S&P Global
Market Intelligence

Kinsale Capital Group, Inc. NYSE:KNSL

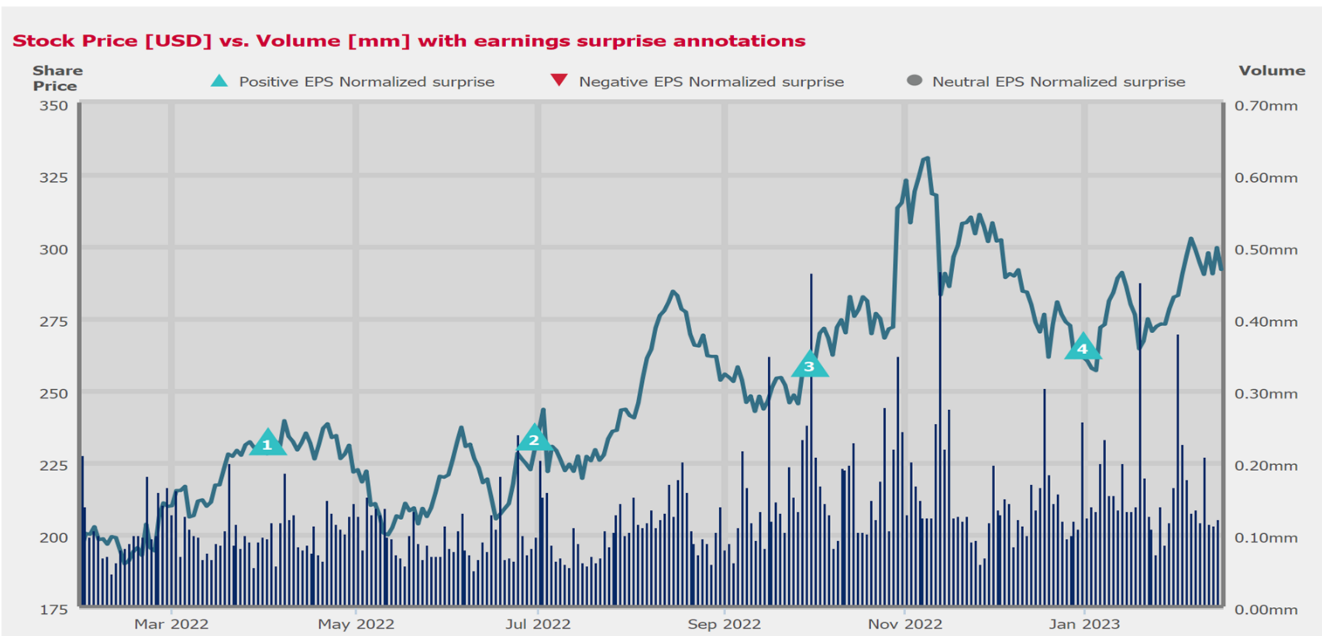
FQ4 2022 Earnings Call Transcripts

Friday, February 17, 2023 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	2.13	2.60	▲22.07	2.13	7.32	7.80	▲6.56	9.45
Revenue (mm)	236.24	242.96	▲2.84	247.36	810.39	819.20	▲1.09	1105.19

Currency: USD
Consensus as of Feb-17-2023 8:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2022	1.52	1.63	▲1 7.24 %
FQ2 2022	1.62	1.92	▲2 18.52 %
FQ3 2022	1.24	1.64	▲3 32.26 %
FQ4 2022	2.13	2.60	▲4 22.07 %

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Call Participants

EXECUTIVES

Brian Donald Haney
Executive VP & COO

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Michael Patrick Kehoe
President, CEO & Director

ANALYSTS

Andrew E. Andersen
Jefferies LLC, Research Division

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Michael David Zaremski
BMO Capital Markets Equity Research

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Rowland Juran Mayor
RBC Capital Markets, Research Division

Presentation

Operator

Before we get started, let me remind everyone that throughout the course of the teleconference, Kinsale management may make comments that reflect their intentions, beliefs and expectations for the future. As always, these forward-looking statements are subject to certain risk factors, which could cause actual results to differ materially. These risk factors are listed in the company's various SEC filings, including the 2021 annual report on Form 10-K which should be reviewed carefully.

