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# Heritage Insurance Holdings, Inc. (HRTG)

Q2 2021 Earnings Call

### **CORPORATE PARTICIPANTS**

**Arash Soleimani** 

Kirk Howard Lusk

Executive Vice President, Heritage Insurance Holdings, Inc.

Chief Financial Officer, Heritage Insurance Holdings, Inc.

**Ernesto Jose Garateix** 

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

### OTHER PARTICIPANTS

Marla Backer

Analyst, Sidoti & Co. LLC

**Mark Hughes** 

Analyst, Truist Securities, Inc.

**Paul Newsome** 

Analyst, Piper Sandler & Co.

### MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and welcome to Heritage Insurance Holdings Second Quarter 2021 Financial Results Conference Call. My name is Illy, 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.

I would now like to turn the conference over to Arash Soleimani, Executive Vice President at Heritage. Please go ahead.

#### Arash Soleimani

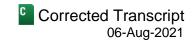
Executive Vice President, Heritage Insurance Holdings, Inc.

Good morning and thanks 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 a 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 on management's current expectations and are subject to uncertainties and changes in circumstances. In our earnings press release and in 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 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 fillings.

With us on the call today are Ernie Garateix, our Chief Executive Officer; and Kirk Lusk, our Chief Financial Officer. I will now turn the call over to Ernie.

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#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Thank you, Arash. Good morning, everyone. Thank you for joining us today. We have been very fortunate that COVID-19 continues to have virtually no impact on our business and much of that has to do with our employees. Productivity remains high, and we continue to provide our policyholders and distribution partners with the service they have come to expect from Heritage. I would like to thank all of our employees for their dedication.

At first glance, the second quarter's negative net income appears disappointing, but there's a brighter story underlying the quarter's results. Despite a \$9.4 million reinstatement premium in the quarter and a \$4.1 million uptick in weather losses relative to the first quarter of this year, net income improved sequentially, suggesting the benefits of our underwriting and pricing actions are starting to show. It's still early innings, but we're optimistic that we're on the path to improvement.

We're continuing to aggressively raise rates and taking underwriting actions to improve our profitability. As we previously communicated, our focus is firmly on bottom line results rather than top line growth. We demonstrated this in the second quarter as gross premiums written growth decelerated from the first quarter. Additionally, premiums in-force growth significantly outpaced policies in-force growth, which is indicative of our focus on rate adequacy.

We renewed our core excess-of-loss reinsurance program in the second quarter, and I believe we are solidly positioned for hurricane season. Relative to prior years' program, we've prepaid all reinstatement and eliminated co-participation above our retention. Overall, we have a solid program with fewer moving parts, which is a testament to our relationship with our valued reinsurance partners.

I will now turn the call over to Kirk to provide more details on our financials.

#### Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

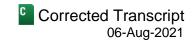
Thank you, Ernie. Good morning.

Despite the loss of the quarter, we are seeing favorable trends that we believe will lead to continued improvements and return to profitability. Gross premiums written for the quarter were \$337.7 million, up \$47.3 million or 16.3% from the prior-year quarter. Premiums in-force were \$1.17 billion and up 18% from June of 2020, while policies in-force were up 8.4% over the same timeframe. The premium increase outpacing the policy increase reflects the higher rates we are implementing throughout our book of business, which is consistent with our focus on margin expansion and adequate rates. We anticipate that we will continue to have substantial rate burning through the portfolio this year and into 2022.

The ceded premium ratio was 48.7% in the second quarter, up 2.1 points year-over-year. Second quarter seeded premiums were impacted by \$9.4 million of reinstatement premium associated with a severe convective storm reinsurance agreement. The reinstatement premium added 3.3 points to the ceded premium ratio and 6.3 points to the net combined ratio. The net loss ratio for the quarter was 68.8%, which is 7.7 points higher than the net loss ratio in the second quarter of 2020.

As previously disclosed, second quarter weather losses were \$35.5 million, which is approximately \$8.7 million higher than the second quarter of 2020. In addition, we had \$0.6 million of favorable prior-year reserve

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development in the second quarter of 2021, down from \$5 million last year. The combination of these two items impacted the net loss ratio by 6.5 points.

