S&P Global
Market Intelligence

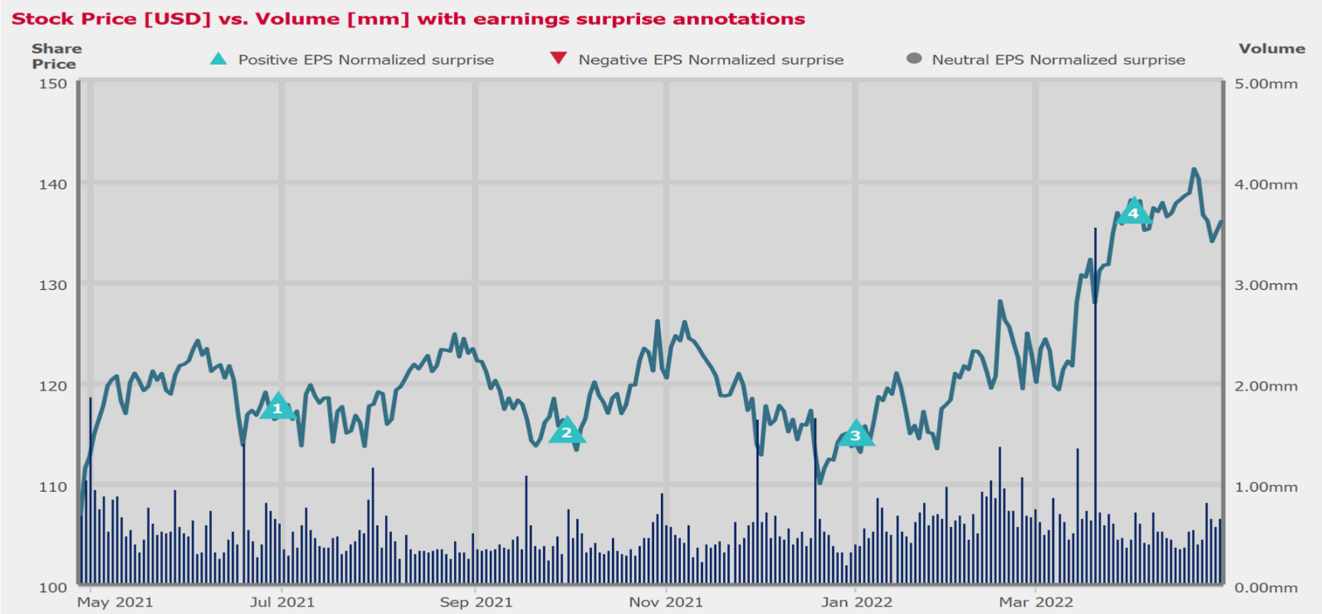
Cincinnati Financial Corporation NasdaqGS:CINF
FQ1 2022 Earnings Call Transcripts

Friday, April 29, 2022 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.45	1.58	▲8.97	1.01	5.44	NA
Revenue (mm)	1825.20	1215.00	▼(33.43 %)	1858.65	7495.40	NA

Currency: USD
Consensus as of Apr-24-2022 6:22 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	0.98	1.79	▲1 82.65 %
FQ3 2021	0.91	1.28	▲2 40.66 %
FQ4 2021	1.36	1.97	▲3 44.85 %
FQ1 2022	1.45	1.58	▲4 8.97 %

Table of Contents

Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

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

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Steven Justus Johnston
Chairman, President & CEO

ANALYSTS

John Thomas Heagney
Dowling & Partners Securities, LLC

Mark Alan Dwelle
RBC Capital Markets, Research Division

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

Presentation

Operator

Thank you all for standing by, and welcome to the CIF First Quarter 2022 Earnings Conference Call. [Operator Instructions] Please also note that today's call is being recorded.

I'll now turn the call over to your host, Dennis McDaniel, Investor Relations Officer. Sir, you may now begin.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our first quarter 2022 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 President, 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, and good morning, everyone. Thank you for joining us today to hear more about our first quarter results. It was another quarter of good operating performance. Our agency-focused strategy led to profitable growth and reflects well on the skill and dedication of our associates and excellent relationships with terrific independent agents. We reported a net loss of $273 million for the quarter, due to the recognition of a reduction in the fair value of securities held in our equity portfolio.