The company has furnished a Form 8-K with the Securities and Exchange Commission that contains the press release announcing its fourth quarter results. Kinsale's management may also certain non-GAAP financial measures in the call today. A reconciliation of GAAP of these measures can be found in the press release, which is available at the company's website at www.kinsalecapitalgroup.com. I will now turn the conference over to Kinsale's President and CEO, Mr. Michael Kehoe. Please go ahead, sir.

Michael Patrick Kehoe
President, CEO & Director

Thank you, operator, and good morning, everyone. Brian Haney, Kinsale's Chief Operating Officer; and Bryan Petrucelli, Chief Financial Officer, both with me. Each of us will make a few comments, and then we'll move on to any questions that you may have for us.

In the fourth quarter, Kinsale's operating earnings per share increased by 48% and gross written premium grew by 45%. The company posted a 72.4% combined ratio for the quarter and an operating return on equity for all of 2022 of 25%. We believe these results are principally driven by Kinsale's unique business model of disciplined underwriting, and technology-driven low costs.

The results are also boosted by the favorable E&S market, which continues to experience a strong inflow of new business that allows for meaningful rate increases and exposure growth. Kinsale continues to raise rates above loss cost trend as we've been doing for 4 years now. And we continue to establish reserves for future losses in a conservative fashion. Investors should have a high level of confidence in Kinsale's balance sheet and reserve position. As an E&S company, part of Kinsale's long-term success is reacting quickly to market disruptions and turning those disruptions into opportunities. Over the last couple of years and continuing even today, Kinsale is taking advantage of disruption in the property market to grow our book of business at a rapid rate.

As always, we are mindful of the volatility associated with property accounts, especially hurricane-exposed properties in the Southeastern United States. Although we are writing more property business than ever. We maintain strict limits on the geographic concentration of business. We model the portfolio regularly. We manage our policy limits carefully. We purchased a substantial reinsurance program and most importantly, we are being well paid for the risks we are taking. All of these steps allow us to write the business and capture an attractive return while continuing to limit the volatility of the book.

In 2022, property amounted to just under 23% of our gross written premium with below 10% of our overall gross written premium having any meaningful hurricane exposure. We announced in late December that Kinsale had acquired two office buildings and 29 acres of land for just over $76 million. This property is adjacent to our existing headquarters building. One of the office buildings is subject to a long-term lease. The other is mostly vacant, and we are planning to renovate that property.

The purchase gives Kinsale expansion space next to our existing building and also provides an interesting investment opportunity as we consider selling parts of that property to real estate developers over the next several years. Lastly, we continue to have an optimistic outlook for the market for the balance of 2023, at this point, halfway through the first quarter.

The property market is quite favorable, but we also see opportunities across our casualty product line as well. Regardless of where the market goes in the next couple of years and given Kinsale's competitive advantages, we expect the company to continue to grow and generate best-in-class returns under any market conditions. Now I'll turn the call over to Bryan Petrucelli.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Thanks, Mike. Again, just a really strong quarter and close to the end of the year with a 45% growth in written premium and net income and operating income increasing by 39% and 48%, respectively. 72.4% combined ratio for the quarter includes 3 points from net favorable prior year loss reserve development compared to 4 points last year and a negligible impact from cat losses in either period.

Most of the improvement in the quarterly expense ratio of 19.9% this quarter compared to 21.4% last year related to ceding commissions from the company's Casualty and Commercial property proportional reinsurance agreements. Net investment income increased by 107% over the fourth quarter last year as a result of continued growth in the investment portfolio and higher interest rates with a gross return of 3% for the year compared to 2.5% last year.

