril of a hurricane.

We continue to look at the best avenues for shareholder returns. We don't believe our current share price is reflective of the company's value, ROE and business prospects as evidenced by the substantial purchases made by our officers and directors, including myself, during the second quarter. We believe in the future of the company. We are heavily invested in that future, and we will balance return of capital through share repurchases and dividends with opportunities we see on the horizon for growth and strategic expansion.

We will also continue to evaluate attractive M&A and opportunities to form key partnerships, which we believe will strengthen our company for years to come. I will now turn the call over to Steve Martindale, our CFO to provide more detail on our financials.

Steven Martindale

Chief Financial Officer

Thank you, Bruce and good morning.

Gross premiums written for the second quarter were $177.3 million, an increase of 31% year-over-year. Approximately 10% of the gross written premiums for the quarter were outside of Florida, with 8% from Hawaii, and 2% from North Carolina.

Related to our assumed business, takeout activity from Citizens was minimal for the quarter, with less than 2,000 policies assumed. The written premium associated with these assumptions was more than offset by late opt-out activity from prior quarters.

Our total policy count at June 30, 2016 was approximately 331,000. The total Heritage personal lines policy count was approximately 253,000. Heritage voluntary personal lines policies increased by 4,550 during the quarter, largely due to our expansion into North Carolina. The Zephyr acquisition added approximately 74,300 personal lines policies, bringing us to a consolidated personal lines policy count of approximately 327,500. In addition, our commercial lines policy count was approximately 3,600 at June 30, 2016.

Our total premiums in-force at June 30, 2016 were $660 million, an increase of approximately 29% from one year ago, and an increase of almost 12% from the end of 2015. Commercial residential premiums in-force were approximately $125 million. Gross premiums earned were $164 million for the second quarter of 2016 compared to $127 million for the second quarter of 2015.

Our ceded premium ratio was 33.5% for the second quarter of 2016 compared to 25.4% for the second quarter of 2015. The increase in ceded premium ratio was largely attributable to the significant reduction in premiums assumed during the fourth quarter of 2015 and the first quarter of 2016 of $72 million compared to $215 million assumed during the fourth quarter of 2014 and the first quarter of 2015.

On June 1, we renewed our catastrophe reinsurance program. We purchased approximately $3 billion of reinsurance coverage compared to approximately $2.2 billion of coverage in 2015. This used program provides for $1.9 billion of first event protection in Florida, a $1.1 billion first event coverage in Hawaii. The increase in coverage was necessary in light of our significant growth, including commercial residential and wind-only business in Florida, and the acquisitions of Zephyr.

The total cost of the 2016 program was $240 million compared to $177 million for the 2015 program. The cost of the annual reinsurance program is amortized over the 12 months beginning June 1. Accordingly, the ceded premiums or reinsurance costs are significantly higher for the month of June versus the first two months of the second quarter and the first quarter of 2016. We expect the ceded premium ratio to be in the 37% to 39% range for the rest of the year, depending on takeout activity in the fourth quarter. Comparatively, the ceded premium ratio on the 2015 and 2016 reinsurance program was approximately 35%.

Our loss ratio as measured against gross premiums earned was 29.8% for the second quarter of 2016 compared to 26.7% for the second quarter of 2015. As we reported on our first quarter earnings call, our loss ratio for the first quarter of 2016 was 44.1%. The first quarter loss ratio was impacted by severe weather activity and over $14 million of adverse development on prior-year reserves, particularly 2015. We indicated that it will be reasonable to expect our gross loss ratio to be in the 29% to 32% range for the remainder of the year, considering the elevated loss ratio we had been experiencing in personal lines, primarily driven by the increase in water claims associated with the assignment of benefits issue, offset somewhat by the increase in commercial residential business, which has a much lower loss ratio, and the wind-only business of Zephyr.

It appears that the reserve strengthening we did at March 31 was in line with what was needed, at least as measured at June 30. During the quarter, we had approximately $200,000 of favorable prior-year development.

