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Cincinnati Financial Corporation NasdaqGS:CINF

Earnings Call

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Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

Michael James Sewell
CFO, Principal Accounting Officer, Executive VP & Treasurer

Stephen Michael Spray
President & Director

Steven Justus Johnston
Chairman & CEO

ANALYSTS

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Grace Helen Carter
BofA Securities, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
BMO Capital Markets Equity Research

ATTENDEES

Unknown Attendee

Presentation

Operator

Good morning, and welcome to the Cincinnati Financial Corporation Third Quarter 2023 Earnings Conference Call.

[Operator Instructions]

Please note, this event is being recorded. I would now like to turn the conference over to Dennis McDaniel, Investor Relations Officer. Please go ahead.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our third quarter 2023 earnings conference call. Late yesterday, we issued a news release on our results, along with our supplemental financial package, including our quarter end investment portfolio. To find copies of any of these documents, please visit our investor website, cinfin.com/investors. The shortest route to the information is the quarterly results link in the navigation menu on the far left.

On this call, you'll first hear from Chairman and Chief Executive Officer, Steve Johnston; and then from Executive Vice President and Chief Financial Officer, Mike Sewell. After their prepared remarks, investors participating on the call may ask questions. At that time, some responses may be made by others in the room with us, including President Steve Spray; Chief Investment Officer, Steve Soloria and Cincinnati Insurance's Chief Claims Officer, Marc Schambow and Senior Vice President of Corporate Finance, Theresa Hoffer.

First, please note that some of the matters we discuss today are forward-looking. These forward-looking statements involve certain risks and uncertainties. With respect to these risks and uncertainties, we direct your attention to our news release and to our various filings with the SEC. Also, a reconciliation of non-GAAP measures was provided with the news release. Statutory accounting data is prepared in accordance with statutory accounting rules and therefore, is not reconciled to GAAP. Now I'll turn over the call to Steve.

Steven Justus Johnston
Chairman & CEO

Good morning, and thank you for joining us today to hear more about our results. We are pleased with our operating performance in the third quarter as we again saw improved underwriting ratios for almost every major line of business compared with the first half of this year.

The net loss of $99 million for the third quarter of 2023 included recognition of $362 million on an after-tax basis for the reduction of fair value of equity securities still held. We continue to believe the value of our equity portfolio will increase over the long term. As of September 30, it had $5.6 billion in appreciated value. It decreased 8% during the third quarter but has increased 2% since the end of last year.

Non-GAAP operating income of $261 million for the third quarter more than doubled last year's $116 million, including a decrease of catastrophe losses of $58 million on an after-tax basis. The 94.4% third quarter 2023 property casualty combined ratio was 9.5 percentage points better than the third quarter of last year, including a decrease of 4.8 points for catastrophe losses.

Our 2023 ex-cat accident year combined ratios are also better than '22, improving 3.4 percentage points for the third quarter and 1.7 points on a 9-month basis.

Similar to last quarter, we also see signs of positive momentum in operating performance. Pricing segmentation by risk and significant average price increases contributed to the increase in our underlying profit combined with risk selection and other efforts to address elevated inflation effects on incurred losses.

On a current accident year basis, measured at September 30, before catastrophe losses, our 2023 consolidated property casualty loss and loss expense ratio improved from 2022 by 4.3 percentage points on a case incurred basis. For the same time period, we increased the incurred but not reported or IBNR component of the ratio by 3.0 points as we continue to recognize uncertainty regarding ultimate losses, remaining prudent in our reserve estimates until longer-term loss cost trends become more clear.

Agencies appointed by Cincinnati Insurance are producing profitable business for us, working with associates who provide outstanding service to agents and their clients. Our underwriters are working diligently to retain profitable accounts while managing loans that we determine have inadequate pricing. They are also careful in selecting risks and pricing new business policies.

Estimated average renewal price increases for the third quarter continued at a healthy pace. Our Commercial Lines segment again averaged near the low end of the high single-digit percentage range, while our Excess and Surplus Lines Insurance segment continued in the high single-digit range. Personal Lines for the third quarter included auto rising to the low double-digit range and homeowner rising to the lower end of the high single-digit range.