We're investing new money in shorter duration securities with new money yields averaging close to 5% during the quarter, and duration has decreased to 3.5 years, down from 4.3 years at the end of 2021. Book value was positively impacted in Q4 from a combination of net income, an increase in the fair value of our fixed income securities during the quarter and the $47.5 million equity raise in November, notwithstanding the positive fourth quarter movements.

Our fixed income portfolio continues to be an overall unrealized loss position, resulting from the higher interest rate environment. The company continues to generate strong positive operating cash flows, which gives us the ability to hold these securities to maturity and the higher interest rate environment allows us to invest new money at the better yields that I just touched on. As it relates to capital, as I mentioned, we raised approximately $47 million in our fourth quarter equity offering to fund the expected growth of the company.

We continuously monitor our needs as market conditions change. Given the continued favorable market conditions and related premium growth, there's always the possibility that we'll need additional supporting capital. Support can come in the form of debt or equity with a bias towards debt given our current modest debt to capital position. And lastly, diluted earnings per share was $2.60 per share for the quarter compared to $1.76 per share last year. And with that, I'll pass it over to Brian Haney.

Brian Donald Haney
Executive VP & COO

Thanks, Bryan. As mentioned earlier, premium grew 45% in the fourth quarter, largely consistent with the first 3 quarters. Overall, the E&S market remains favorable with strong growth across most of our product line. The property market continues to be hard and in the wake of Hurricane Ian, the contraction in industry capacity has continued as we believed it would.

In addition to our Property divisions, we are seeing strong growth across most of our Casualty divisions, our energy, general casualty and entertainment divisions, in particular, continue to grow at a significant pace. There are some pockets of business that are more competitive and flatter slower growing, such as management liability and product liability. Submission growth continues to be strong, just under 20%, which represents a very slight deceleration from the previous quarter.

We sell a lot of array of products and the rates in those products don't move in lockstep. But if we pull it all down to one number, we see real rates being up around 7% in the aggregate during the fourth quarter compared to 8% in the third quarter. The property market is certainly boosting that number. The rate changes for property would be well higher than the average.

The rate changes for the Casualty divisions were very greatly, but overall, it would be less than the average, but still positive, which indicates that the combination of rate change and premium trend is exceeding loss cost trend. It is important to stress that rate change and rate adequacy are two different concepts. Our rates are more than adequate. We are continually reviewing and adjusting our rates based on a number of considerations such as our target combined ratio, our target return on equity, the market opportunity and ships and the competition.

We continue to keep it on inflation. We feel we're in a good position because we've been achieving rate increases ahead of loss cost trend for several years now, as Mike mentioned. These increases, combined with our strategy of conservative reserving further protects us from the threat of inflation that some of our peers may be more exposed to.

The market conditions are generally favorable across the board. We do still see a proliferation of MGAs and fronting deals. We don't delegate underwriting authority ourselves, but virtually all our competitors do in some fashion or another. Some of these MGAs are being overly aggressive on rates and terms, not all, but some. But despite these new MGAs and new fronting funding deals, the market has not been too affected at this point. Overall, clearly, a good quarter, and we are happy with the results. And with that, I'll hand it back over to Mike.

Michael Patrick Kehoe
President, CEO & Director
Thanks, Brian. Operator, we're ready for questions now.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Mike Zaremski from BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Maybe first, touching on -- it sounds like a continued more optimism a bit on the property growth front. And I think we can see the -- you're ceding a bit more to, I believe, to reinsurers? And just any -- I'm assuming the math works, right, if you're growing opportunistically into property versus higher reinsurance costs. Maybe you can update us whether we how should we think about the growth and whether we should think about any changes to the reinsurance -- your reinsurance program throughout the year?

Michael Patrick Kehoe
President, CEO & Director

Okay. Yes, this is Mike. So our -- we buy a lot of our reinsurance on our excess casualty book, where we put up larger limits and on our property book. And so yes, the growth in the property is going to result. I mean, that mix of business shift, both the growth in casualty and property is going to result in a higher ceding ratio over time. The property is ceded on an earned premium basis. So there's a little bit of a lag between when we write the business and when we earn it. But in general, it would be reasonable to expect an incremental increase in the ceding ratio here for the near term.