Quarter one losses had unfavorable development of approximately $800,000, despite the strengthening of the loss development factors last quarter. The weather-related claims activity that occurred during the second quarter was in line with the expectations. Water-related claims activity, particularly in the Tri-County improved when compared to the first quarter, but remained elevated when compared to a year ago.

IBNR represented approximately 60% of our total loss reserves at June 30. And the change in IBNR accounted for 3.2 points of the loss ratio for the quarter compared to 4.1 points for the second quarter of 2015. Our expense ratio as a percentage of gross premiums earned was 22.4% for the second quarter of 2016 compared to 19% for the second quarter of 2015. The year-over-year increase in our expense ratio is primarily related to the larger benefit realized a year ago from assumed earned premiums from Citizens takeouts, where there are no acquisition expenses associated with the premium. The benefit to the second quarter of 2015 was 3.3 points compared to 1.9 points in the second quarter of 2016.

Our combined ratio as a percentage of gross premiums earned was 85.7% for the second quarter of 2016 compared to 71.1% for the second quarter of 2015. The larger takeouts from the first quarter of 2015 and the fourth quarter of 2014 resulting in the lower ceded premium and expense ratios in 2015 was the primary reason for the significant difference in the combined ratios. The elevated personal lines loss ratio in the second quarter of 2016 also contributed to the higher combined ratio.

With the new reinsurance program and assuming no hurricanes this year, we believe that our combined ratio in the range of 90% to 92% is a reasonable expectation for the third and fourth quarters.

Net income for the second quarter of 2016 was $18.4 million compared to $25.4 million for the second quarter of 2015. Zephyr contributed approximately $3.2 million to our consolidated net income in the second quarter of 2016.

On the balance sheet side, stockholders' equity increased to $372 million, an increase of approximately $16 million from December 31. During the quarter, the company repurchased $7 million of its common stock for a year-to-date total of $16.6 million, resulting in approximately 1.1 million shares repurchased so far this year. Statutory surplus in our two insurance subsidiaries at June 30 were approximately $209 million and $75 million for Heritage and Zephyr, respectively.

Our invested assets at June 30 were $550 million, an increase of approximately $150 million from December 31, with about half of the increase attributable to the inclusion of Zephyr's invested assets into our consolidated balance sheet.

Our cash position at June 30 was $143 million. Most of the cash was in our two insurance subsidiaries, where we were holding larger balances for reinsurance deposits that were due in July. Our total assets were $1.1 billion at June 30.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Mark Hughes of SunTrust. Please go ahead.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

Thank you. Good morning.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Good morning, Mark.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

Do you think the assignment of benefits issue has stabilized here? You had mentioned that water-related losses in the Tri-County were better in 2Q. Was that a weather issue or do you think the AOB has kind of hit its plateau for now?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

It's impossible to predict the future. So I'll caveat it that way. But we have seen a reduction in water loss claims. The water loss claims are not weather-related, those are mainly burst pipes. And we've also seen a leveling off of litigation from attorneys that represent, in particular, assignments of benefit contractors. So quarter-over-quarter, we have not seen an escalation in the number of lawsuits filed. And that appears to be plateauing. I think others in the industry have seen that as well. And in terms of the water loss ratio, we are doing a little bit better quarter-over-quarter and there is a lot of premium in Tri-County, so a 2% improvement is pretty significant.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

Right. Can you give us a sort of lay of land in terms of takeouts now? And maybe I'll put it in the broader context, when we think about the growth trajectory for Heritage, given the voluntary production, given the takeout opportunities, what should Heritage be doing at the top line over the next year or two?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, so in terms of takeout activity, we think takeouts are going to be minimal for the remainder of this year. We like the quality of the book that we have right now. We are credit scoring our voluntary policies. That has been very effective in terms of underwriting new risk. We are focused on expanding our footprint outside of Florida. That is the main driver of our growth. We're also going to look at some M&A opportunities as well. But we've been saying for a while that Citizens is slowing down, and I think that that's probably the prudent way to go, given that, the vast majority of their policies right now are in the Tri-County area. We do not have an increased appetite in the Tri-County for personal lines. We'd rather go in and take that TIV that's available there and write it in commercial lines.

