S&P Global
Market Intelligence

Cincinnati Financial Corporation NasdaqGS:CINF

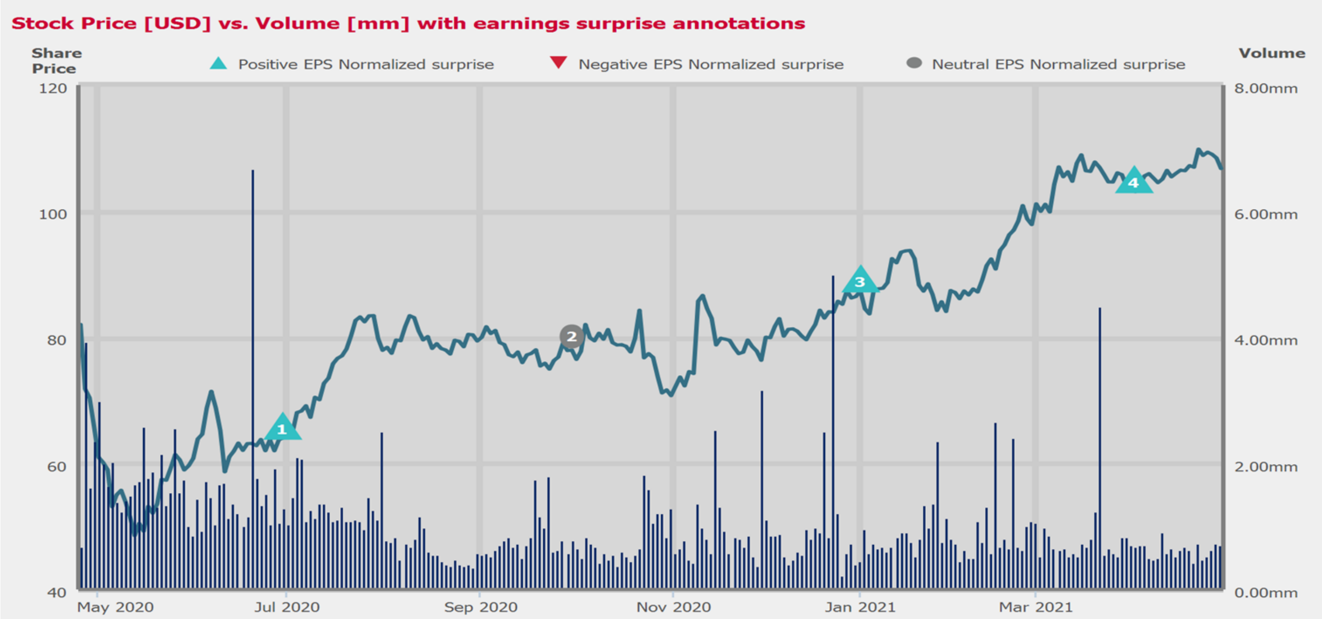
FQ1 2021 Earnings Call Transcripts

Thursday, April 29, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2021-			-FQ2 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.10	1.37	▲24.55	0.59	6.45	NA
Revenue (mm)	1679.08	2227.00	▲32.63	1706.50	6855.20	NA

Currency: USD
Consensus as of Apr-29-2021 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2020	0.37	0.44	▲1 18.92 %
FQ3 2020	0.39	0.39	2 0.00 %
FQ4 2020	1.20	1.61	▲3 34.17 %
FQ1 2021	1.10	1.37	▲4 24.55 %

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Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

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

Steven Justus Johnston
Chairman, President & CEO

ANALYSTS

Mark Alan Dwelle
RBC Capital Markets, Research Division

Presentation

Operator

Good day, and thank you for standing by. Welcome to the First Quarter 2021 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions] Thank you.

I would now like to hand the conference over to your speaker today, Mr. Dennis McDaniel, Investor Relations Officer. Please go ahead, sir.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our first quarter 2021 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, President and Chief Executive Officer, Steve Johnston; and then from 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 Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance's Chief Insurance Officer, Steve Spray; Chief Claims Officer, Marc Schambow; and Senior Vice President of Corporate Finance, Theresa Hoffer.