Michael David Zaremski
BMO Capital Markets Equity Research

And just thinking -- should we be thinking at all about kind of higher reinsurance costs kind of impacting kind of how we should think about any of the ratios into '23? Or that will be kind of TBD this time as the year progresses?

Michael Patrick Kehoe
President, CEO & Director

I don't -- it's hard to say, right? Our program renews on six one. There's been a lot of commentary about reinsurance costs arising. And we would certainly expect that, that would be the case in our cat excess of loss treaty. That's not an enormous cost for our company. We buy $75 million [ex of $25 million] today. So on the proportional side, I think the largest contract there is our commercial property quota share. The results there have been quite favorable. So we don't expect any kind of dramatic change in economics on the renewal of that treaty, and likewise, on the casualty side. I think we've ceded away very attractive returns to our reinsurers, in general, over the long term. And so I think that will be reflected in the renewal pricing. But again, it's a [six one tree,] so it's a little bit speculative at this point.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Understood. We obviously know that you're [indiscernible] more profitable than the industry. So maybe pricing for you guys is a bit better. Just thinking about your commentary about growth in the near term. I mean, is there enough line of sight into kind of new growth in the property side that we should be thinking about the gross premiums written growth rate kind of continuing near recent levels, at least for the foreseeable future?

Michael Patrick Kehoe
President, CEO & Director

The things we look at, I would say, if you look at the last 4 years, we've been growing either just below or just above that 40% rate. I would say that's an extraordinary growth rate in our industry. It's driven in part by some pretty dramatic increases in pricing. And it's been driven in part by strong growth in exposure. I think Brian Haney commented that our flow of new business submissions continues around that 20% growth level. And we've always looked at that as a little bit of a leading indicator. And then just some of the commentary, again, in the press and whatnot about distress in the reinsurance market, just been a little bit of commentary lately about reinsurers concern with adverse development across the industry for the 15 to 19 accident years on the casualty side.

I think that would be a good omen in terms of forecasting decent growth prospects for the industry. The E&S tax receipt information from some of the big E&S states like California, Texas, Florida and New York, seem to indicate that at this point in the first quarter of 2023, the E&S market continues to grow at a pretty dramatic rate. So all those things, I think, give us a good sense of optimism for 2023, certainly. Beyond that, it gets a little bit more speculative.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Great. And just lastly, some industry participants have seen a bit of narrowing spread between pricing and estimated loss cost trend. I appreciate the commentary you gave us on pricing just now. But anything notable you're seeing in terms of loss trend, any incremental pickup in loss trend in any lines?

Brian Donald Haney
Executive VP & COO

No. I think we noted a slight deceleration in real rate. And the reason we mentioned real rate is because there's the effect of premium trend in there. So we're seeing generally the same thing our competitors are going. We're just trying to convey it in a way that makes more sense and sort of ties more towards the movement in adequacy across the book.

Michael David Zaremski
BMO Capital Markets Equity Research

And I think our estimate of loss cost trend is pretty steady from the third quarter.

Brian Donald Haney
Executive VP & COO

Yes. So -- yes, what we see in the underlying data is not dissimilar to what our competitors should say. And it's like a very slight deceleration, or if you want to call it this way, have a reduction in margin is what you said? Or reduction in the Gap? Spread, yes. Got it.

Operator

Your next question comes from the line of Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

When you're talking about real rates up 7%, you're defining that as nominal pricing less your judgment on inflation trends. Is that right?

Brian Donald Haney
Executive VP & COO

Plus also adjusted for the effect of premium trend. Remember, a lot of our policies are sold on inflation-sensitive exposure basis. So as prices go up, the underlying premium goes up without even irrespective of rate. So for example, we cover products manufacturers. If the price of the product they're selling goes up because of overall inflation, that's going to give us more premium with that resulting in more exporter necessarily. So I mean it's nominal rate change adjusted for loss cost trend and adjusted for premium trend.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Okay. So your spread essentially versus inflation, it would still be considered 7 points. Is that the right way to think about it?