We reported 12% growth in consolidated property casualty net written premiums for the quarter. That included an 11% increase in third quarter renewal written premiums, reflecting higher levels of insured exposures in addition to price increases.

Considering operating performance by insurance segment, I'll comment on premium growth and how profitability is improving compared to a year ago. Commercial Lines grew net written premiums 5% in the third quarter, reflecting pricing discipline. For example, lower written premiums this year for workers' compensation and commercial umbrella together reduced the third quarter 2023 growth rate for total Commercial Lines by 2 percentage points. The Commercial Lines combined ratio improved by 3.8 percentage points despite an increase of 2.2 points from higher catastrophe losses.

Personal Lines grew net written premiums 29% with growth in middle market accounts in addition to Cincinnati Private Client business for our agencies high net worth clients. The combined ratio was 4.6 percentage points better than last year, including 2.0 points for lower catastrophe losses.

Excess and Surplus Lines improved its combined ratio by 3.4 percentage points and continue to grow profitably with net written premiums up 6%. Both Cincinnati Re and Cincinnati Global, again enhanced our overall combined ratio and continue to demonstrate risk diversification benefits. Cincinnati Re's combined ratio for the third quarter of 2023 was an excellent 81.0% with net written premiums essentially matching last year's third quarter.

Casualty premiums again decreased as we saw fewer attractive opportunities in certain segments of the market. Property premiums increased 24%, largely due to higher pricing while specialty premiums increased 31% due to attractive opportunities in pricing.

Cincinnati Global's combined ratio was an excellent 79.5% while reporting strong growth with net written premiums up 21%. Our life insurance subsidiary again performed well, with third quarter 2023 net income up 9% and term life insurance earned premiums growing 2%.

I'll conclude with our primary measure of long-term financial performance, the value creation ratio. While our VCR on a 9-month basis is 4.4%, our third quarter 2023 VCR was negative 2.6%. Net income before investment gains or losses for the quarter contributed positive 2.4%, lower valuation of our investment portfolio and other items contributed negative 5.0%.

Next, Chief Financial Officer, Mike Sewell, will add his commentary about our financial performance.

Michael James Sewell
CFO, Principal Accounting Officer, Executive VP & Treasurer

Thank you, Steve, and thanks to all of you for joining us today. Investment income again contributed nicely to improved operating results, growing 17% for the third quarter 2023 compared with the third quarter of 2022. Dividend income was up 5% for the quarter, in part due to net equity security purchases for the first 9 months of 2023, that totaled $89 million.

Bond interest income continued to show strong growth, up 19% for the third quarter of this year. We added more fixed maturity securities to our investment portfolio with net purchases totaling just over $1 billion for the first 9 months of the year.

The third quarter pretax average yield of 4.44% for the fixed maturity portfolio rose 36 basis points compared with last year. The average pretax yield for the total of purchased taxable and tax-exempt bonds during the third quarter for 2023 was 6.4%. Valuation changes in aggregate for the third quarter of 2023 were unfavorable for both our equity and bond portfolios.

Before tax effects, the net loss was $463 million for the equity portfolio and $369 million for the bond portfolio. At the end of the quarter, total investment portfolio net appreciated value was approximately $4.4 billion. The equity portfolio was in a net gain position of $5.6 billion while the fixed maturity portfolio was in a net loss position of $1.2 billion.

Cash flow continued to boost investment income, adding to the benefit of rising bond yields, cash flow from operating activities for the first 9 months of 2023 was nearly $1.5 billion, up $54 million from a year ago. We always strive for our expense management efforts to strike an appropriate balance between controlling expenses and making strategic investments in our business.

The third quarter 2023 property casualty underwriting expense ratio was 0.6 percentage points higher than last year, primarily due to an increase in associate and travel-related expenses. On a 9-month basis, it was 0.4 points lower.

Moving on to loss reserves. Our approach consistently aims for net amounts in the upper half of the actuarially estimated range of net loss and loss expense reserves. As we do each quarter, we consider new information such as paid losses and case reserves and an updated estimated ultimate losses and losses expenses by accident year in line of business.