First, please note that some of the matters to be discussed 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, President & CEO

Thank you, Dennis. Good morning, and thank you for joining us today to hear more about our first quarter results. We were pleased with operating performance, and believe it reflects our proven strategy and careful execution as we seek to continue growing profitably over the long term. Net income for the first quarter of 2021 rose by $1.8 billion compared with the first quarter a year ago, and included increases in the fair value of our equity security portfolio. Non-GAAP operating income was up $85 million or 62% for the quarter despite higher catastrophe losses, reducing it on an after-tax basis by $21 million more than last year. Our 91.2% property casualty combined ratio was 7.3 percentage points better than a year ago, with elevated catastrophe losses this year, causing an increase of 1.3 points.

The current accident year loss and loss expense ratio before catastrophe loss effects continued to improve and was 2.3 percentage points better than the same quarter a year ago. Our results continue to benefit from efforts to diversify risks by product line and geography, and likewise, from segmentation of risks as we underwrite and price policies. While economic effects of the pandemic and pricing discipline continued to slow commercial lines new business premium growth, we believe we are growing our business profitably, and our relationships with the independent agents who represent us are as strong as ever.

Consolidated property casualty net written premiums rose 12% in the first quarter of 2021, and we continue to see various indicators of good pricing and underwriting discipline. Renewal pricing during the first quarter continued to be ahead of our estimate for prospective loss cost trends for each property casualty segment. Our commercial and personal lines insurance segments again experienced mid single-digit percent range estimated average price increases, while the excess and surplus lines insurance segment improved to the high single-digit range.

The combined ratio for our commercial lines segment improved by 17.1 percentage points compared with the first quarter a year ago, and we grew net written premiums by 5% with an ongoing emphasis on pricing segmentation on a policy-by-policy basis.

Our personal lines segment grew first quarter net written premiums by 6%, with the high net worth portion of this segment continuing to progress as planned. The combined ratio for personal lines was 6.8 percentage points higher than the first quarter a year ago, with underlying improved performance offset by catastrophe losses that were 9.1 points higher.

Our excess and surplus lines segment produced a 92% combined ratio and grew net written premiums by 16%. Cincinnati Re contributed to roughly half of our net written premium growth in the first quarter by taking advantage of improved pricing in the reinsurance market, growing its premiums by $91 million. Losses from winter freeze events hurt its results and caused a modest underwriting loss.

Cincinnati Global produced another nice underwriting profit and grew its net written premiums by 11%. Our life insurance subsidiary reported first quarter net income at a satisfactory level and grew term life insurance earned premium by 9%.

Before I close my prepared remarks, I'd like to mention 1 important update with respect to business interruption claims litigation. Earlier this month, the Ohio Supreme Court agreed to answer the question certified to it by the Federal District Court. That is, does the general presence in the community or on surfaces at a premises of the novel coronavirus known as SARS-CoV-2 constitute direct physical loss or damage to property? Or does the presence on a premises of a person infected with COVID-19 constitute direct physical loss or damage to property at that premises? We appreciate the court's decision to hear our case. We believe resolving these questions of law at the state level will create a more efficient judicial process throughout Ohio, benefiting all parties involved.

I'll conclude with the value creation ratio, our primary measure of long-term financial performance. Our VCR was 4.1% for the first quarter of 2021, including 2.2 percentage points contributed by improved valuation of our investment portfolio.

Now our Chief Financial Officer, Mike Sewell, will add his comments regarding other important areas of our financial results.

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

Thank you, Steve, and thanks to all of you for joining us today. Our first quarter 2021 investment performance was quite good as investment income grew 5%, dividend income rose 9% for the first quarter, and net purchases for the equity portfolio totaled $13 million. Interest income from our bond portfolio grew 5% compared with the same quarter a year ago. The pretax average yield was 4.14%, up 10 basis points from the first quarter of last year.

The average pretax yield for the total of purchased taxable and tax-exempt bonds during the first quarter was 3.71%. We continue to invest in the fixed maturity portfolio with net purchases during the first 3 months of the year totaling $137 million. Investment portfolio valuation changes for the first quarter of 2021 were favorable for our stock portfolio, but unfavorable for our bond portfolio. The overall net gain was $308 million before tax effects, including $491 million for our equity portfolio, offsetting a decrease of $193 million for our bond portfolio. We ended the quarter with total investment portfolio net appreciated value of approximately $6.3 billion including $5.4 billion in our equity portfolio.

