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Heritage Insurance Holdings, Inc. (HRTG)

Q1 2016 Earnings Call

CORPORATE PARTICIPANTS

Melanie Skijus
Director-Investor Relations

Stephen L. Rohde
Chief Financial Officer, Secretary & Treasurer

Bruce Thomas Lucas
Chairman & Chief Executive Officer

OTHER PARTICIPANTS

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Matthew J. Carletti
JMP Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Heritage Insurance Holdings First Quarter 2016 Financial Results Conference Call. My name is Laura, 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 Melanie Skijus. Please, go ahead.

Melanie Skijus
Director-Investor Relations

Good morning. The first 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 risks, 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 filings made with the SEC from time-to-time.

With us on the call today are Bruce Lucas, Chairman and CEO; and Steve Rohde, Chief Financial Officer.

I will 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 first 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. Heritage was once again named a Top Workplace in Tampa Bay in 2016, and that would not be possible without the collegiality and professionalism of our co-workers.

The first quarter was difficult, in that it had multiple tornado and extreme weather events that impacted our loss ratio. We also increased reserves to cover future development on claims and strengthen our balance sheet. Despite these headwinds, I am pleased to report that Heritage posted 7.4 million in net operating income.

I want to start with a few highlights from the first quarter of 2016. In force premium grew approximately 28% year-over-year from \$533 million to \$683 million, gross premiums written increased 10% year-over-year to \$147 million. Gross premiums earned increased 21% year-over-year to \$151 million. Policy count increased 51% year-over-year to 332,000.

Net income was \$7.4 million for the first quarter. We repurchased 612,300 shares of common stock for a total of \$9.6 million in the first quarter. The acquisition of Zephyr successfully closed on March 21, 2016, and business in North Carolina ramped up with approximately 200 agents appointed, and 548 policies written during the quarter.

With respect to voluntary production, we are already seeing strong results in North Carolina, where our partnership with National General Insurance is already producing approximately one-third of new business policies written per month.

Heritage is now licensed in seven states, and we are on pace for additional state roll-outs in 2016. Our commercial residential division wrote approximately \$16 million in new business in the first quarter. To-date, the loss ratio on this line of business has been less than 5%, and it further diversifies our spread of risk.

I am very pleased with our acquisition of Zephyr Insurance. The integration of the two companies has been seamless, and we are very happy with the retention ratios and increase in net income. Zephyr is truly non-correlated to the Florida market, and further diversifies our source and location of revenue. Zephyr is extremely important to our diversification and growth initiatives.

We are focused on delivering shareholder returns. To that end, we repurchased more than 600,000 shares of common stock in the first quarter. The Board of Directors has approved a \$50 million increase in the company's share repurchase authorization. When combined with our original repurchase authorization, we now have authority to purchase a total of \$60 million of common stock.

In addition, we approved a quarterly cash dividend of \$0.06 a share, a 20% increase over the prior quarter dividend, which will be payable on July 1.

I will now turn the call over to Steve to provide some more detail on our financials.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

Thank you, Bruce, and good morning. Gross premiums written for the first quarter were \$147.3 million, an increase of 10% year-over-year. This is made up of approximately \$138 million of direct premiums written and \$9 million of assumed premiums written.

Related to our assumed business, we participated in Citizen take-outs during January, February, and March, resulting in approximately 10,000 personal residential policies, and 100 commercial residential policies assumed. We netted approximately \$22 million of annualized premiums from these three assumptions, as compared to \$46 million from the first quarter of 2015. As a reminder, we only record the unearned premium as transferred from Citizens as assumed premiums written.

Our total Heritage personal lines policy count increased during the quarter to approximately 254,000 policies, an increase of approximately 10,000 from last quarter. Our voluntary personal lines policies increased by 3,800 during the quarter. In addition, the Zephyr acquisition added approximately 74,500 policies, bringing us to a consolidated personal lines policy count of approximately 328,500. In addition, our commercial lines policy count was approximately 3,600 at March 31.