For the first 3 quarters of 2023, our net addition to property casualty loss and loss expense reserves was $655 million, including $539 million for the IBNR portion. During the third quarter, we experienced $53 million of property casualty net favorable reserve development on prior accident years that benefited the combined ratio by 2.7 percentage points.

On an all lines basis by accident year, net reserve development for the first 9 months of 2023 included favorable $123 million for 2022, $7 million for 2021, $72 million for 2020 and $11 million in aggregate for accident years prior to 2020.

In terms of capital management, we also have a consistent long-term approach. During the third quarter of 2023, we paid $115 million in dividends to shareholders. We did not repurchase any shares. Our assessment of our financial flexibility and our financial strength is that both are in excellent condition.

As usual, I'll conclude with a summary of third quarter contributions to book value per share. They represent the main drivers of our value creation ratio. Property casualty underwriting increased book value by $0.56. Life insurance operations increased book value, $0.73. Investment income, other than life insurance and net of noninsurance items added $1.04. Net investment gains and losses for the fixed income portfolio decreased book value by $1.86. Net investment gains and losses for the equity portfolio decreased book value by $2.33. And, we declared $0.75 per share in dividends to shareholders. The net effect was a book value decrease of $2.61 per share during the third quarter to $67.72 per share. Now I'll turn the call back over to Steve.

Steven Justus Johnston
Chairman & CEO

Thanks, Mike. I'm proud of the way our associates continue to help the independent agents who represent Cincinnati Insurance navigate this challenging market. We're sticking to our fundamentals, listening, offering solutions and building strong relationships. Because our field associates live in the communities

our agents serve, we see and respond quickly to market pressures most impacting them. We are then able to find solutions that contribute to our agent success, leading to long-term shareholder value.
As a reminder, with Mike and me today are Steve Spray, Steve Soloria, Marc Schambow and Theresa Hoffer. Gary, please open the call for questions.

Question and Answer

Operator

[Operator Instructions]

Our first question is from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Can we start off with -- in your press release, you've talked about the 193 new agent appointments this year. How long does it take them once they've been pointed to get up to some minimum levels of premium on a per agent basis? Or put it another way, what's sort of the production targets you have in mind when you appoint the new agents. And can you just clarify the comments of the agents that are just doing Personal Lines only?

Stephen Michael Spray
President & Director

Yes, Greg, this is Steve Spray. It really depends agency by agency. One thing I think as a company, we've always prided ourselves on as we do business with the best independent agents out there. And we are very deliberate about the agencies we appoint. We spend a lot of time kind of making sure that it's a fit for both us and the agency. So when we go into a relationship, we feel pretty confident that we're aligned and that the future will bear fruit. It just depends on the size of the agency, maybe the state and community but over time, we are the #1 or #2 carrier as measured by premium volume in the majority of the agencies we do business with for at least 5 years or more.

So that gives you a little -- just a little flavor of the trajectory that we have. And so it just depends but we don't want to be just in consequential -- inconsequential player in any agency.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

And the percentage of -- I think you called out in the press release, a chunk of those were Personal Lines only. Was that geographically focused? Or can you add some color on that?

Stephen Michael Spray
President & Director

Yes, sure, Greg. Sorry, you asked that. Typically, Personal Lines only agencies will be private client or high net worth focused agencies to where maybe as an example, let's say, in the state of California, we're not active there for Commercial Lines right now. So if we make an agency appointment in California would be Personal Lines only, and it would be high net worth or private client-focused.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Got it. All right. I guess pivoting to the commercial lines side of the business. If we look at new business trends in your commercial, it's kind of flattish the last couple of quarters. And by the way, we've heard some other carriers talk about pockets of increased competition. Maybe you can give us some perspective inside your book of commercial, where you're seeing some headwinds from competition and where you're seeing some opportunities?

