S&P Global
Market Intelligence

Kinsale Capital Group, Inc. NYSE:KNSL

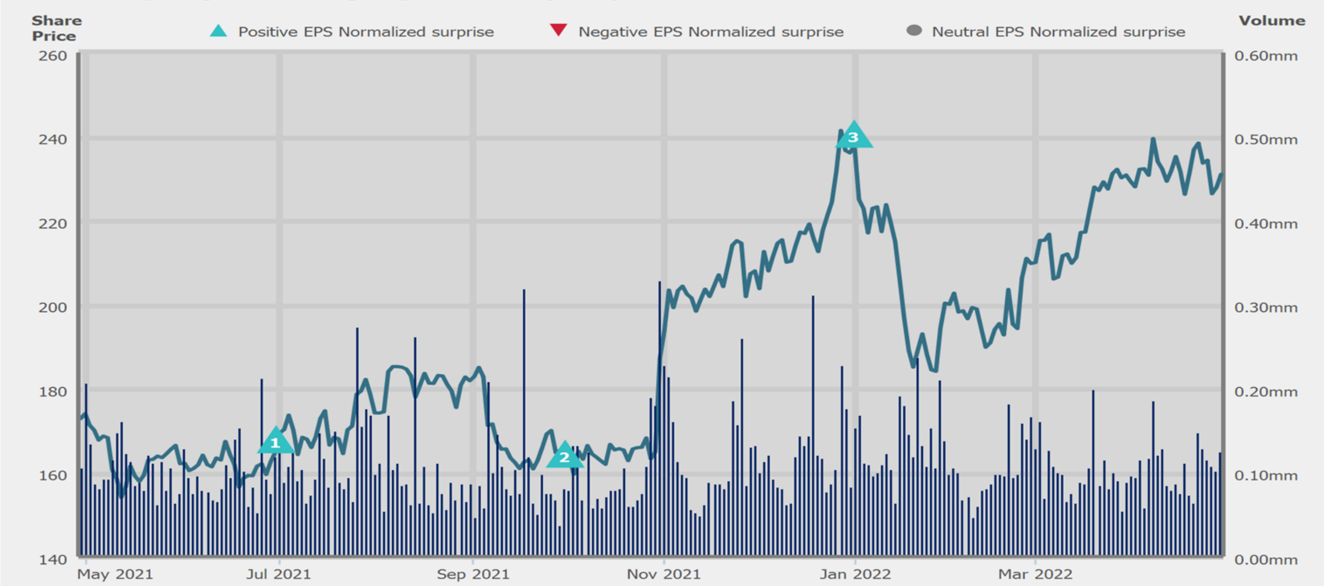
FQ1 2022 Earnings Call Transcripts

Friday, April 29, 2022 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.52	NA	NA	1.64	6.74	NA
Revenue (mm)	179.95	180.32	▲0.21	197.24	804.67	NA

Currency: USD
Consensus as of Apr-29-2022 6:43 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	1.06	1.28	▲1 20.75 %
FQ3 2021	0.99	1.59	▲2 60.61 %
FQ4 2021	1.38	1.76	▲3 27.54 %
FQ1 2022	1.52	NA	NA

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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

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

Mark Douglas Hughes
Truist Securities, Inc., Research Division

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 through the course of the teleconference, Kinsale's 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 first quarter results. Kinsale's management may also reference certain non-GAAP financial measures in the call today. A reconciliation of GAAP to 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. Welcome to our first quarter conference call. As usual, both Bryan Petrucelli, Kinsale's CFO; and Brian Haney, Kinsale's COO, are joining me. We will each make a few comments on the quarter and then proceed to any questions that you may have.

Kinsale's operating earnings for the first quarter 2022 increased by 47% over the same quarter in 2021, and gross written premium was up 45%. The company posted a 79% combined ratio for the quarter and an annualized operating return on equity of 22.1%. The performance of the business in the first quarter of 2022 is really a continuation of what we have been seeing for the last couple of years, a favorable and growing E&S market is creating a tailwind for Kinsale, in particular, by allowing us to raise rates and grow our premium at an unusually high level.