We think that's a much better play. Our loss ratios there are very modest at around 5%. And although reinsurance costs are much higher, we simply do not have assignment of benefits problems in that book of business and that is a huge diversifier and hedge that we have in place.

I think you wanted to know kind of our thoughts on what it will look like next year. We're not really in a position to give forward guidance a year out on where our voluntary growth is going to be, simply because we're ramping up in new states and we have some new initiatives that are in process and it's just too early to predict what that will be. But I do think for now, we're essentially a flat company in terms of top line growth, but we're getting better risk profiles, improving loss ratios, and getting more reinsurance synergy. So the bottom line should benefit from our business plan.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

Thank you. And then I think that covered it. From an expense ratio standpoint, it's not as much benefit from the takeouts. Should you get any leverage there or are we in a kind of a similar kind of a steady holding pattern on the expense ratio?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah. I mean the big driver on why expense ratio was up a little bit and it wasn't up a ton, it was maybe 10% or so, is simply a reflection of the fact that in 2014, we had a huge commercial residential takeout and a very big personal line takeout and so that took the expense ratios year-over-year, say, second quarter 2015 and dropped them down. As we said, going back to the time of our IPO road show, the commercial residential opportunity in terms of Citizens was essentially a one-time opportunity. We got pretty much, I don't know, 95% of the good policies there. So, it was a one-time pop at the end of 2014 and beginning of 2015. That's why you saw the expense ratio a little bit lower a year ago. I think that in terms of G&A, we are probably going to be fairly flat from where we are now. I think that's a good gauge.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

And flat on an absolute basis or ratio wise?

Stephen L. Rohde
Consultant, Heritage Insurance Holdings, Inc.

A

Yeah. This is Steve Rohde. I would say that going forward if you take out the benefit of the takeouts that our expense ratios running in the 23.5% to 24% range is what we should be considering.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

Great, thank you.

Operator: The next comes from the Arash Soleimani of KBW. Please go ahead.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Thanks and good morning. Can you just quickly talk about in terms of AOB, have you exhausted Citizens policy language [indiscernible] (20:22) new policy language?

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

That's a good question, Arash. We did submit some revisions to the Citizens policy language that have been approved by the OIR. So that adoption of that endorsement is in place now, and so we just have to put it on the book of business. But we thought like there was some language that really needed to be tightened up there and we worked with OIR for a long time on that language to find a good solution to some potential issues that we saw and I'm happy to report that that approval was secured this week.

Arash Soleimani
Keefe, Bruyette & Woods, Inc. Q

Okay, great. And is that language similar to what we saw at Citizens writing based that it's something in the neighborhood of 3,000 for emergency repairs and then more major repairs must be inspected by the insurers, is it along those lines or did you guys do something little bit different?

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

The language is essentially identical to the Citizens policy endorsement, so all the caps on coverage et cetera are identical. Our big thing was we believe the policyholder should have an obligation to allow us to inspect the property post loss. And what the lawyers do, they advise their client to report the claim and then they never want to let the insurance carrier in to even adjust the loss. That's their MO. They want a situation where the claim is reported, they demo, they rebuild, they send us a bill. We never even get a chance to look at it. That violates the terms and conditions of our policy and it results into non-coverage.

You have to give us an opportunity to look at it and this is an issue that Citizens has been talking about as well. So we strengthened language around policyholder obligations, our duties in terms of letting us into the property to actually adjust the loss. And I think that is just a favorable step that will help to curb some of the abuses that we're seeing from assignment of benefit contractors [indiscernible] (22:31).

Arash Soleimani
Keefe, Bruyette & Woods, Inc. Q

So basically if repairs are made and you are not there to adjust that first, you can be pretty confident that you're not going to be on the hook in that scenario?

Bruce Thomas Lucas
Chairman & Chief Executive Officer A

The language as written provides that if they unreasonably withhold access to the property, that the caps are in place.