Cash flow continues to help boost investment income. Cash flow from operating activities for the first 3 months of 2021 was very strong and generated $354 million, up 112% from a year ago. Expense management is always an important matter and we aim to balance strategic business investments with expense controls. The first quarter 2021 property casualty underwriting expense ratio was 3.0 percentage points lower than last year's first quarter. The pandemic continued to cause lower spending for several items such as business travel. We expect some of those expenses could return to a more normal rate in future quarters as restrictions lift and people feel more comfortable meeting in person.

In terms of loss reserves, our consistent approach aims for net amounts in the upper half of the actuarially estimated range of net loss and loss expense reserves. During the first quarter of 2021, we experienced a fair amount of property casualty net favorable development on prior accident years. The combined ratio effect was 7.4 percentage points for the quarter, or $110 million, and was higher than a typical quarter.

Each quarter we consider new information, such as paid losses, and estimate ultimate losses and loss expenses by accident year and line of business. As we obtain and study new data during the year, we update estimates as needed.

Our workers' compensation line of business, which represents 15% of our total gross property casualty loss and loss expense reserves at just over $1 billion at the end of the quarter, had the largest amount of first quarter favorable net reserve development. This line has the longest tail as claims can remain open for many years. While the amount of reserves released for any given accident year was relatively small, the aggregate amount was $25 million.

On an all lines basis by accident year, net reserve development for the first 3 months of the year was favorable by $82 million for 2020, $16 million for 2019 and $12 million in aggregate for accident years prior to 2019.

Regarding capital management, we continue to approach consistent with the past. We believe that our financial strength and financial flexibility were in excellent shape at the end of the quarter. During the first quarter, we repurchased approximately 284,000 shares at an average price per share of $100.48.

As I always do, I'll end my prepared remarks with a summary of the first quarter contributions to book value per share. They represent the main drivers of our value creation ratio. Property casualty underwriting increased book value by $0.65. Life insurance operations increased book value by $0.06. Investment income other than life insurance and reduced by noninsurance items added $0.57. Net investment gains and losses for the fixed income portfolio decreased book value per share by $0.94. Net investment gains and losses for the equity portfolio increased book value by $2.41, and we declared $0.63 per share in dividends to shareholders. The net effect was a book value increase of $2.12 per share during the first quarter to a record high $69.16 per share.

Now I'll turn the call back over to Steve.

Steven Justus Johnston
Chairman, President & CEO

Thank you, Mike. Before we close, I want to thank our associates for their continued focus and dedication. While still balancing serving customers and ever-changing pandemic conditions, our claims associates, both in the field and at headquarters, work together to deliver our hallmark of fair and empathetic claim service to the many policyholders impacted by severe winter weather over the past few months.

We've continued to release new products and services, creating additional ways to help the independent agents who represent us, grow profitably and offer value to their clients. Overwhelming claim service layered on top of industry-leading products and services generates a pipeline of future opportunity. We remain optimistic about our long-term prospects as we stay focused on executing our strategy.
As a reminder, with Mike and me today are Steve Spray, Marc Schambow, Marty Hollenbeck and Theresa Hoffer. Patricia, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mark Dwelle from RBC Capital.

Mark Alan Dwelle
RBC Capital Markets, Research Division

A couple of questions. I was hoping you could talk through a little bit more detail related to the prior reserve release related to the catastrophe events. Are those like 2020 events? Or do they go back further than that? Very unusual to have such a large adjustment for cats?

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

That's a great question. I appreciate it. And it was -- it does seem a little high. So it was 2 points in total for the prior year development. The largest, really, when you look at it, was coming through on our primary business related to 2020 cats, but it was widespread. There was at least 10 cats in there where we had $1 million to $2 million favorable adjustments. And then there was many other smaller items that were below the $1 million range.

When you also look at CGU, there was -- it was really concentrated around 3 items. The first one was Delta, that was in 2020, that was about a $5 million favorable adjustment. Sally, that was also in 2020, that was a $3 million adjustment. And then I think it was the previous year, there was the Australia wildfire, and that was $2 million. So when you add it all up, it's about $30 million, and that's your 2 points of favorable development in cats.