Our total premiums in force at March 31, 2016 was \$683 million, an increase of almost 28% from the same quarter one year ago, and an improvement of almost 18% from the end of last quarter. Commercial residential premiums in force were approximately \$124 million, an increase of approximately \$11 million during the quarter. This level of in force premium resulted in \$152 million of gross premiums earned in the first quarter of 2016, compared to \$126 million for the first quarter of 2015. The Zephyr acquisition took place on March 21, so only 10 days of Zephyr's gross earned premium was included in our consolidated financial statements, which was approximately \$1.7 million. Going forward, we'd expect Zephyr's gross earned premium contribution for a full quarter to be in excess of \$15 million.

Our ceded premium ratio was 30% for the first quarter of 2016, compared to 19.5% for the first quarter of 2015. The increase in the ceded premium ratio was primarily attributable to a smaller amount of premiums assumed from Citizens during the quarter relative to the first quarter of 2015, \$22 million of assumed premiums versus \$46 million, as well as the significant reduction of previous comparable fourth quarter assumptions of \$169 million in the fourth quarter of 2014, to \$50 million in the fourth quarter of 2015.

Our loss ratio as measured against gross premiums earned was 44.1% for the first quarter of 2016, compared to 25.8% for the first quarter of 2015. The loss ratio was unfavorably impacted by severe weather activity, generated by several tornados during the quarter. These storms, including their associated IBNR impacted the first quarter loss ratio by 6.7 percentage points. Additionally, we had adverse development on prior year reserves, particularly from losses occurring in three previous quarters, the second, third, and fourth quarters of 2015.

The adverse development was largely related to losses, particularly water losses occurring in the Tri-County area that was represented by an attorney, public adjust or loss consultants, and from increased severity related to claims and litigation, particularly new lawsuits served during the first quarter. The actual development losses was approximately \$8.3 million higher, versus what was expected using the loss development factors that were used in the estimation of IBNR at December 31, 2015, which caused a 5.5 percentage point impact on the loss ratio for the quarter.

As a result of the adverse development, we increased our loss development factors again at March 31, resulting in an additional \$6.2 million of reserve strengthening. Reserve strengthening had a 4.1 percentage point impact on the loss ratio. The total impact from the adverse development, including the reserves strengthening had a 9.6 percentage point impact on loss ratio for the first quarter. At December 31, 2015, we estimated that the personal lines' ultimate loss and LAE ratio, which includes the associated IBNR would be 34.9% for the loss and accident year 2015.

As of March 31, we have revised our estimated personal lines ultimate loss ratio to be 38.2% for the loss or accident year 2015, based on the re-estimation of IBNR, which is a 3.3 percentage point increase.

The 38% loss ratio for the personal lines book of business is why we have filed for a 14.9% rate increase on our Citizens' business, with a particular focus on the Tri-County, and why we will be filing for an additional voluntary HO-3 rate increase soon, following the 4.4% increase, which became effective in February, again with the focus on the Tri-County.

We're also making updates to our forms language and taking certain underwriting actions. We believe these corrective actions will result in Florida personal lines combined ratio of 85% in 2017, excluding the potential impact of hurricanes.

On a consolidated basis, including commercial residential business with its lower loss ratio and the wind-only business of Zephyr, a 29% to 32% loss ratio is a reasonable expectation for the remainder of 2016, assuming no hurricanes.

IBNR represented approximately 60% of our total loss reserves at March 31, and accounted for 11.8 points of the loss ratio for the quarter, compared to 3.3 points for the first quarter of 2015. Our expense ratio as a percentage of gross premiums earned was 21.4% for the first quarter of 2016, compared to 19.3% for the first quarter of 2015. The year-over-year increase on our expense ratio was primarily related to larger impact from assumed earned premiums from Citizen take-outs, where there are no acquisition expenses associated with premium. This improved the Q1 expense ratios for 2016 and 2015 by approximately 2.3 points and 4.5 points, respectively.

Our combined ratio as a percentage of gross premiums earned was 95.5% for the first quarter of 2016, compared to 64.6% for the first quarter of 2015. The elevated loss ratio due to the severe weather activity and the adverse development caused an approximate 16.2 percentage point increase to the Q1 2016 combined ratio when compared to Q1 2015. The larger takeouts related to Q1 2015 resulted in an additional 12.7 point difference due to the lower ceded premium and expense ratios.