Our net expense ratio decreased by 2.5 points, reflecting our focus on expenses and reduction in executive compensation. The net expense ratio also [ph] bedded (00:05:51) by roughly 80 basis points from a \$1.2 million premium tax benefit. The net combined ratio for the first quarter of 2021 was 105.2 basis points, which is up from 100 basis points in the prior year period reflecting a higher net loss ratio partially offset by a lower net expense ratio. The \$9.4 million reinsurance reinstatement premium in the quarter, mentioned previously, was attributable to increasing the net combined ratio by 6.3 ratio points in the second quarter of 2021.

Although we are not pleased with the loss in the quarter, net income did improve from the first quarter of 2021 despite having a substantial reinstatement premium and higher weather losses which we think demonstrates the very early benefits of the rate increases earnings through the portfolio and the underwriting actions we are taking.

We're now available to take your questions.

### QUESTION AND ANSWER SECTION

**Operator**: We will now begin the question-and-answer session. [Operator Instructions] Our first question today comes from Marla Backer with Sidoti.

#### Marla Backer

Analyst, Sidoti & Co. LLC

Thank you. So obviously, realizing that the weather is an unknown and something over which you have little control, can you give us any sense in terms of timing around – we are starting to see some of the benefits of your proactive strategy and initiatives, but can you give us any sense around timing for when you expect to see a more meaningful benefit from some of the measures that you've undertaken?

#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Sure. So as we mentioned in the earnings call here, we're starting to see that rate come through. Those rates were taken in January of this year as well as April. So, from a renewal cycle, those started as early as March, but will take 12 to 18 months to cycle through our entire portfolio. So, as we mentioned, we're starting to see the early signs of it. The remaining rates should be taken and coming through the third and fourth quarter of this year and well into 2022.

#### Marla Backer

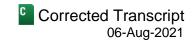
Analyst, Sidoti & Co. LLC

Okay. And then last question from me is we've seen you in the past eliminate certain policies that you considered perhaps the riskiest or and the riskiest regions and that your business was different, at that point, when you took those initiatives. But do you see yourselves potentially not renewing or eliminating other policies going forward?

#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

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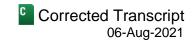
Well, what I would say is that's a continuous effort. We're always looking at the probability of each policy, each region and where we write. And again, given some of the rate adequacy, those policies will be analyzed to determine as based on reinsurance rates, based on lost trends, whether those policies will keep or those policies may be not renewed. But it is an ongoing effort and it is something that is a continuously taking it from an underwriting perspective that we do. We take a look as markets do change, so, we're constantly taking a look at that and making sure we have the most profitable policies on the books.

Marla Backer Analyst, Sidoti & Co. LLC	Q
Okay. Thank you.	
Ernesto Jose Garateix Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.	A
Thank you.	
Operator: Our next question comes from Mark Hughes with Truist.	
Mark Hughes Analyst, Truist Securities, Inc.	Q
Yeah. Thanks. Good morning.	
Ernesto Jose Garateix Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.	A
Good morning, Mark.	
Mark Hughes Analyst, Truist Securities, Inc.	Q
How are you looking at growth in the back half of the year? Where are you seeing police seemed attractive to you?	ies that at this point
Ernesto Jose Garateix Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.	A
So, as we look at the continued new business growth rate, we are cautiously optimistic as the rate comes true that those policies are rate adequate. That's not just in Florida, be southeast region, even into the northeast region as well. So, we have a lot of healthy new are ensuring that it is profitable growth as it comes through. So, we'll be a little more to ensure that we, again, as we mentioned earlier, have the most profitable policies on the mentioned that growth is great but not at the expense of the bottom line. So, there has the between that.	out throughout the ew business growth, but e selective in those areas the books. We've
Kirk Howard Lusk Chief Financial Officer, Heritage Insurance Holdings, Inc.	A
Yeah, yeah. I think we'd expect our gross written premium to continue to increase quart	er-over-quarter because of

the amount of growth we've experienced in the past. However, when you look at a gross written premium

standpoint, that growth is going to start slowing.

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#### Mark Hughes

Analyst, Truist Securities, Inc.

So, Ernie, do you see the pricing as adequate in most of your market at this point?

#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Yes, we're looking at that end. And because the market has been taking more rate, that is a very promising sign for us as we can continue growing in some of these markets, but we will not stop looking at the rate adequacy in these markets. And if there is a need to take more rate, we definitely will be doing that.