Non-GAAP operating income for the first quarter of 2022 was up $31 million or 14% versus a year ago. Our 89.9% first quarter property casualty combined ratio was 1.3 percentage points better than last year's first quarter. The current accident year loss and loss expense ratio before catastrophe loss effects rose slightly compared with accident year 2021 measured at 3 months, reflecting an increase in large losses for our property lines of business.

We again managed our business to healthy levels of policy retention with meaningful average renewal price increases for each of our property casualty insurance segments. Policy retention rates for both commercial and personal lines improved from a year ago to the upper 80% range. Consolidated property casualty net written premiums rose 12% for the first quarter of 2022. Our pricing segmentation efforts continue to support what we believe is profitable growth as our underwriters work to retain and write more profitable accounts while taking appropriate action on opportunities that we determine have inadequate pricing. We also believe renewal pricing during the first quarter was again ahead of our estimate for prospective loss cost trends for each property casualty segment.

Our commercial lines insurance segment continued to experience estimated average renewal price increases in the mid-single-digit percentage range, similar to the fourth quarter. In the first quarter, personal lines average renewal price increases slowed by a small amount compared to the fourth quarter, remaining in the low single-digit range. Our excess and surplus lines insurance segment continued in the high single-digit range.

Our commercial lines segment grew first quarter 2022 net written premiums by 8% and with a combined ratio of 92.3%. Our personal lines segment net written premium grew 11%, reflecting our continued planned expansion of high-net worth business produced by our agencies. The segment's first quarter combined ratio of 83.9%, improved 17.2 percentage points from a year ago, driven by lower catastrophe losses. Our excess and surplus lines segment had an 85.9% combined ratio and continued strong growth, with first quarter 2022 net written premiums rising by 25%.

Cincinnati Re and Cincinnati Global, each had a nice quarter with healthy growth. Cincinnati Re grew net written premiums by 30% for the first quarter of 2022 with a combined ratio in the mid-90% range. Cincinnati Global, grew net written premiums by 24%, with a combined ratio also in the mid-90% range.

Our life insurance subsidiary generated first quarter 2022 net income of $10 million, matching last year's first quarter, and grew term life insurance earned premiums by 6%.

I'll conclude with the value creation ratio, our primary measure of long-term financial performance. VCR was negative 6.9% for the quarter, while net income before investment gains or losses contributed 1.9 percentage points. Lower investment valuations during the quarter resulted in the investment gains or losses component contributing negative 8.6 points.

Now our Chief Financial Officer, Mike Sewell, will highlight several other important aspects of 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 grew at a good pace, up 6% for the first quarter of 2022 compared with the same period a year ago. First quarter dividend income was up 12% and net equity securities purchase totaled $34 million. Bond interest income grew 4% in the first quarter while the pretax average yield of 4.01% for the quarter was down 13 basis points from a year ago. The average pretax yield for the total of purchased taxable and tax-exempt bonds during the first quarter of 2022 was 3.64%. We again purchased additional fixed maturity securities with net purchases during the quarter totaling $109 million.

Valuation changes for our investment portfolio during the first quarter of 2022 were unfavorable in aggregate for both our stockholdings and our bond holdings.

[Audio Gap]

dollars before tax effects, including a net decrease of $746 million for unrealized gains in our bond portfolio. At the end of the first quarter, total investment portfolio net appreciated value was approximately $6.6 billion, including $46 million for our bond portfolio.

Cash flow again helped to grow investment income. Cash flow from operating activities for the first quarter 2022 generated at $198 million compared to $354 million a year ago.

Balancing strategic investments in our business with expense containment initiatives continues to be a priority. The first quarter 2022 property casualty underwriting expense ratio was 2.2 percentage points higher than last year. Most of the increase was from higher accruals for profit-sharing commissions for agencies and related expenses.

Regarding loss reserves, we aim for a consistent approach by targeting net amounts in the upper half of the actuarially estimated range of net loss and loss expense reserves. As we do each quarter, we considered new information such as paid losses and case reserves and then updated estimate ultimate losses and loss expenses by accident year and line of business. During the first quarter of 2022, we experienced $41 million of property casualty net favorable development on prior accident years have benefited the combined ratio by 2.5 percentage points.