Net income for the first quarter of 2016 was \$7.4 million compared to \$30.1 million for the first quarter of 2015. The 10 days of ownership of Zephyr contributed approximately \$430,000 to our consolidated net income.

On the balance sheet side, stockholders' equity remained at \$356 million, virtually unchanged from December 31. The shares of common stock repurchased during the quarter of \$9.6 million offset net income and the improvement in other comprehensive income.

Statutory surplus in our two insurance company subsidiaries at March 31 were approximately \$211 million and \$71 million for Heritage and Zephyr respectively.

Estimated goodwill and intangible assets net of the deferred tax liability associated with the intangible assets increased by approximately \$53 million, as a result of the Zephyr acquisition, pending the independent valuation of the transaction.

Intangible assets will be amortized over approximately 10 years to 15 years. The actual split between intangible assets and goodwill, and the actual amortization of the intangibles will be finalized later in the year, when the independent valuation is completed. Our invested assets, at March 31, were \$481 million, an increase of approximately \$80 million from December 31, with most of the increase attributable to the inclusion of Zephyr's invested assets into our consolidated balance sheet.

Our cash position decreased to \$169 million following the close of our acquisition of Zephyr. Most of the cash was in our two insurance subsidiaries, holding balances for reinsurance deposits that were due in April. Our total assets were \$879 million at March 31.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And our first question will come from Mark Hughes of SunTrust.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Thank you. Good morning.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

Good morning.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Steve, you talked about a 29% to 32% loss ratio for the balance of 2016. Do you think you'll be there in the second quarter?

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

Yes. I think, in the second and third quarters, we're generally impacted more by weather than we are in the fourth quarter. So I think in the second quarter, I'd see us on the – sort of the higher end of that range, and then as we go through the year, moving down towards the lower end of the range. And then, you'll start seeing some of the benefits of our rate increases starting to occur in the fourth quarter, but really those rate increases will impact 2017 more than it will 2016.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Or do you think the model can support a lower loss ratio? I guess, it all depends on how the price increases, assuming they get approved in hold, should we just assume kind of 29% to 32% on a go-forward basis? And I'm thinking about 2017 and beyond.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

Yeah. I think with 2017, we get the full benefit of Zephyr, and commercial. I think we would expect our loss ratio to be below 30% in 2017, with personal lines probably running in the mid-30%, and then commercial being in that 5% to 6% range, and then Zephyr with – assuming no hurricanes, would be at a 0% loss ratio.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

The 85% combined ratio for 2017, was that personal line, specifically?

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

Yes.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Okay. And just thinking back on how this all developed the last three months since the fourth quarter report. When you look back, is it something you missed in your underwriting, or was it just a market tsunami, so to speak, that you didn't anticipate? There was obviously some discussion of these issues previously, and you've talked about them yourself. Can you walk us through what happened?

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Yeah. Essentially, Mark, this is Bruce. So I mean, obviously the first thing we had was a big shock loss. And we telegraph that to the market on the fourth quarter earnings call. At the time, we said it could get as high as 8 points, it came in at about 6.7 points. So we did a little bit better than what we estimated, but we still got to see how that tail develops.

The number one thing that drove adverse development was litigated claims, plain and simple. These are claims that came in either attorney-repped, or were in an active litigation. We had claims that settled. We paid the policyholder. It was a closed claim. And then they come back three months to six months later with an attorney, and they want more money. Those were the single biggest drivers of the adverse development. And that's something that you just can't predict.

If you look at \$8 million of adverse development that was primarily related to the last three quarters of 2015, so approximately, if you just want to average it by quarter, just taking a straight line approach, that's about \$2 million a quarter, on a book of business that's \$500 million, \$600 million. It's not that far-off, but when you add it up, and take it as – in one quarter, it has a big impact on your net operating income, and that's the big driver. It's lawyers primarily, reopened files especially. So that's – call that, the bulk of the \$8 million.

And then, as we look back and say, okay, well, if these attorney-represented claims are reopening and are coming back and they're having additional payouts on them, then we need to take a reserve adjustment now, use management's best estimate to cover that. And that resulted in \$6.2 million that we also decided just to go ahead and take this quarter. That way, hopefully, using our reserve methodology, we're okay now. And we expect loss ratios to be on a more normalized basis on a go-forward basis, but the vast majority of the adverse development are quite honestly and simply it's lawyers'.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Is there enough...