Adding to this tailwind is our own unique business strategy, expert underwriting and claim handling together with a technology-driven low-cost operation, the combination of which creates a powerful opportunity to deliver best-in-class profit and growth in years ahead. We remain confident that the E&S market environment will remain favorable and allow for further rate increases and strong premium growth over the course of the next year.

Beyond that, we have a little less visibility on the broader market, but we do have visibility on our competitive advantages, which we believe have real durability to them, specifically controlling our own underwriting and not contracting that out to third parties; and secondly, building a core competency around technology, just like we do underwriting and claims handling. Owning our own core system and not relying on external parties for that function contributes to our highly automated business process and all the various benefits that flow from it, productivity gains, superior customer service, more robust and accurate data. And of course, it's driving our low expense ratio and boosting our returns.

I'll now turn the call over to Bryan Petrucelli.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Thanks, Mike. The business continues to perform at a very high level with gross written premiums growing by 45% due to the continual favorable market conditions Mike just mentioned. We reported net income of $31.8 million for the first quarter of 2022, down slightly from $32.1 million last year due primarily to unrealized losses on our equity portfolio. Net operating earnings, which excludes the impact from fluctuations in equity values, increased by approximately 48%, up to $38 million from $26 million last year. The company generated underwriting income of $38 million and a combined ratio of 79% for the quarter compared to $25 million and 80% last year.

The combined ratio for the first quarter of 2022 included 4.7 points from net favorable prior year loss reserve development compared to 5.7 points last year with cat losses being negligible in both periods. A 21.6% expense ratio for the quarter continues to benefit from some economies of scale with earned premiums that are growing faster than our operating expenses. Operating return on equity was approximately 22% for the year and again, ahead of our mid-teens guidance.

Book value decreased by 4.8% for the quarter primarily due to unrealized losses on our fixed income securities 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 better yields. This ultimately benefits the company over the long term.

Net investment income increased by 31% over the first quarter last year, up to $9 million from $7 million last year as a result of continued growth in the investment portfolio. Annual gross investment returns, excluding cash and cash equivalents, was 2.5% for the quarter compared to 2.6% last year. Earnings per share was $1.63 per share for the quarter compared to $1.11 per share last year.

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 first quarter, up from 36% in the fourth quarter. We saw further hardening in the property market, particularly in hurricane-exposed areas in the Gulf and Atlantic states. Beyond that, we are seeing gradual acceleration in submission growth. In the first quarter, it was in the high teens.

Closure bases are going up, driven by economic activity and by inflation. Growth was particularly strong in our Commercial Property and in the Marine divisions. Also, our General Casualty book grew significantly helped by the reopening of the economy. We saw rates up in the low double digits in the aggregate during the first quarter, generally consistent with the past several quarters.

The reason that the overall rate change is not moderating as has been reported by some other carriers is that we are growing fastest in the areas where rates are increasing the fastest, which tends to raise the weighted average. We are carefully monitoring inflation and loss cost trend and being cautious in our approach.

Clearly, earlier prognostications in the press that inflation would be transitory did not pan out. The effects of the abrupt massive increase in money supply may take a longer time to work through the economy than many people had thought and will likely cause disruption in pain in the insurance industry, which will serve to prolong the hard market.

Kinsale, with our low expense ratio and higher margins and more nimble efficient processes, is in a better position to navigate the current economic situation than many of our competitors. Also, it is worth noting that we have been achieving rate increases ahead of loss cost trend for several years now. These increases, combined with our strategy of conservative reserving, further protect the company from the threat of inflation that some of our peers are more exposed to. The fact that we write 100% of our business in the E&S market means that we -- and are positioned to react much more quickly to events than our peers that have significant admitted business.

With our control over the underwriting as well as our superior technology, we have the necessary data to understand what is going on in our book much more so than our competitors who delegate underwriting authority or who rely on antiquated technology. Again, it was a good quarter. And again, 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 any questions in the queue.

Question and Answer

Operator

[Operator Instructions]

Our first question comes from the line of Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Anything on average policy size, have you seen much change there?

Michael Patrick Kehoe
President, CEO & Director

I think our average premium size is like around 11,600 or something like that. It may be up very modestly. In general, our strategy is still to target the small- to medium-sized accounts. Depending on the mix of business in any quarter, that could shift a little bit, but clearly, rate is helping as well.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. The ceded premiums, just the ratio down a few points year-over-year. You mentioned how a property is a focus for you. I don't know whether that impacts the ceded premium? Or is there an issue of excess versus primary that's influencing that?