In recent years, we've experienced significant growth in commercial umbrella coverage within our commercial casualty lines of business, including 16% in 2021 as industry pricing for umbrella has been strong. Umbrella losses tend to be frequently -- relatively infrequent with high severity and we recently experienced an elevated level of large losses, particularly for accident year 2019. Due to increased uncertainty for our umbrella business, we strengthened reserves for certain accident years and estimated ultimate losses for accident year 2022 at what we believe is a prudent level.

On an all-lines basis by accident year, net reserve development for the quarter was favorable by $46 million for 2021, $24 million for 2022, unfavorable by 2020 by $28 million for 2019, and unfavorable by $1 million in aggregate for accident years prior to 2019.

Now let me turn to capital management. We continue to follow a consistent approach that includes share repurchases as part of maintenance intended to offset the issuance of shares through equity compensation plans. However, changing circumstances or opportunities can influence us to repurchase more or less than historical averages. We believe that our quarter end financial strength was excellent and provides ample financial flexibility.

During the first quarter of 2022, we repurchased 375,000 shares at an average price per share of $120.05. I'll conclude my prepared remarks as I usually do, with a summary of 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 $0.81. Life insurance operations increased book value $0.06. Investment income, other than life insurance and net of noninsurance items, added $0.53. Net investment gains and losses for the fixed income portfolio decreased book value per share by $3.67. Net investment gains and losses for the equity portfolio decreased book value by $3.33. And we declared $0.69 per share in dividends to shareholders. The net effect was a book value decrease of $6.29 per share during the first quarter to $75.43 per share.

And now I'll turn the call back over to Steve.

Steven Justus Johnston
Chairman, President & CEO

Thank you, Mike. It's satisfying to see the steady execution of our initiatives producing these strong results. March and April brought a return of business travel and a return of our headquarters associates working together in person. It's wonderful to see so many familiar faces in the hallway and to be able to get out from behind our desk to visit with agents in our field teams across the country. This return to a bit of normalcy has produced an energy you can feel across our organization, bringing with it lots of optimism for the future of Cincinnati Financial.
As a reminder, with Mike and me today are Steve Spray, Marc Schambow, Marty Hollenbeck and Theresa Hoffer. Jesse, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from the line of Meyer Shields of KBW.

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

I apologize if you covered this. I didn't think I caught it, but there seems to have been a lot of losses above $1 million, like in $1 million to $5 million range. Is that inflation? Or is that just random noise? Or anything else?

Steven Justus Johnston
Chairman, President & CEO

Meyer, this is Steve, and good question. We think it's more in the random noise category for this first quarter. Certainly, inflation, we're keeping a close eye on and so forth. But it's 1 quarter, it was largely in our property lines. And we will continue to keep a close eye on it. We think it was more random noise. And it did reflect about 4 points on the current accident year when comparing it to that 0.9% increase overall in the current accident year.

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

Okay. That's helpful. Second question, when -- we've been seeing, I guess, some level of wage inflation, which is clearly helping, I guess, with workers' compensation premiums. Is it your sense that the impact on same costs for indemnity are in line with that? Or is there any disparity with how -- with the premium and the loss impacts of higher wages?

Steven Justus Johnston
Chairman, President & CEO

Yes. We're keeping a close eye on that as well because with payroll being the exposure basis for workers' compensation, that should help on the premium side. Also, we've got the inflation. I think our -- we feel confident in our workers' comp book. It's the loss ratios have been rising as the competitive environment in the industry and NCCI have decreased rates. But we still feel good in terms of what we've done, in terms of really working workers' compensation down as a percentage of our overall commercial premium. But at the same time, supporting agents and -- on what we feel to be the best risk, the most adequately priced risks.

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

Okay. And if I can throw in one other real quick question. One of the competitors in the high-net worth homeowner space has talked about double-digit loss trends there. Does that match what you're seeing in your book?

Steven Justus Johnston
Chairman, President & CEO

No, I don't think we've been seeing double-digit loss trends in our book, no. And we do feel good about the high-net worth book. Thank you. Meyer.

Operator

Next question is from the line of Mark Dwelle of RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, Research Division

I've got a few questions. So Meyer kind of touched on it a little bit. But I guess the increase in the current accident year loss ratio in the commercial lines segment, is that primarily attributable to the number of large losses in the quarter? Or is there kind of more work beneath the surface there?