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Go ahead.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

I'm sorry. Is there enough experience at this point to say that it's stabilized or could the trend still be getting worse?

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

We think we've got a good handle on it, and we're going to watch it closely. What we've seen recently, call it the last specialty – last half of the year, with the reopens, et cetera, is that there's just a change in tactic in the Tri-County. And the lawyers are getting extremely aggressive down there. That's been the big change from my perspective.

You look at AOB, our percentage of AOB claims is roughly 15% to 20%, I'd say of all claims reported. That's not really any different year-over-year. That's about what it was a year ago for us. It's the percentage of claims that have an attorney on them, that's what's higher.

Stephen L. Rohde
Chief Financial Officer, Secretary & Treasurer

A

And what's happening on those types is, particularly down in the Tri-County, especially, that they won't let us in the house to inspect the damage. So based on what's reported, we set up reserves and sent a, the undisputed damage, as we called it, check to them and close out the claim. And then found out later, like Bruce said, several months later come back to us with a much larger demand. So this non-cooperation that we're getting is what's different about the claim, and benefits from what it was in the past. And that's again because we feel the attorneys are involved with those.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah, I mean, our reserve methodology has been very consistent over the years. And we use an outside, independent actuary to set our reserves. We don't do that in-house. So our methodology has been strong. We had favorable development a year ago, right. So development factor swing both ways. But when we see a change in activity, mainly from the legal side of it, and the way that they're handling claims and reopening claims, we have to do a change in reserve methodology. It's really that simple.

So we'd rather just take it now and adjust for it rather than have a bigger problem down the road. So that's where we are on the lawsuit environment. I think that's the big driver. That's just something that you're not always going to capture in your reserves. Especially, when it's a different tactic today than it was a year ago.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc.

Q

What's your sense – please, go ahead.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

I was just going to add that the ones that were closed in the first quarter that were attorney-repped, the average of the severity on those was about \$18,000. And those that were not attorney-repped was about an average about \$10,000.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

And remember, Florida, has a one-way attorney fee statute. So it's no surprise that you see attorney-repped claims settle higher, because they get fees, all right. So just by putting an attorney on the file drives up the costs. So as we see an increase in the litigated claims, which I think everybody is seeing right now, we have to go ahead and make the reserve adjustment for that, which we did this quarter. We just went ahead and took it.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

And then, on the effort, Mark, our IBNR associated with the first quarter of 2016, so the current loss quarter, we set up over \$25 million of IBNR for the current loss quarter, at 12/31 the quarter forward, the current loss quarter we had about \$16 million of IBNR set up. So we set up almost \$10 million more of IBNR for the current quarter to reflect this development trends that we saw last quarter.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Q

Then, is there any momentum in the state to address that legislatively, I know, Citizens has been vocal on it, any reason to think that'll change?

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Yeah. I mean – there was some optimism that we would get there this past session. And definitely it went down to the wire, there was a full court press to get it done. There were a couple of politicians that were very instrumental in blocking it. Because quite honestly, they're making millions of dollars off of this setup.

So they don't really want to see reform come through because this is how they're making their money. One representative, who I won't name, himself has sued us a hundred times, and probably sued Citizens 500 times, 600 times. And that doesn't include the other carriers. So we have a problem with some of the politicians in the legislature, in that they're the real drivers of this, and they're making money on it. So that makes it a difficult environment to get reform through.

I'm more optimistic as we head into the next session, because quite honestly, where we are in this process state-wide is that the innocent homeowners are the ones who are getting penalized for this behavior. Their rates are going up. Everybody is filing rate increases right now. Citizens is filing rate increases, we are. And 90% of your policyholders never report a claim, but yet their premiums are going to go up.

So I don't think we're going to see a fix, obviously not now because session's over. But we'll see about next session. Right now, it's up to Commissioner Altmaier to do something about it. And they really have two choices to make at the OIR, either they take some pretty firm and aggressive steps to allow companies to change their policy forms to combat, assignment of benefits, and especially litigated claims, or they just keep stamping rate increases on innocent consumers. Those are the two choices that they have to make.