Michael Patrick Kehoe
President, CEO & Director

Yes. Yes, mix of business. We see it off more in the excess than the primary casualty policies we just keep at. So the mix is going to impact that. If you're comparing year-over-year, our retentions have incrementally increased.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Yes, and I think there were some reinstatement premiums last year in the first quarter that were booked to you, Mark.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Okay. And so you say your retentions have increased, just keeping more of the business yourself. Is that the way to think about it?

Michael Patrick Kehoe
President, CEO & Director

Well, if you look back a number of years, yes, there's been incremental adjustments in our retention. So the change in retention, the mix of business, the reinstatement premium last year, all those things could kind of, I guess, obfuscate your year-over-year comparison.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. And then, Brian, you talked about the, I think, did you say gradual acceleration in submissions.

Brian Donald Haney
Executive VP & COO

Yes.

Mark Douglas Hughes

Truist Securities, Inc., Research Division

Okay. And so that's kind of through the first quarter, you continue to see acceleration?

Brian Donald Haney
Executive VP & COO

Yes. I don't -- the growth rate in the first quarter in submissions was marginally higher than the growth rate in the fourth quarter.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. And then any other end markets or lines you mentioned Commercial Property, marine, general casualty. Any other observations you might make your point about you were going after the business that you're getting more rate is -- seems very relevant. Any more detail on that front?

Brian Donald Haney
Executive VP & COO

No. I mean, I would just say that the growth is widespread. I'd say most -- has it been the case for a while now, most of our divisions grow in those quarters. And there may be like little pockets here and there that get faster or slower, but like the core of what we do grows a very steady, right?

Michael Patrick Kehoe
President, CEO & Director

And then that's been consistent really, Mark, the last couple of years now.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Yes. And then one more. Anything about the claims frequency, severity, you've talked about inflation, how that prolonged the hard market. But are you seeing any -- I know you've got the tools to deal with it, but any signs of inflation in your book, yes.

Michael Patrick Kehoe
President, CEO & Director

Yes. The 2 trends I comment on are, yes, we do see inflation, right, especially when we're adjusting property claims, the cost of building materials and whatnot. I mean that's all being factored in settlement. So the inflation is real. I would say, the more interesting trend at the moment, which again has continued now throughout COVID is that reported losses have come in slower than we would have expected. And we continue to offset those lower reported losses with higher IBNR because there's a real question around whether the trends in the reported losses are being driven principally by disruption in the core system.

And if that's the case, and the courts have now largely reopened and they're trying to probably play a little catch up. I think there's a question as to whether those loss trends kind of reverts to their need and so we're prepared for them to do that and if they don't in the future, then some of that extra redundancy will kind of waterfall out year after year, but I think we always like to reiterate with our investors that we take a very conservative approach to reserving, and they should have a lot of confidence in our balance sheet.

Operator

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

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

So your gross fee and gross rate was one of the highest in our recent history. I think it's close to $80 million on an absolute basis versus last year. Was there anything unusual about the business you booked this quarter? Or do you see that type of growth continuing at a similar pace through the remainder of the year, whether measured in absolute terms or in terms of percentage?

Michael Patrick Kehoe
President, CEO & Director

Pablo, this is Mike. I would say that Brian highlighted a couple of the divisions where we're seeing a little bit stronger growth, property, in the Marine, our general casualty area, where we write a lot of hospitality and apartment type business, premises liability, but we're seeing good growth across the portfolio. If you look back the last several quarters, you're going to see that the growth rate does have a little bit of volatility to it. And we don't really forecast growth specifically. But obviously, we've made some very optimistic comments about the market overall.

And we feel very positive about the next several quarters. I'm trying to remember our growth rate in the fourth quarter, I think it was in the 30s. Yes. So we grew 36% in the fourth quarter, 45% in the first. I think you have to allow for a little bit of volatility like that. But in general, these are really extraordinary times in the E&S market, and we're working really hard to take advantage of them.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Understood. and then if I turn to your margins, there was a distinct quarterly pattern in the accident year loss ratio in 2021, where the ratio -- or where the loss ratio was lower in the second half versus first half. It was also present in 2020, but a little less prominent. Do you expect a similar pattern this year maybe as a function of business that is renewing in any specific quarter?