Steven Justus Johnston

Chairman, President & CEO

Yes. And if we would break the commercial lines segment down, the current accident year rose by 1.2 points, and the effect of large losses on that was 5.1 points. So well more than the amount of the total increase in the current accident year.

Mark Alan Dwelle
RBC Capital Markets, Research Division

So if -- I mean, there must be some normalized kind of large loss load though that would be kind of embedded in a normal combined ratio. So if I was to try to -- if your large losses were more like normal, would there have been, I guess, a 2- or 3-point improvement, I guess, in the accident year loss ratio, kind of all else equal?

Steven Justus Johnston
Chairman, President & CEO

That's a good question. I don't have that handy. We've got it, but the -- the over time there but I can tell you for the quarter -- the first quarter here of 2022, it was 8.6 points in total in large losses over $1 million for the current accident year. For the first quarter of 2021, it was $3.5 million. So that difference is the $5.1 million that I just mentioned. So I feel -- it's like more of a feeling right now not having the numbers, but that $3.5 million seems more normal, feels more normal.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Got it. Okay. Marc -- go ahead.

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Mark -- I'm sorry. No, this is Steve Spray, Mark. I was just going to add that it's a normal process for us on any large loss that we take a look at risk category, geography, the policy inception date and agency or field marketing territory to see if we can any trends or patterns. And we have not. And like Steve said, we feel it's 1 quarter. And I think it's going to be more important to look at it over a longer period of time, but it is something that we absolutely watch on a regular basis.

Steven Justus Johnston
Chairman, President & CEO

While we still have you Mark, Dennis, as usual, is quick to help me out with the numbers. And in terms of the -- what we're seeing, I could turn you to Page 65 of our Q and -- or is it the K?

Dennis E. McDaniel
VP & Investor Relations Officer

The K.

Steven Justus Johnston
Chairman, President & CEO

I'm sorry, the K. And there it is, more, I would say, a little bit higher than what I said more in the 4% range. The last -- 2021 was the current accident year losses above $1 million, $4.2 million; $3.6 million for 2020; and 4.6% for '19. And then we had another -- for that over $5 million. So that was in the range of $1 million to $5 million. 1.8, 0.9 and 0.5, respectively. So more in that, say, 5, 5.5 range for that.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. That's helpful. It definitely helps clarify kind of what the more normalized run rate might really look like. The second question, and I know this is a little bit of a long shot. But is there -- do you have any exposure to the Russian-Ukraine conflict, either via the Cincinnati Re or the Cincinnati Global book? I know historically, you've written some aviation, but I didn't know if there was anything that might be impacted.

Steven Justus Johnston
Chairman, President & CEO

Yes. We -- it wouldn't be in aviation, but we have had a little bit of loss in CGU. It's about $5 million. So not a big amount to the organization. And really, hearts go out to all the people there in Ukraine for the suffering that's going on. For Cincinnati Re, it's de minimis in terms of loss, and we'll continue to keep an eye on it. But about $5 million for us for the quarter in total.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. That's helpful. And then last question, I guess, kind of related to the investment portfolio. Do you have a sense of about how much of your portfolio might mature and roll over the course of, say, the next 12 months or the balance of '22? I'm really just trying to get a sense of kind of what portion of the fixed income portfolio will have the opportunity to renew at the relatively higher new money rates that we're all seeing right now.

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

Yes, Mark. I do actually have that information. So this is looking the balance of 2022, about 4.4% of the portfolio; '23 6.3%; '24, [just 8%]; and '25, 9.3%. And book yields on that range is from 3.7% up to about 4.5% in 2025.

Operator

[Operator Instructions] Your next question from the line of John Heagney of Dowling & Partners.

John Thomas Heagney
Dowling & Partners Securities, LLC

I had a question on your multiyear policies in commercial. How does that impact your ability to reprice for the inflation we're seeing over the past 3 to 4 months?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Yes, John, Steve Spray. Yes, we're committed to that 3-year policy. We think it's important to our agents and our policyholders. It's consistent with our desire to have long-term relationships. And so when we can get an adequate rate for the risk terms and conditions, we're keen to offer a 3-year policy on our commercial packages. Just so you know on that, too, or maybe to give you a little more color, what that does is that really locks in the rate for the property, the general liability, the crime and the inland marine coverages.

