Heritage Insurance Holdings, Inc. [HRTG]
Q1 2023 Earnings Conference Call
Friday, May 5, 2023, 9:00 AM ET

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

Analysts
Maxwell Fritscher, Truist Securities

Presentation

Operator: Good day, and welcome to the Heritage Insurance Holdings First Quarter 2023 Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Mr. Kirk Lusk. 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, and thank you all for joining us today.

I will provide some highlights of our first quarter performance, discuss our progress in achieving key objectives and offering insights into our strategic initiatives. Following my remarks, Kirk will provide details on key financial performance metrics, after which we will open the call for

Q&A.

I am pleased to report another consecutive quarter of solid financial results with net income for the first quarter of $14 million. The improvement from last year reflects the progress we are making with our strategic profitability initiatives as well as the benefit of favorable weather this quarter. As I described last quarter, our strategic profitability initiatives include rate adequacy, selective underwriting, capital allocation, providing the appropriate coverage for the market and a balanced and diversified portfolio. We believe that the combination of these initiatives will enable Heritage to achieve consistent, long-term quarterly earnings and shareholder value.

Our focus on rate adequacy has led to over 50 rate filings across products and states in 2021 and 2022 combined, with over 50 rate filings planned for 2023. These continued rating actions throughout our book resulted in achieving our highest in-force premium while decreasing policy count to the levels we had in 2018. We are also maintaining our underwriting discipline, including tightening underwriting criteria within regulatory guidelines and restricting new business for policies in overconcentrated markets for products.

We are allocating capital to products and geographies that maximize long-term recurrence. During the quarter, we selectively grew our commercial residential in-force premium by 69.6% over the prior year quarter while total insured value, or TIV, only increased 39.9% and policies in-force increased by only 11.8%. We reduced the policy count for our Florida personal lines product by 16.8% from Q1 2022 and 5.9% from the fourth quarter of 2022.

Reducing Florida personal line exposure remains a key focus and will continue until a positive impact of recent legislation to reduce abusive claim practices is realized. Our disciplined underwriting approach and focus on rate adequacy resulted in a policy count reduction of 5.2% in other states while generating an 8.8% increase in premiums in-force.

Efforts to maintain a balanced and diversified portfolio continued with no state representing more than 26% of the company's TIV despite the substantial increase in commercial business. The top four states within our portfolio grew TIV by an average of 3.7%, while the smallest five states grew by 38.8%.

As a result of the diversification efforts, the top five personal line states represented 71.5% of all TIV in the first quarter of 2023, compared to 73.3% of all TIV in the first quarter 2022. We will continue to seek profitable opportunities while maintaining a balanced portfolio.

We are working to finalize our 2023 catastrophe reinsurance program, and we'll announce it when it is completed. Last year, we deferred the Florida Reinsurance to Assist Policyholders program, also known as RAP, because our program was already fully placed. The RAP layer will provide reinsurance to flow to FHCF at no cost to the company. This year's catastrophe reinsurance program and costs will also include the remaining limit of $100 million from catastrophe bonds issued in 2022 by Citrus Re, which provides multiyear reinsurance protection. We anticipate complementing this year's traditional reinsurance placement with another ILS transaction.

Given the expected pricing and capacity for catastrophe reinsurance going forward, we will continue to evaluate and adjust our portfolio to manage exposure concentration and therefore manage the cost of reinsurance. This includes limiting the amount of new business we expect to write and the amount of existing business we may review while maintaining compliance with individual state regulations.

Our first quarter results underscore the effectiveness of our targeted strategies. We anticipate the rate increases and the underwriting changes made in 2022 and planned for 2023 will have a favorable impact on our financial position throughout the year. We are focused on achieving consistent long-term quarterly earnings and sustainable shareholder value.

We acknowledge the challenges posed by the litigated claims environment in the Florida market and continue to take the rating and underwriting actions that we believe will position the company well for the future. This could temporarily dampen our future growth in the Florida market. Efforts to shift personal lines business away from Florida have led to a 16.8% reduction in policy count as compared to the first quarter of last year.

Before turning the call over to Kirk, I want to reiterate my encouragement during last quarter's call related to Florida Senate Bill 2A passed during the December special session of the Florida legislature. I continue to be optimistic that this important legislation will accomplish the goals of the legislature, our Governor and the state CFO to stabilize the Florida property insurance market and curtail abusive claim practices. That being said, our strategy will remain unchanged until we see a meaningful and sustained favorable impact of the legislative changes on our results.

Let me now turn things over to Kirk for a review of the results in the quarter and key financial performance metrics.

Kirk Lusk: Thank you, Ernie. Good morning, everyone.