So we are very optimistic that the Office of Insurance Regulation is going to side with consumers, and allow Florida companies to take action to stop the source of the rate increase at its base. So that's something that we look forward to working with the Office on.

Mark Douglas Hughes

SunTrust Robinson Humphrey, Inc.

Thank you very much.

Q

Bruce Thomas Lucas

Chairman & Chief Executive Officer

Thank you, Mark.

A

Operator: And our next question will come from [indiscernible] (25:19) of KBW.

Hello, good morning. This is [ph] Anthony (25:22) filling in for Arash. Thank you for taking my questions.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

Of course.

Q

A

Sorry if I may have missed this, but how much of the development stems from assignment of benefits. And what were the other drivers of the development in the quarter?

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

Yeah, if we split it out between some of the components, the attorney-repped assignment of benefits, of that total \$14.5 million, I would say about \$6.5 million came from assignment of benefit attorney-repped, and about \$7.5 million came from litigation, and then \$600,000 from other things.

Q

A

Bruce Thomas Lucas

Chairman & Chief Executive Officer

So it's actually, as you look at those numbers, you're looking at something in the neighborhood of 90% of this is coming essentially from files that have an attorney attached to them.

Q

Got it, great, I appreciate the color. And when I look at your initial loss picks, do you think that you should put them a little bit higher than your historicals given the impact of AOB and litigation?

Bruce Thomas Lucas*Chairman & Chief Executive Officer*

A

No, I mean, we really didn't see an increase in AOB. We have a set methodology for our reserves that have to go through an independent third-party actuary who sets those ranges for us. There's no way that we could have seen the change in tactic on the attorney-repped claims. You always get losses, and the difference now is, I think they're taking a much harder line. They're trying to increase numbers. They're not settling at more reasonable numbers as they've done in the past, it's reopening claims. You have to watch your paid, and so you set your reserve on day one, you might not have a paid on it for six months to nine months. So you don't know what the true implication is or the fall-out of it until you have it paid.

Similar, you settle a claim, and then six months later it's reopened with an attorney on it. There's no way that you could've seen that coming. As we look at our current status, we are making that adjustment now based on the paid activity that we've seen going back in time. And that's why you see a \$6.2 million increase in the reserve methodology.

Stephen L. Rohde*Chief Financial Officer, Secretary & Treasurer*

A

And we did increase our loss development factors in the fourth quarter compared to third quarter based on the trends we were seeing, but as Bruce mentioned, the snowballing effect that happened in the first quarter was something far beyond what was expected.

Q

Yeah.

Stephen L. Rohde*Chief Financial Officer, Secretary & Treasurer*

A

And so then, again, we've adjusted our factors up again this quarter to...

Bruce Thomas Lucas*Chairman & Chief Executive Officer*

A

And that was particularly the case in March. And so, as we look at that fresh data in March on the page, we said, you know what, we were going to have to change the methodology a little bit, use management's best estimate on the go-forward, which is why we decided to go ahead and make the \$6.2 million increase in the reserve methodology.

Q

Great, perfect. And if I can ask one more, just a housekeeping item, what were the assumed premiums written in 1Q 2016?

Stephen L. Rohde*Chief Financial Officer, Secretary & Treasurer*

A

Assumed premiums written? We were – on the written basis, they were \$9.1 million, and that was off of \$22 million of premiums – the annualized premium that was assumed. So, again we only booked the unwritten premium portion. So it's generally little bit less than half.

Q

Thanks. That's all from me.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Okay, thank you.

Operator: [Operator Instructions] And our next question will come from Matt Carletti of JMP.

Matthew J. Carletti

JMP Securities LLC

Q

Hey, thanks. Good morning.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Good morning, Matt.

Matthew J. Carletti

JMP Securities LLC

Q

Just sort of a common numbers question, I apologize if I missed it, I got on the call little late. I'm looking at the lawsuit numbers at least was publicly available of all the different companies in Florida, and I can see for Heritage, there really was a spike, I mean throughout Q1, but March seems to stick out as a pretty high number.

Is there any color you can give us on where April stands if it came back down, if it continue to accelerate? And kind of the second part of that question being, you know, when you set these numbers, the additional reserves that you've put up, kind of the trend through April considered in that?