And I would say this to you, too, is every year, whether it be those policies that are renewing off of a 3-year or the coverages that are subject to annual adjustment, about 75% of our commercial premiums are subject to an anniversary adjustment even with that 3-year policy. Does that make sense?

John Thomas Heagney
Dowling & Partners Securities, LLC

Yes. So essentially, I have a 3-year rate, but I can adjust it for the change in TIV. So that would be an inflation adjustment on an annual basis. Is that --

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

You can adjust it -- yes, you can adjust it for an inflation on TIV. And right now, that's -- we're running that in the high single digits. And you also -- say, your general liability, which would typically have your exposure, your premiums are based off of gross sales or payroll. As those increase, the premium goes up, it's just that the rate is locked in.

John Thomas Heagney
Dowling & Partners Securities, LLC

Right. Okay. How much of your portfolio overall is multiyear, if I just think of it crudely in terms of net premium written in commercial?

Stephen Michael Spray

Senior VP, Chief Insurance Officer & Director

Yes, it's about 60% of our policy count.

John Thomas Heagney
Dowling & Partners Securities, LLC

Okay. Then the next question I had, on CGU and then with your new delegated authority of Lloyd's. How much business is that MGA putting through to your own syndicate versus putting through to other syndicates at Lloyd's. I'm just trying to get a sense for how big the -- that delegated authority business could be. Because, obviously, you have a limit on your capacity at Lloyd's in your syndicate, but if you're writing elsewhere, it would seem that you have a bigger underwriting capability, at least for your agent.

Steven Justus Johnston
Chairman, President & CEO

Right. And sure, John. Good question. We're just with our first coverage that we are handling through the delegated authority, and it's a deductible buydown. And for that particular product, and especially given this is our first, it will be for our syndicate. As we look to future and rolling out additional coverages, we would open it up to partnerships with other syndicates over there.

John Thomas Heagney
Dowling & Partners Securities, LLC

Got it. So I'm asking that a little bit a little bit too far in advance in terms of where you are. And then finally, just 1 last kind of numbers question. E&S, how much of your E&S business is written with a standard insurance contract. So I was just trying to get a sense of how much your agents are leveraging that platform for the standard commercial product they're also offering?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Yes. John, Steve Spray. About 50% of the time when our E&S company writes coverage, Cincinnati Insurance company writes business on the standard side. So it's a high percentage. It's key to what we do. It works really well for the agents. It's -- I could get into a lot of detail, having the same claims rep, having -- actually having the same resources at Cincinnati Insurance Company for our agents and for those policyholders, whether it's admitted or non-admitted, is a big, big deal, and we're trying to do more and more of it. And you can see with the growth and the profitability in CSU, both have been extremely strong. So we feel really good about where that is going forward.

John Thomas Heagney
Dowling & Partners Securities, LLC

And then the rest of the book there, that's not wholesale market stuff, right? That's still giving retail agents better access to the E&S market. Is my understanding correct there?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Well, that is correct. That's exactly right. CSU, our E&S carrier and our wholly owned subsidiary, brokerage, C -- what we call C Super, only provides access to retail agents of Cincinnati Insurance company to our non-admitted offering. We do not -- our in-house brokerage does not place business in the broader E&S market. I think that might have been part of your question at the end. Only with our own non-admitted carrier and only for licensed and appointed agents of Cincinnati Insurance Company.

John Thomas Heagney
Dowling & Partners Securities, LLC

Right, right. Yes. No, I was getting at -- so the strategy is really geared towards making life easier for all your agents. It's just an agent-centric strategy.

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Absolutely. Everything we do. Yes, everything we do is agency-centric.

Operator

Thank you, participants. I'll now turn the call back over to Mr. Steven Johnston for final remarks.

Steven Justus Johnston
Chairman, President & CEO

Thank you, Jesse, and thanks to all of you for joining us today. We hope to see some of you at our Annual Meeting of Shareholders on Saturday, May 7, at the Cincinnati Art Museum. You're also welcome to listen to our webcast of the meeting available at cinfin.com/investors. We look forward to speaking with you again on our second quarter call. Have a great day.

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