Brian Donald Haney
Executive VP & COO

Right. Another way of saying it is that if the real rate was 0, our rate adequacy should be steady. The real rate is positive, our rate adequacy in theory should be getting stronger. And our real rate is 7%.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Got you. Okay. And so the nominal rate presumably is something higher than that, add your inflation assumption on top of that would be your nominal rate. Is that right?

Brian Donald Haney
Executive VP & COO

The nominal rate is going to be something in the high single digits at this point. Loss cost trends also going to be in the higher single digits as well and then the new premium trend.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Brian, what was your precise comment about commission growth just under 20 compared to '20 or a little bit better than '20 previously?

Brian Donald Haney
Executive VP & COO

I think yes, I think that's exactly right. I said just under 20 this quarter. And I think last quarter, I said just slightly north of 20. So -- but it's a very modest. Actually, the number in the fourth quarter would be very similar to the number we saw in the first quarter of 2022. There really hasn't been a lot of change.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Okay. And then Mike, you mentioned the you don't buy that much XOL, cat XOL. What was the dollar amount of your payment last year for the CAT XOL coverage?

Michael Patrick Kehoe
President, CEO & Director

We'll have to get back to you on that. I don't have that. I think it was $7 million or something like that, is a guess. We'll get back to you on that.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And 7 -- and my question was how much did you pay for the reinsurance coverage maybe not how much did you see to the reinsurer, I don't -- maybe that you're answering my question, but...

Michael Patrick Kehoe
President, CEO & Director

It was somewhere in the mid-single digits is what we paid for our cat XOL treaty for the current year in terms of deposit premium.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. All right. So if you get inflation on that, it's not a big deal to your point?

Michael Patrick Kehoe
President, CEO & Director

Correct.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then how much more appetite do you have? Is there a kind of upper bound in the near to medium term when you think about where you're getting this growth in property and excess casualty? How much more are you comfortable taking on to -- within your mix?

Michael Patrick Kehoe
President, CEO & Director

Well, I think you're always looking at the risk you take relative to your capital base and relative to the expected profitability. So we've got a strong appetite to grow our business, especially when we're able to get rates like we get in the current pricing environment. Keep in mind, we've been raising rates ahead of trend for probably 4 years in a row now. So this is an extraordinary opportunity to create wealth for our stockholders. And so yes, we're working very hard to take advantage of it.

The one added complication on the property side is property, depending on the coverage you're selling, can come with an extraordinary amount of volatility. And that's why I kind of belabor that point about, yes, property is growing for us at a rapid rate, but we're doing all sorts of things to make sure that the volatility is not growing. We maintain a very broad geographic spread. So a lot of our property business is really driven by fire apparel as opposed to hurricanes that you would get if you write coastal business in the Southeast United States and the like. So we see it as a tremendous opportunity. We're working hard to take advantage of it, but we're also managing the volatility carefully.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then Bryan Petrucelli, the profitability when we think about your gross written premium up 45%, consistent with earlier periods, but maybe there's a little more mix shift in favor of property or the excess casualty. You take less of that to earn, but you get ceding commissions, and so it reduces your expense ratio. Is the earnings contribution from that written premium comparable, a little bit less, a little bit more? When you think about the puts and takes around what you retain, and how it impacts the P&L? I'm just thinking that, trying to gauge the quality of the 45% growth with this mix versus a different mix from earlier periods.

Michael Patrick Kehoe
President, CEO & Director

Mark, I'll take the first one. I would look at it this way. As a public company, our investors don't -- are not interested in a lot of volatility in our results. And so one way we manage that volatility is by buying reinsurance, especially on the property where you've got natural catastrophe exposure and especially on the excess casualty where we're putting up larger limits. There is a lot of margin in that business. Our reinsurers have made a decent return reinsuring our book of business over the years, but we're also well compensated with that ceding commission. Effectively, we're offloading the volatility, and we're replacing some of our investment income on those reserves with that ceding commission. So I think, in general, it's a very positive trade and I don't look at that as less profitable than our primary business. It's just -- there's other considerations beyond just profitability. It's again, managing that volatility.