Arash Soleimani
Keefe, Bruyette & Woods, Inc. Q

Okay.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

And we think that's fair. I mean we've had multiple examples. I can give hundreds of them where we actually – we always send an adjuster out to the loss, no matter what, and we have no problem knocking on the door and saying, let us in to take a look. And it's shocking when you see the homeowner home and a contractor in there doing repairs and the homeowner says, we are not going to let Heritage in, because advice of counsel is not to let the insurance carrier into adjust the loss, that's shocking. So taking a little hard line against that, because we think that is wrong, it violates the policy terms and conditions. And if they have a loss, we have to be able to adjust it before we pay out. Otherwise, we have no idea if there was even a loss that occurred.

So and we look at it too from the consumer side, Arash; what happens to the poor consumer when they sign away all their rights, they don't know what's going on, they are told what to do, and it results in a denied claim. They then owe tens of thousands of dollars potentially to an AOB contractor, who had no right to do what they did and they don't even have coverage in place. That consumer is the one that actually pays the price. And we're trying to do what we can to protect the consumer as well. These are our policyholders, and we hate to see them being taken advantage by scrupulous contractors and trial attorneys.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Right, right. And thanks for [indiscernible] (24:32). And so the next question, I think there was an article in one of the Florida papers, just on one of the recent rate increases, I think you were filing for. Just wanted to see – maybe it was the 14.9% increase, if I remember correctly. Is that something that you, I guess, are refiling, or is that delayed at this point, just wanted to know how to think about that in terms of the rate environment for your book over the next few quarters?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Sure. And that's a great question. First, I'd like to thank the Florida office of insurance regulation for working with us on that filing. We did have a filing in place at 14.9%. And then we have given the OIR numerous proposals, variations of that filing that our designed to curb AOB abuses and reduce rate increases on policyholders. So we've given them several things to consider, a lot of things to work through. We're trying to be innovative and find a cure for the disease instead of simply treating it by rate increases on innocent policyholders, who had nothing to do with the fraud. That's our goal here. We want to keep our rates as low as possible, but there is no doubt that there is a small percentage of policyholders who are engaged in this fraud and they are driving up rates for everyone.

So we have some proposals pending with the Office of Insurance Regulation that we believe will go a long way to curbing the source of the fraud and stop it from happening. And in exchange, we can give some rate cuts to our policyholders. They have been great and looking at every proposed solution. We're all working hand in hand to try to find a fix to the problem.

So it's too early to comment. But yes, we are working with OIR, pretty much every week. And we'll have a resolution soon, I'm sure. But until then, I really don't want to comment publicly about private conversations that we're having with our regulators.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Okay. That's fair. I guess, just a question I have on the loss ratio side. With I guess – is it fair for us to think of those going forward the same way? I guess, you've guided to in the past, if the rate changes don't happen.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Well, I guess, that look at Arash, there will be a rate change of some magnitude here on the book of business. I'm not going to say what that will look like. I can tell you though, we have not had one person at the OIR tell us that we are not entitled to a pretty significant rate increase. That conversation has never taken place.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Right.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

So rather than raising rate though, if we can find a solution that actually stops the fraud from happening, and all that does is punish the fraudulent and protect the innocent. And in exchange for that, curb of abuse, we could have a much lower or potentially no rate increase. That is the best solution, because the innocent are being protected. And I have every faith in Commissioner Altmaier and the OIR that they are going to side in favor of innocent consumers and work with us to fix this problem.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.
Q

Okay. Thanks for that. And last question, where are you setting initial loss fix now versus a year ago?

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

I think we're in the same place we were a year ago. We reserve to roughly the mid-point of the actuarial range.