#### Mark Hughes

Analyst, Truist Securities, Inc.

Then what's your latest thinking about the SB76, new changes that have been put in place? How much progress are they really going to make in limiting losses in Florida?

**Ernesto Jose Garateix** 

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.



Yeah. So, I would say I'm very cautiously optimistic that that will help. But keep in mind that just went into effect July 1. So, we're very, very early in that. I'd like to see the proof after several months of SB76 being in place and see how that pans out, but I am cautiously optimistic that that could help down the road.

Mark Hughes

Analyst, Truist Securities, Inc.



And do you think that several months will be enough time to get a good look at it?

that are taking hold, but a several months should give us a better indication

**Ernesto Jose Garateix** 



Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Yeah. I would think, right at a few months into it, I would say, fourth quarter would give us a little bit better indication and feeling of how things are going and then well into - obviously, into the beginning of 2022 because that way - again, having been signed into effect July 1 and here we are in August, it's kind of tough to tell whether

#### Mark Hughes

Analyst, Truist Securities, Inc.



Are there any momentum building for any further either regulatory or legal changes in the state? I'll throw in also, what's the [ph] IRR's (00:12:34) view of further price increases? How much distress is there out there in the sector? What else might be coming to make things better?

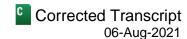
#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.



Well, I would say that there are some more things. I think, we would want some legislative assistance with, and then that we'll be going back to the table on that next legislative session on that piece of it. I do believe the [ph] IRR (00:13:02) has been very helpful with us in getting rate adequacy in the market. As far as distress out there in the market, I would say it's a very tough market. But I think those who are keeping to their underwriting standards, understanding rate adequacy are those that will get through the market and others unfortunately may not.

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Mark Hughes	
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Analyst, Truist Securities, Inc.

Thank you.

**Ernesto Jose Garateix** 

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

Thank you, Mark.

**Operator**: [Operator Instructions] Our next question comes from Paul Newsome with Piper Sandler.

#### **Paul Newsome**

Analyst, Piper Sandler & Co.

Maybe if you could talk a little bit more about the components of the rising inflation excluding catastrophe losses. And there's lot of talk about the issues in Florida with respect to liability. But it does seem like a lot of this is just like non-cat and weather and other issues that maybe just aren't related to that [indiscernible] (00:14:09).

#### Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

Yeah. So for example, in the second quarter, there was one very large PCS event, [ph] PCS 2120 or 2115 (00:14:20), which was very large and that impacted a number of carriers. It's a little bit different than the second quarter of last year where there was an impressive number of PCS events. This quarter was just like had the one large one and there was a couple of other, the smaller ones.

When you look at the claims inflation that we're seeing, some of it is COVID-related. When you look at the price of lumber, when you look at the price of building materials and some of the repair costs, that type of stuff, that has augmented these, the claims inflation. That is starting to subside.

As far as being able to build that into your rates because of how we look at the rates, we look at over a longer period of time, some of that will get itself in. But it'll take longer for some of that inflation, if it holds, to get into the rate activity. However, we are starting to see that subside. We think that probably claims are going to be, not go down to the level they were before, but we think that they are going to go below where they are right now.

#### **Paul Newsome**

Analyst, Piper Sandler & Co.

And that's the severity [indiscernible] (00:15:28) issue or is it also a frequency of loss issue? [indiscernible] (00:15:33) is in the not cat what I'm thinking. Just trying to get my arms around it, like what you call weather or non-weather stuff.

#### Kirk Howard Lusk

Chief Financial Officer, Heritage Insurance Holdings, Inc.

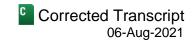
Yeah. It's more or less a severity issue than it is a frequency issue. I would say that frequency is up slightly, but not to the extent of severity.

#### **Paul Newsome**

Analyst, Piper Sandler & Co.



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Got it. Thank you.

**Operator:** This will conclude our question-and-answer session. I'd like to turn the call back over to Ernie Garateix for any closing remarks.

#### **Ernesto Jose Garateix**

Chief Executive Officer & Director, Heritage Insurance Holdings, Inc.

We'd like to thank everybody for their participation today and hope everybody has a great weekend. This concludes our call.

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

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