Operator

Your next question comes from the line of Casey Alexander from Compass Point.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Yes. First, my first question is in relation related to the ceding commissions and the impact on the expense ratio, is there any persistency to that? Or is that really just a onetime impact on the quarter?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Well, I think it's going to depend on the mix of business, right? So if you have continued growth in the lines of business, for which we buy reinsurance that have related ceding commissions then I think theoretically, you could have a have a little movement there. But I think in general -- I think if you look at our expense ratio over the 12-month period and focusing less on sort of the volatility quarter-to-quarter is probably a good way for you to look at it.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Okay. And secondly, while you've been earning more yield from your investment portfolio, over the last couple of quarters, the duration has been going down pretty rapidly, which tells me that you're really just still rolling short-term securities on that. Is there a strategy to eventually expand that duration and capture some of that yield for the longer term?

Michael Patrick Kehoe
President, CEO & Director

Yes, Casey, this is Mike. The yield curve is inverted. So we're getting paid a lot more on the 2-year duration, if you will, than you are on the 4 of the 5. And so we're capturing that and we'll probably shift at some point, but we're willing to accept, if you will, the rollover risk of a shorter portfolio for the higher yield. And I think Brian had indicated in his remarks that we're getting around 5% on new money. So that's -- I think that's probably double where we were a little over a year ago.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Lastly, what is the -- do you -- what's the age of the buildings that you bought?

Michael Patrick Kehoe
President, CEO & Director

I think one may have been built in the 60s. In one, maybe in the '80s -- around 1980 -- I kept forgetting exactly, but they're very well maintained. And I don't think there's any real issue with the one that's subject to the long-term lease. The older of the two does need to be renovated and our basis in that purchase is pretty modest. So we feel pretty positive about return prospects on that deal.

Operator

[Operator Instructions] Your next question comes from the line of Andrew Andersen from Jefferies.

Andrew E. Andersen
Jefferies LLC, Research Division

Really strong growth this quarter, so it doesn't appear to be coming in results, but I'll ask anyways. I think last quarter, you had mentioned some slowdown in construction-related business, has the degree of that changed or expanded to any other lines? Maybe just more broadly, just economic thoughts here.

Brian Donald Haney
Executive VP & COO

Yes. We still see a little bit of relative slowdown from previous years. I would like to point out that we -- our construction unit covers residential and commercial and both new construction and renovations and all across the spectrum. If you look at total construction spending in the U.S., it's not actually down. It's just not growing at the rate it has been growing in the previous year. So what we're seeing is consistent with what you would see in the Federal Reserve data on total construction spending. It's growing probably around 6% or 7% nominally.

Andrew E. Andersen
Jefferies LLC, Research Division

Got it. And then submission growth still very strong here, ticked down just a bit, but perhaps with casualty becoming less of a difficult marketplace for brokers to place business, could that create some pressure on commission rates that you're paying to broker since I think it's a bit below average right now?

Michael Patrick Kehoe
President, CEO & Director

This is Mike. I would say there's always pressure on commission. Our brokers are critical to our success. We work very hard for them. We do pay slightly lower commissions than some of our competitors, but we also offer the marketplace and our brokers a much broader risk appetite by not delegating underwriting authority. We're able to consider some tougher traditionally E&S placements where a lot of our competitors that delegate underwriting authority, especially on small accounts had to almost migrate to more of a preferred type risk. We also have a very high service model. We quote an extraordinary percentage of the new business submissions we receive and we closed them very quickly.

So I think that helps offset some of the commission issues. And finally, we're a low-cost provider. One of the extraordinary things about Kinsale's business model is we're able to operate with an expense ratio that's really dramatically lower than the general marketplace, which gives us a lot of flexibility to offer more value to the business owner in the form of more competitively priced insurance but at the same time, deliver best-in-class returns to our stockholders. So for those reasons and a variety of others. Yes, there's always pressure on commission, but we don't anticipate any changes there.