Stephen L. Rohde
Consultant, Heritage Insurance Holdings, Inc.
A

Yeah, this is Steve Rohde again. For the first quarter of 2016, the first half of 2016 – for personal lines, we said 39% ultimate loss ratio. Compared to a year ago, we would have been at 34% for the first half of 2015. So it has gone up because of assignment of benefits issue, largely again from the assignment of benefits issue, about 5 points than we were before.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

But we're reserving based on the development factors that we see in our loss triangles. We use an independent auditor that sets our reserves and so our methodology really isn't any different. It's just we had an increase in the first quarter, because we didn't like the uptick in litigated claims. Now, I'm glad that that has slowed. It's not as elevated as it was say fourth quarter and first quarter, but when we saw that increase in the litigated claim activity, we had a duty to increase reserves, and we took our lumps in the first quarter much like I think some other people in the market have done this quarter.

Arash Soleimani
Keefe, Bruyette & Woods, Inc.

Q

Right, okay. Thanks for all of the answers and congrats on this quarter.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Thank you.

Steven Martindale
Chief Financial Officer

A

Thank you.

Operator: The next question comes from Matt Carletti of JMP. Please go ahead.

Matthew J. Carletti
JMP Securities LLC

Q

Hey thanks, good morning.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Good morning.

Matthew J. Carletti
JMP Securities LLC

Q

Bruce, I just had a question on your new reinsurance program and I appreciate a lot of the quantitative color that you've provided. We've heard a lot of the earnings calls, a lot of the reinsurers talk about how in Florida, they've taken an approach to kind of inflate themselves from AOB of trying to be more selective in who they support. And so I was curious if you can give us any color on, was there any change and kind of the major change and kind of that your panel of reinsurers whether for the better or for the worse?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, we did have a big change in our panel and that was for the better. I mean, we had a panel of reinsurers on Zephyr's program that were essentially non-existent on Heritage's reinsurance program. So, having some of the combined layers, where we had multi-zonal coverage including our cap bond, it allowed us to significantly diversify our reinsurance panel. That was extremely synergistic for us. It was very beneficial for us. We were able to reduce concentrations with some of our old reinsurers and kind of diversify that the spread of coverage around much, much better. So we actually had a really positive change year-over-year from this year's treaty for last year's treaty.

Steven Martindale
Chief Financial Officer

A

I'd like to add that we have 20 new reinsurers on the program this year and it's about 38% of the capacity. So we diversified significantly.

Matthew J. Carletti
JMP Securities LLC
Q

Great, great. And then just one numbers question, I apologize. I think you mentioned this, I just didn't catch it. What were the assumed premiums in the quarter from takeouts?

Steven Martindale
Chief Financial Officer
A

They're essentially zero. I mean, we assumed about 2,000 policies, but late opt-outs offset that. So it was netting to essentially nothing.

Matthew J. Carletti
JMP Securities LLC
Q

Okay great. Thanks very much.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Yeah, and to kind of further on that point, when we were in the first half of the year, what we really focused on is managing the reinsurance treaty and our projected PML. So we are very careful as to what we are adding. We don't want to get over-concentrated in the Tri-County and that's the number one focus that we have right now. And we're going to take risk there. We luckily, by design, we have a great hedge in place with commercial residential. And that's really where we're going to pick up TIV in the Tri-County. We think that's a much better growth driver, because you simply don't have the AOB problems in that line of business that you have in personal lines.

Matthew J. Carletti
JMP Securities LLC
Q

Right, right, all right, great. Thanks for the color and congrats on a quarter where things seem to be headed in a little bit better direction.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Thank you.

Operator: The next question comes from Mike Zaremski of BAM Funds. Please go ahead.

Michael D. Zaremski
Balyasny Asset Management LP
Q

Hi, good morning, gentlemen.

Bruce Thomas Lucas
Chairman & Chief Executive Officer
A

Hi, Mike, how are you?

Michael D. Zaremski
Balyasny Asset Management LP
Q

Doing well, thank you. Couple of questions. First, regarding the catastrophe load, in the past you set a model in the catastrophe load by taking the full retention and roughly dividing it by three, because that's the probability of the large cat in any given year. Can you update us on that math, given the evolving footprint in the new reinsurance program? And I guess related to that, can you clarify a figure, your loss and combined ratio guidance from the prepared remarks includes that cat load?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, so I mean our retention on a first event is – in Florida is $40 million. So I guess that would be the top line number that you take divided by three, so roughly $13 million or so a year on pre-tax. And our numbers do not include cat loads that we report. We simply don't know when a catastrophe will happen, but I understand that analysts and a lot of investors impute some type of cat load in their forward projections.