Stephen Michael Spray
President & Director

Yes. Again, Steve Spray, Greg. It's that new business that you're pointing to is all around underwriting discipline and pricing segmentation and just discipline from our field underwriters on the pricing front. So it's a very competitive -- it's always a competitive market, and it varies by state. It varies by territory on who we're competing with. But we have just -- over the years, our proven model, appointing the best agents, assigning field associates to those agencies, making decisions locally, that has served us really well over the long fall.

In the last 10 years, the pricing precision, the pricing segmentation, the tools that we have, have really been what's driving quite frankly, the profitability that you see that we're producing and our new business underwriters working with our agents out in the field are executing on that disciplined strategy. And it's to put pressure candidly, it's put some pressure on the new business this year. But I can tell you each quarter of this year, is that commercial market has gotten a little more disrupted, we are seeing more and more opportunities at the underwriting terms, conditions, quality and pricing that we feel are adequate.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And then I guess the final question would be on Personal Lines because if we look at your results for the quarter, actually, you're doing pretty well in the context of how the rest of the market is performing. And you're also reporting some substantial growth in new business written. So -- maybe give us sort of an updated view on the trends you're seeing inside your Personal Lines business. And I'm thinking about auto and property, clearly. So if you could separate the 2, that would be great.

Stephen Michael Spray
President & Director

Sure. First of all, I might comment -- just we're pleased and encouraged by the improvement in ex-cat. Actually the core loss ratio that we're seeing in Personal Lines as well, certainly had some pressure with inflation and with increased cat levels, but feel like we are -- I shouldn't say feel like, we're confident that we're getting the rate on a prospective go-forward basis that's adequate. The fact that about 55% of our Personal Lines today would be what we call private client, 45% roughly middle market. We think that is a key for us with our agency model in the marketplace. That we can be a go-to care for our agents on -- regardless of the size of the home. And the way we handle claims locally fast [indiscernible] with empathy, we think, puts us in a really good position going forward on all Personal Lines.

Yes, it's -- the loss ratio has been -- has certainly been under pressure with inflation and the increased cat activity, but we're confident in where it's headed going forward. We see a lot of opportunity out there. A lot of disruption in that Personal Lines market. Candidly, I've never seen a harder market than the Personal Lines market we're seeing today. And we think with our balance sheet, our agency strategy, the way we're approaching it, the expertise, the pricing precision, we think it's going to bode well for us in the future to grow that Personal Lines book.

Operator

The next question is from Mike Zaremski with BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

I guess maybe going back to kind of the topic of growth and risk selection. And maybe just sticking with Commercial Lines. So if I kind of just step back, Cincinnati Financial's pricing power levels are fairly similar to a number of your peers yet your growth rate, just overall growth rate is much lower than your historical growth rate relative to the industry, which you've been talking about this about changing your appetite a bit and every quarter, this isn't like a surprise.

But just kind of then curious like, are -- I would have thought, it doesn't seem like you're losing business because of pricing because your pricing levels are similar to peers. So is it -- or maybe I'm wrong and in just certain lines, actually, you're actually -- we're looking at all-in rate and certain lines, you actually are casualty raising a lot more than the average. Or is the -- has your fundamental risk selection process change that you're just not willing to take on certain risks or you're trying to shed certain risks and kind of just kind of see where we are in this kind of journey to whether the -- your historical growth rate will get back to what it used to be historically relative to the industry if your appetite decides to change.

Stephen Michael Spray
President & Director

Yes. Mike, Steve Spray again. Steve Johnston commented in his opening remarks on the net written premium piece of Commercial as I might start there in that we've got a 2 full point drag on Commercial Lines from workers' compensation and umbrella or excess you could call it, both for different reasons. We're comp about 1 point drag, that has been going on now for several years. Just simply, the rate decreases that are being pushed through really for the industry. On umbrella, that is deliberate. It started probably a little over a year ago here in Commercial Lines. In certain jurisdictions, certain states, we really took aggressive, appropriate underwriting action on our umbrella book, reducing limits, maybe shedding some of that business. So that's putting a weight on the Commercial Lines growth as well.