Andrew E. Andersen
Jefferies LLC, Research Division

And maybe just like a market-related question. I think we heard from a larger peer that they think of like a sandbox for small commercial E&S of around $8 billion. Is that roughly how you view it? Or is it a bit more of a moving target?

Michael Patrick Kehoe
President, CEO & Director

No. We would say that would wildly understate the market. I haven't seen the 2022 statistics, but the biggest E&S writer in the United States is Lloyd's, which is obviously not a single entity, but it's a marketplace. And I think they were close to 17% market share in 2021. I think that put some -- a number over $8 billion. And most of what I think they write in the United States is small commercial. They delegate underwriting authority to all of the wholesale brokers we work with. For most of those brokers, Lloyd's is one of -- or maybe is their largest market. So we would look at the total addressable market for E&S is somewhere between 2/3 and 3/4, and we would estimate the market for 2022 was about $100 billion.

Operator

Your next question comes from the line of Pablo Singzon from JPMorgan.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Mike, can you comment on the competitive environment you're seeing in the market? So other E&S companies have been growing fast as well. Some of them are the largest, right? And I think at this point about other E&S industry has a recognized attractive opportunity in. So just sort of your thoughts on the latest on where you see competition these days?

Michael Patrick Kehoe
President, CEO & Director

Yes. I think as Brian Haney indicated, we feel very positive about the market environment. It varies by product line. But in general, it's a bit of a seller's market more so than a normal intensely competitive period in the insurance cycle. That being said, we only find about 10% of our new business quotes and that's consistent with the way our book has performed over the last 4 years. So I think that just reiterates -- there's plenty of competition. There's a lot of new entrants, lots of fronting companies, 15 or 20 or maybe even more than it opened up in the last couple of years.

They exist to connect MGAs to reinsurance capacity. So there's lots of delegated underwriting authorities out there. But that being said, there's a lot of business being pushed from the standard to the nonstandard market, and we're battling and competing with probably 75 other risk-bearing entities. And I don't even know how many MGAs. It's tons. So it's kind of -- I see it as a bit of a balanced market. Property is a little bit of an exception just because of the -- some of the cat losses the last several years, the reduction in reinsurance capacity. That's definitely a hard market. But all of our casualty lines, in general, we feel very good about. Positive rate changes, good top line growth, phenomenal levels of profitability even in this inflationary environment. So I think that kind of sums up our view.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Got it. And then just a couple of more questions on underwriting here. The first one is just given your comment on the spread between pricing over loss trends, do you see -- would it be reasonable to assume some level of continued improvement in your [AOI] loss ratio next year, but maybe not as much as in previous years. Is that a fair way to think about it?

Michael Patrick Kehoe
President, CEO & Director

I would say, just given the level of inflation, the court systems are reopening from COVID. There's still a lot of uncertainty out there. And so I think that always causes us to be cautious in terms of establishing reserves for future claims and just being very conservative in that regard. You saw our favorable development drop by a point or so. Again, you're just seeing some of the conservative approach to building the balance sheet. So I don't think we're really forecasting where that loss ratio could go. You have to balance. I think the prices we charge with expectations for inflation and loss development.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Okay. And the comments made on cost control in the press release. You probably don't run the business this way. But I guess, is there some effort to make sure that revenue growth always outstrips expense growth? Or like how are you sort of thinking about that aspect of the business? And I ask because you did mention another one of the -- you did mention it in the commentary in the press release.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Well, Pablo, I think if you look at the way that our costs break down, so say, on average, a 20% expense ratio on average 12% or so relates to commissions and the other 8% relates to other operating expenses. And of that 8% and the other operating expense bucket, the vast majority of that relates to human capital cost. So as we're monitoring sort of the movement of the business. We're hiring along the way to manage that growth. And as we see, if the market shifts and growth sort of goes in the other direction, I think we're well positioned to react pretty quickly on that.