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Yeah. You definitely caught one data point that I don't have with me, and that's the April lawsuit number. I could get that for you on a follow-up, but I don't have that in front of me today. We've had some good days, some bad days. So, I hate to give a qualitative statement, I'd rather just give the numbers, I think that's a much better way to do it.

Matthew J. Carletti

JMP Securities LLC

Q

Okay. Fair enough.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

And looking at the April results, the month of April actually has done...

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Pretty good.

Stephen L. Rohde
Chief Financial Officer, Secretary & Treasurer

A

Pretty good from an incurred or reported basis. So, no IBNR implications there, and total incurred was \$12.3 million and the average for the first quarter was \$16.6 million. So \$4.3 million less compared to the average of first quarter.

When we were setting IBNR for the first quarter, we did look at the development up through April 30, and the IBNR that we selected, I think, is in line with the development that were seeing through – but just 30 days out of 91 days, so I can't say it's – right at this point, looks good through April 30.

Matthew J. Carletti
JMP Securities LLC

Q

Thanks. That's helpful.

Bruce Thomas Lucas
Chairman & Chief Executive Officer

A

Yeah. And we're seeing good things too on the book of business so far that we've been adding in North Carolina has been performing very well at definitely way ahead of our expectations. As the credit score book, the credit scores are extremely high. We are on pace now to do – I'm going to say approximately 1,800 new business policies in the second quarter if current number is maintained, and we're doing about a third of our daily production now outside of the state of Florida.

And we're getting a good spread of risk there. It's not all coastal. We're writing a lot of the inland business as well. So we're off to a great start there. It's still pretty early, but I think we've had one claim so far, pretty minor one, but it's a different book of business. We like the diversification we get there. We like the diversification with Zephyr.

We don't like to see the change in the way that the attorneys are handling their claims, and we don't like to see adverse development or increase in loss reserves, but that had a big impact on the first quarter. Let's just take those lumps in one quarter, so that we can get to a more normalized basis going forward, and that's the key.

We do not think this is the end of the universe. We still made \$7.4 million, we're on track for a pretty high ROE that's targeted around upper-teens to low-20%. We feel pretty good about the business as it stands now, and we know that OIR is going to take corrective action on AOB. We know that rate increases are coming. We're watching things on the underwriting guidelines, especially down in Tri-County. And I'd say right now that we're feeling pretty good about the rest of the year.

And to answer your question, we just got the data for April lawsuits. That's down from March. I'd say it's down about 25% from the March numbers.

Matthew J. Carletti
JMP Securities LLC

Q

Okay, great. That's helpful. And then one last question, just I mean, kind of tailing from this, but also you know, because there's other factors as – I'd imagine you're pretty far into your reinsurance renewal discussions at this point. What are you seeing? How has the reception been from your reinsurance panel and has this lawsuit issue – has that been a focus or cause for concern from those reinsurers that could have an impact on the renewal?

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

No. I mean, the reinsurers are mainly looking at the wind components. I do think reinsurers are concerned about assignment of benefits, because what happens after a storm could implicate them, right?

Matthew J. Carletti

JMP Securities LLC

Q

Yeah, right.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

And change the way that they view their models. So AOB could have an effect there, but on the day -to-day, I mean, they'll look at us and say, we've got one of the strongest balance sheets in the state, we have a very, very high surplus number, we have no debt, we have no quota share, we – even in our worst quarter we're making more than most of the other Florida companies. We're doing pretty well. I don't think there is any concern on that front.

With respect to how we're doing in terms of the negotiation, obviously, that's a process that's still underway. So that's probably one that we need to kind of keep close to the vest at this point, given that we're still in – protracted negotiations on the pricing of our tower.

Matthew J. Carletti

JMP Securities LLC

Q

Understood. Thank you for the answers, and best of luck.

Bruce Thomas Lucas

Chairman & Chief Executive Officer

A

Thank you.

Stephen L. Rohde

Chief Financial Officer, Secretary & Treasurer

A

Thank you.

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

Bruce Thomas Lucas

Chairman & Chief Executive Officer

I would just like to thank everyone for their participation in the first quarter call.

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

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