So your comment of returning to historical levels or walking away from other business, like I was saying before, I think we've got a winning strategy. We've got a winning model, doing business locally with the best agents in the business, face-to-face that has served us well for many, many years. And our risk selection, our claims handling, our loss control, those things have all improved on linear basis since I've been here, I think, 32 years ago. Our pricing precision, segmentation has improved exponentially over the last 10 years. So where we just didn't have those tools, say, when I was a field rep 15 years ago and the look into each individual account that we do and price them on their own merits.

So yes, our field underwriters and our renewal underwriters have those pricing precision tools that they use to where -- if we don't feel like we can get an adequate rate on a risk-adjusted basis, we're -- we'll walk away from an account, and we'll wait it out. First and foremost is we need an underwriting profit. We've got 11.5 years in a row now of -- 11 years and 9 months of underwriting profit and we want to keep that rolling. I don't worry about growth over the long haul at Cincinnati Insurance Company. We are talking about agency appointments. We have plenty of runway to continue to do that. We're growing our E&S company. You see what's going on in Personal Lines. Well, I'm not -- I don't worry about growth prospects for the future.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. That's thorough and helpful answer. And my follow-up is you've been deliberate in your actions to kind of increase IBNR. And you've talked about uncertainty in terms of -- more uncertainty in terms of the loss cost trend environment. Growth is obviously -- you just talked about maybe a little bit slower, too. So would it be fair to characterize that Cincinnati is taking a view that loss cost trend is a bit higher on a go-forward basis than it has been a year or 2 ago. Is that a fair characterization?

Steven Justus Johnston
Chairman & CEO

Greg, this is Steve Johnston. And I think what we've seen was kind of a rapid acceleration of inflation starting at the beginning of 2021. It is now in the last several months moderated, still going up, but moderated. I think just with the way that we time our rate increases in rolling on to the book, it takes a little while for them to actually reach all the policyholders. But the key point, I think, is that we are very prospective in terms of the way we look at inflation. The most important thing we can do is to look out into the prospective policy periods that we're pricing for right now, do our best to estimate the loss costs and the inflation impact on that prospective period and set the pricing right and do it on a individual policy-by-policy basis the best we can. And I think we're in a good position to continue doing that.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. So you clearly feel it sounds like pricing is in excess of loss trend, knock on wood, if everything plays out. If you don't agree with that...

Steven Justus Johnston
Chairman & CEO

I would agree with that.

Operator

The next question is from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

Looking at kind of results line by line in the Commercial segment, it seemed like quite a few saw year-over-year improvement but the workers' compensation line sticks out a little bit kind of the second quarter in a row where we've seen a decent bit of pressure on the underlying loss ratio. I was just curious if we could get more color on what's going on there. I mean, obviously, you'll have referenced the pricing pressure for that book. But we've also heard some other peers talk about concerns regarding medical inflation. And if you all could just give us some more color on what's happening there?

Stephen Michael Spray
President & Director

Yes, Grace, Steve Spray. Thanks for the question. The accident year combined ratio, loss ratio for work comp is, yes, it's under pressure. Calendar year is still performing quite well. The -- it is -- I hate to keep telling the same story, but it really is simply just pressure -- downward pressure on the rates that are put out by the rating bureaus. And fortunately, I think for Cincinnati Insurance company is we've always been conservative on the workers' compensation line. We've got tremendous expertise, we're ready to grow that business when we think that the pricing is at an attractive level. But right now, it's -- again, we're doing it risk by risk, and we are running new workers' compensation business. But just -- it's a line that, as you mentioned, medical inflation can impact it over time. I can't see that we're seeing anything out of the ordinary with the medical inflation at this point. But that line of business is definitely under pressure on an accident year basis and primarily from just rate pressure.

Grace Helen Carter
BofA Securities, Research Division

And I guess on Cincinnati Re, you all mentioned kind of reducing casualty premiums in that book for a couple of quarters now. And we've also heard some more players in the market start talking about concerns over casualty loss cost trends here lately. I was just curious if you think if there's anything particularly new going on in casualty reinsurance or if the recent comments are surprising to you all at all? Or -- and I guess, next year, just if you think opportunities from property, specialty, et cetera, will outweigh any sort of ongoing pressure on the casualty piece of that book to allow it to inflect back to growth?