As Ernie mentioned, Heritage had its second consecutive positive quarter with $14 million of net income, or $0.55 per diluted share for the first quarter of 2023. This result reflects an improvement from the net loss of $30.8 million, or $1.15 per diluted share in the first quarter of 2022. The improved financial results can be attributed to favorable weather during Q1, favorable loss development and progress on profit initiatives.

Premiums in-force exceed $1.3 billion for this quarter, representing a 10.9% increase from the first quarter of 2022, driven by rate increases across the portfolio while policy count was down 9%. These actions resulted in average premium per policy increasing 21.9% while TIV increased only 2.8%.

In the first quarter of 2023, our gross premiums written increased 9.6% to $310.3 million, up from $283.2 million in the same period of 2022. Gross premiums earned increased to $317 million in Q1 of 2023, an increase of 10.3% compared to $287.4 million in Q1 of 2022. This growth in premiums can be attributed to our strategic efforts to selectively expand our commercial residential business, higher average premiums per policy throughout the book and the use of inflation guard.

Total revenues for the quarter of 2023 reached $176.9 million, an 11.5% increase, compared to $158.6 million in Q1 of 2022. In addition to higher net earned premiums, the growth reflects an increase in net investment income, which rose from $2 million in Q1 of 2022 to $5.6 million in Q1 of 2023. We also realized net investment gains of $1.9 million during the first quarter of 2023. The current yield curve has led us to invest proceeds from fixed income maturities and incoming premiums into short-term treasury bills and money market funds, resulting in higher yields and higher liquidity.

Our total cash plus invested assets expanded to $959.9 million as of Q1 of 2023, up from $934.5 million as of year-end 2022. We will continue to look for opportunities to [drive] business and to make investment and other decisions that improve the profitability of the company and drive shareholder value.

Losses and loss adjustment expense for the quarter were $97.5 million, down $42.6 million from the first quarter of 2022. Net current accident weather losses of $12.8 million were down substantially from $63.8 million in the prior year quarter. Current accident year weather losses include $5 million of net current accident quarter CAT losses, down from $45 million in the prior year quarter; and $7.8 million of other weather losses, down from $18.8 million in the prior year quarter. The net loss ratio was 58.7%, down 32.9 points from 91.6% in the first quarter of 2022. Excluding the impact of weather losses, the net loss ratio was down 2.2 points.

For the quarter, the net combined ratio was 94.5%, an improvement of 23.9 points from 129.5% in the first quarter of 2022. This reflects a lower net loss ratio just mentioned and a 2.1% improvement in the expense ratio, which decreased from 37.9% to 35.8%. We have made progress in our margins and expect to continue that progress until consistent quarter-over-quarter margins are achieved.

The book value per share rose to $6.05 as of March 31, 2023, signifying a notable improvement from the fourth quarter of '22 of $5.13. This increase was driven by net income generated in the first quarter of 2023 and a reduction of unrealized losses on our fixed income securities portfolio. With over $330 million in cash and cash equivalents, we don't anticipate a need to sell fixed income securities in advance of maturity.

The amount of cash held outside our investment portfolio and money market funds is now generally earning a return north of 4%. Our duration is short at 3.2 years, and the average credit rating on our investment fixed portfolio is A-plus. As such, we expect the unrealized losses to roll off as investments mature.

The Board of Directors will continue to assess our dividend and stock repurchase strategies on a quarterly basis to ensure alignment with the company's financial performance and market conditions. As such, the Board of Directors has decided to continue its temporary suspension of the quarterly dividend to shareholders. No shares of common stock were repurchased during the quarter.

Our first quarter 2023 results highlight management's continued focus on our strategic profitability initiatives. We operate in a constantly evolving business landscape and seek to capitalize on growth opportunities, effectively manage risk exposures and maintain cost discipline to continue to improve financial results. We remain committed to delivering long-term value to our shareholders and maintaining sustainable growth and profitability in the future.

Thank you. We will now open the line for questions.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions) And the first question will come from Maxwell Fritscher with Truist.

Maxwell Fritscher: I'm calling in for Mark Hughes. You mentioned the significantly lower weather losses this quarter. I was wondering if there's any underlying benefit from reform on this.

Ernie Garateix: No. At this point -- you're referring to the reform from the December special session?

Maxwell Fritscher: Yes.

Ernie Garateix: Yes. So as we said previously, that really is very early in the ballgame here on that piece of it. So we really haven't seen much of it, but we do expect that to flow through over the next six to 12 months and maybe a little bit further into that.

Maxwell Fritscher: Okay. Thank you. And what has the trajectory in lawsuits been like over the past several months?

Kirk Lusk: Yes. Fairly consistent with what we've seen. So, I mean, at this point, again, I know that the legislation passed. But I think we're still waiting to see the impact of that in the future.

Operator: (Operator Instructions) This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Ernie Garateix for any closing remarks. Please go ahead.

Ernie Garateix: Thank you, everyone, for joining our call today. And we hope everyone has a great weekend.

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