Mark Alan Dwelle
RBC Capital Markets, Research Division

I see. So ultimately, this was more about, like, as you said, almost a dozen small adjustments rather than 1 big adjustment where you kind of miscalled it or something?

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

That's exactly right, Mark. You have it. Thank you. That was a great question.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. The second question that I had related to the sizable level of growth in Cincinnati Re. Again, that's a fairly new business unit. So I'm not really used to what the -- it doesn't have a lot of historical run rate data. So I guess I'm curious, 2 things. One is kind of where you saw opportunity that prompted such a large increase in writing. And then maybe thinking a little bit longer term, how you think about that business and how large that business might be relative to -- it's obviously going to be smaller than the core business. But how large would you suppose that could eventually become?

Steven Justus Johnston
Chairman, President & CEO

Yes, Mark, good question. This is Steve, and -- Steve Johnston, we have 2 Steves here. Basically, the short answer is, we just have a talented team there that's well connected, and they're supported by great financial strength here of the organization that just had the opportunity to take advantage of firming prices, firming conditions. And it is an allocated capital model. We didn't form a Cincinnati Re. It's written on the Cincinnati Insurance Company paper. It's got the full strength of our balance sheet. And what we ask is that they just opportunistically try to estimate how much capital they would need for each contract that they enter into. And if we can hit the hurdle rate and if it can be diversified the way we want it to be, then we want them to grow. It will -- if things would turn and go in the other direction, that's an area where it could turn and go in the other direction in terms of writings if the market would turn. But in this quarter, really, across the board, Cincinnati Re had opportunity to take advantage of firming prices and improving terms and conditions and to grow the way they did. Was the growth primarily in property-oriented lines? Or was it casualty-oriented or maybe a mix?

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

It was across the board. It may be have been a little bit more casualty and specialty. But it was across the board where we saw opportunity for good pricing and fair terms and conditions.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. And then I guess my last question, really just -- I mean, you commented a little bit in the opening remarks, but just in terms of the market conditions, the pricing behavior that you're seeing, I mean would you characterize the pricing environment as continuing to improve? Or is it beginning to stabilize a little bit that while it's still at positive pricing levels?

Steven Justus Johnston
Chairman, President & CEO

Yes. You're right. As we mentioned in the prepared remarks, we do feel that we're getting rate that's ahead of loss cost trends. And I think what's important is that we are looking at this policy-by-policy, coverage-by-coverage, state-by-state, it's more of a ground-up approach than a top-down approach. And we still -- we see a consistent pricing environment. I have heard some industry comments that it might be tapering off a little bit. But as you look back through history, our increases may have been a little bit less than others over that period of time. I think that's driven a lot by mix and all the details that I described, and we're just taking our steady approach forward that we think is appreciated by our agents and their clients and getting fair and adequate pricing, risk-by-risk, policy-by-policy.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Do you think your multiyear policies approach, do you think that, that enhances your ability to capture rate as the market moves? Or does it inhibit it?

Steven Justus Johnston
Chairman, President & CEO

Well, it's a steadying influence, Mark. I think as rates go up, we will have prices that are in position for 3 years, same when they go down. The retention is very high on the 3-year policies, and we just think that's stable long-term approach to relationships with our agents and their customers is a winning formula that's proven to work well for us for decades really. And we think we can manage it with the experience we have in it in terms of pricing appropriately for the 3-year contract.

Operator

[Operator Instructions] There are no further questions at this time. I would now like to turn the call over back to Mr. Johnston. Please go ahead, sir.

Steven Justus Johnston
Chairman, President & CEO

Well, thank you, Patricia, and thank you for joining us today. We hope some of you will join us for our virtual shareholder meeting on Saturday, May 8, at 9:30 a.m. Eastern. While we intend to resume in-person meetings at some point in the future. For now, virtual meetings are the best way to keep shareholders, agents and associates safe.

Please visit www.cinfin.com for details on how to register for the meeting. We look forward to speaking with you again on our second quarter call. Thank you, and have a great day.

Operator
This concludes today's conference call. Thank you for participating. You may now disconnect.