Steven Justus Johnston
Chairman & CEO

Thank you, Grace. Really good question. And I think it boils down to our model at Cincinnati Re and that we didn't really actually form a company Cincinnati Re. It writes on Cincinnati Insurance paper. So there's the A+ quality there. And then it's an allocated capital model. So what we try to do is just look at every contract as it comes up. We don't try to do things this much in property, this much in casualty this much in specialty. Just look at each contract that becomes available to us on its own merits and if we can get the target hurdle rate that we're looking for and feel good about how it fits into our overall risk model, we'll go ahead and write that. So I would think that we will see movements in the various business lines that reflect that.

I think right now, just what we're seeing is certain lines like professional liability, transactional liability and so forth are areas where we felt that the pricing and sometimes the opportunity or not is as good as they've been in the past, where we are seeing really good opportunity in the property and specialty lines. So we'll just go at that contract by contract and very bullish with everything that Cincinnati Re is bringing to us in terms of profitability and diversification.

Operator

[Operator Instructions]

The next question is from Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Great. Two questions on Personal Lines. First, is there any appreciable difference in the profitability of private clients and middle market?

Stephen Michael Spray
President & Director

Meyer, Steve Spray. We don't -- right now, we are disclosing the difference in loss ratios for our specific book between middle market and high net worth or private client. But I can tell you, over the long pull, the industry, private client has outperformed middle market by a pretty good margin. And we feel like we can create those same results over time as well.

Not that we want to subsidize middle market. The middle market book needs to stand on its own. We've got the pricing precision there. Again, we've got the agency force. So we expect both segments to be profitable. But we do think, over the long pull, the high net worth of private client will outperform.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. That's very helpful. I completely understood. Second question, a couple of companies have talked about moderating rent cost inflation, specifically for auto physical damage. And I was wondering whether you're seeing that in the third quarter as well?

Steven Justus Johnston
Chairman & CEO

We have seen it in just certain areas within physical damage. As we look at replacement vehicles, rental cars, that sort of thing. But again, we're still kind of looking at inflation on a -- how it's been cumulatively since 2021 as we use that data to forecast the loss cost and the premium needed in the prospective periods. And so we're being cautious, I think, in terms of where we are with our inflation rates, but we do feel that we're getting ahead of our loss cost trends. We are ahead of our loss cost trends with our pricing. And I think we benefited that while we had a stay-at-home credit during 2020. We did not actually -- we bring that through the expense ratio. We did not actually decrease the auto rates. And I think that's helping us now as we contemplate inflation and our pricing.

Operator

The next question is from Fred Nelson, a Private Investor.

Unknown Attendee

I got a call last night from a lady pushing 90, thanking me for Cincinnati Financial and I told her that I would refer that today on the phone on the conference call, and she didn't even know you had one. But the question is battery-operated vehicles of all types, has that changed the pricing of insurance, replacement costs and accidents? Do you have any comments you can share?

Steven Justus Johnston
Chairman & CEO

Yes. Fred, this is Steve Johnston. I think what we just have to do is make sure that we contemplate the costs involved. As we go to having more electronic vehicles in the fleet, there will be more of that cost in the battery. They are less complex, I believe, in terms of all the different parts that are involved. So it is different. It will create a challenge to stay on top of -- as we calculate those costs in price, but we feel that we're up to the task. And please thank your friend to call us. We appreciate your comments.

Unknown Attendee

Well, thank you. The battery operated calls I have people in the farming business with pickup trucks and other machinery and they say it's not an easy thing to work with. And they'll ask the question about insurance soon so thank you for the best you do. I really appreciate it.

Steven Justus Johnston
Chairman & CEO

Well, thank you, Fred. It's always good to hear from you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Steve Johnston for any closing remarks.

Steven Justus Johnston
Chairman & CEO

Thank you, Gary, and thank you to all for joining us today. We look forward to speaking with you again on our fourth quarter call.

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