Michael Patrick Kehoe
President, CEO & Director

Yes. I would just add that expense -- that expense advantage, I think, is a fundamental part of our business strategy. And so it's something we're always working on, not just maintaining but looking for ways to improve on it, principally by driving more automation into our business process. That's a slow steady process that involves rolling out new technology, but that's definitely an ongoing goal.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Okay. And then last one for me. You did mention growth and your expectations on title. But I guess my follow-up there would be, could you provide some sense of the guideposts you're thinking about when squaring capital needs against growth, right? Recognizing that you have these -- all these kind of resources, your earnings can actually support a decent amount of growth, right? If you sustain like 20% ROEs, but I suppose there's some premium level and whether you think about it in terms of percentage growth or actually dollars where maybe you'll have to pack more capital. But any sort of like very broad and high level guidepost that one might think about from the outside when considering your capital needs vis-a-vis growth?

Michael Patrick Kehoe
President, CEO & Director

Yes. So our retained earnings are phenomenal, if you look at the returns we're generating that finances a lot of our growth. I think Bryan indicated that we would look to borrow some additional money should we need external capital. And then, hey, if the growth is so extraordinary that we need additional equity capital, you're liable to see something like we've done in the last several years, very small equity capital raises at attractive prices that really don't impact the existing shareholders much at all.

Operator

Your next question comes from the line of Rowland Mayor from RBC Capital Markets.

Rowland Juran Mayor
RBC Capital Markets, Research Division

Sticking on the debt discussion, I think the debt-to-cap ratio is up to 21% in the quarter. I get the high ROE solved that problem over time. But in thinking about doing more debt offering, would there be a level where you would not take the debt to cap above that in the near term? And where long term do you expect that debt-to-cap ratio to stabilize?

Michael Patrick Kehoe
President, CEO & Director

This is Mike. I mean we like that 20% or so range as a long-term and conservative level of debt on our balance sheet. The ratio has been boosted lately with the real estate purchase, but there's going to be some real estate sales over time that will bring that back down. But in terms of the insurance business, in particular, we like the 20%, and we like the idea of using debt versus equity, if we can and maintain a good conservative balance sheet.

Rowland Juran Mayor
RBC Capital Markets, Research Division

Okay. And then I guess this is another way to come at the growth question, how does your headcount scale relative to your premium growth? And is there a point where it becomes growing 40% on 40% on 40% becomes an issue of not being able to hire enough talent? Or can you just walk through sort of the organizational management of that growth?

Michael Patrick Kehoe
President, CEO & Director

Yes. I mean we're -- when you're growing a business as quickly as we are, you're definitely adding underwriting and claims professionals. We've also, in the last couple of years, dramatically expanded our investment in our IT department. We're making very significant investments there to drive further automation in our business process. I think we've achieved the last couple of years, some pretty extraordinary growth in productivity. If you look at our year-end headcount in 2021, I think it was 367 employees. I think year-end 2022 is 457. So we obviously hired a lot of people.

Our model is to -- this varies by department. But in underwriting, we bring in a lot of new people to the industry and train them in claims and in IT, it's more of a mix between new and more experienced professionals. But I think in sales put an enormous amount of effort in not just the last year, but going back years in developing people and developing human capital. And I think it's paying off and allowing us to grow the business and not have lack of personnel be a constraint on growth.

Operator

And there are no further questions at this time. Mr. Mike Kehoe, I turn the call back over to you for some final closing remarks.

Michael Patrick Kehoe
President, CEO & Director

Okay. Thank you, operator, and thank you for everybody for participating. Obviously, the results we posted for 2022 are the result of a lot of extraordinary hard work by the Kinsale professionals that come to work here every day. So we definitely want to recognize everybody on the Kinsale team and all the Kinsale brokers around the country. They are a critical part of our success. And obviously, we continue to work very hard for them to help them build their businesses, and we look forward to talking to everybody again in a few months.

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