Michael D. Zaremski
Balyasny Asset Management LP

Q

Okay, got it. That's helpful. Yeah, I think some analysts aren't including much of a cat load. And my next question is on the buyback authorization. Now, you guys used, I think, $7 million of the $60 million this past quarter. Can you elaborate on how you guys think about buyback versus, I guess, I know it's wind season right, now versus growth and your excess capital position and what not?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Sure. So in terms of kind of balancing it, we always look at what is going to drive our ROE higher, is it a buyback? Is it a dividend that you give to shareholders? Is it playing in our own reinsurance tower with our retentions? We balance all of that, and then we look at things like M&A opportunities that are in the market and what does that do the ROE needle, and then we make a decision based on what generates the highest return. It's always been our focus.

So, in this past quarter, we looked at it and said, we're obviously better served in participating in our reinsurance tower, especially, on the first event base is down low, because it's the highest rate online. And over time, yes, you may have a cat year, where that level gets eroded. But the numbers don't lie. And over time, that is the single-highest ROE that you can deploy between the two.

With respect to share buybacks, I mean, we look at it and there are times when we've traded below book value, which, Mike, is an original IPO investor. To us, we think that is ludicrous. We're looking at this market, and we generally think about it in terms of, for P&Cs, if you're a book value P&C, you are basically assuming that there is no ROE at all in the company. That's certainly isn't the case. And when you trade at below book value, you're assuming that the entity is losing money on a year-over-year basis; that's definitely not the case. And so, we looked at where our share price is trading and we had no problem buying back stock at numbers that were essentially at book value, sometimes a little bit above it, sometimes a little bit below it, and I echo those sentiments.

In the quarter, officers and directors bought about $785,000 of stock and I bought almost $450,000 worth of shares personally. So I think our individual mentality mimics that of the corporate mentality. There are opportunities to repurchase stock with excess cash; at these valuations we're going to do it. We had to keep some money aside, because we're getting for our reinsurance retention in Osprey because we're getting a much higher

ROE there. But now that that's placed and we have excess capital at the holding company, it's something that we're certainly going to take a hard look at again.

Michael D. Zaremski
Balyasny Asset Management LP **Q**

And what's the excess capital level at the holding company, if you could say?

Bruce Thomas Lucas
Chairman & Chief Executive Officer **A**

Yes, between $5 million and $10 million immediately. Yes. And then every month, we have accretive earnings that come into the MGA.

Michael D. Zaremski
Balyasny Asset Management LP **Q**

Okay, got it. And lastly, did you guys mention the – any reserve movements this quarter during the prepared remarks? I may have missed that.

Bruce Thomas Lucas
Chairman & Chief Executive Officer **A**

I believe so.

Stephen L. Rohde
Consultant, Heritage Insurance Holdings, Inc. **A**

No. We just, we had a couple of million dollars of additional IBNR added. And it remained at 60% of our total loss reserves, IBNR did.

Michael D. Zaremski
Balyasny Asset Management LP **Q**

Okay, so a couple of million dollars of negative development. Is that how...

Bruce Thomas Lucas
Chairman & Chief Executive Officer **A**

No. The development was $600,000 overall. But we increased IBNR by $4.2 million during the quarter.

Stephen L. Rohde
Consultant, Heritage Insurance Holdings, Inc. **A**

And that was because of just increased loss reserve, so.

Bruce Thomas Lucas
Chairman & Chief Executive Officer **A**

Yes.

Michael D. Zaremski
Balyasny Asset Management LP **Q**

Okay. Thank you for the insights.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

All right. Thank you, Mike.

Operator: As there are no further questions, this concludes our question-and-answer session. I would like to turn the conference over to Bruce Lucas for any closing remarks.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

I'd like to thank everyone for joining our second quarter earnings call.

Operator: The conference has ended. You may disconnect your line.