Michael Patrick Kehoe
President, CEO & Director

Yes, I would say there's a number of things that can impact the loss ratio over the course of a given year, including reported losses, cash, that type of thing. But in general, we don't -- we don't have any -- Well, maybe the best way to say it is we're most conservative at the beginning of the year, right? It's a brand-new accident year. Those policies just went out the door. We really have no real indication as to -- we're just relying on actuarial assumptions at this stage of the year. As you get towards later part of the year, you can react to the reported loss activity. Obviously, that becomes more pronounced in the second year and the third year and the fourth year, et cetera.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Yes. So in other words, Mike, there's more flexibility to maybe adjust your loss picks, act into your loss picks later in the year, right? It's especially what you're saying -- is that a fair.

Michael Patrick Kehoe
President, CEO & Director

Yes. We said conservative loss picks. Assuming the losses developed as expected, which I think they're highly likely to do that or even better than expected, I think you would see that, hey, we're a little more cautious at the early part of the year than at the end of the year.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Okay. Understood. and then I have 2 more here. I think I mentioned pricing increasing low double digits. Given the environment, is there any change in where you see loss trends moving, I guess, versus a quarter or 2 quarters ago?

Brian Donald Haney
Executive VP & COO

I mean, obviously, the underlying inflation is going to take a while to sort of roll through. I mean right now, I'd say we're probably at 4% to 6% trends net of exposure-based trends, so net of the prices and the underlying products we're covering going up. So I still think we're in excess of -- we're achieving the rate increases in excess of loss cost trends.

Michael Patrick Kehoe

President, CEO & Director

And again, we have been now for several years. So it's -- I think we're in a very comfortable position with respect to inflation, but it's something we're concerned about, and we pay a lot of attention to.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Got it. And then last for me, I have a comment on submission. It's interesting because I was looking at your disclosure in the K. It seems like submissions have been growing over the past reasons, but actually growing at a slower rate. So I think in '19, it was 30% year-over-year. In '21, it was 13%. But based on your comments, it seems like they're growing high teens in the first quarter. So do you think that there will be an inflection of that level in this year? And what's driving that? Is it basically growth in maybe lines that you weren't growing as much in before?

Brian Donald Haney
Executive VP & COO

We really don't like prognosticate submission growth going forward. If I was to speculate what happened, I think that the COVID and the lockdown created this ripple effect where we actually got in some areas, a lot more submissions and so that when that kind of settled out, I think our submission growth kind of bottomed out in the low teens. But now you start to see the economy and the industry is returning a little bit more to normal. And so you're saying kind of what I'd say is probably the more expected run rate. We're getting past the effects of COVID and the lockdown and all of that. So that would be my guess.

Michael Patrick Kehoe
President, CEO & Director

But it wouldn't be unprecedented to see some volatility in that number either. It does bounce around.

Brian Donald Haney
Executive VP & COO

Yes, that's right.

Operator

[Operator Instructions]

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

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

And this may seem like kind of an arcane question, and you may not even have it with you. If you don't, you can come back to me with it. But I was just wondering, of the fixed income the fixed maturity portion of the portfolio, what percentage of that portfolio is characterized as available for sale. And on the available-for-sale portion of the portfolio, do you know what the average price is relative to par?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Answer to the first part is 100% of it is available for sale. I have to get back to you on the second question. I do not have that in front of me.

Operator

Our next question is the follow-up from the line of Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Any observations about the Lloyd's competitive behaviors? Or also in the past, Mike, you've talked about some of your program competitors being a little too aggressive and maybe there's going to be a reckoning on that front. Any updates on either topic would be helpful.

Michael Patrick Kehoe
President, CEO & Director

No updates other than it's a -- we're at a period in the market where there's a lot of delegated underwriting authority business being transacted. There's a huge growth in the number of fronting companies that assist with that. And I think I've said in the past, there are a lot of those delegated underwriting programs that are quite successful and have been around for a long period of time, but there are many that are not. And so there is a certain amount of volatility, if you will, in that space where programs can come and go rather quickly. But no real change in the last year. I mean it's -- we compete with a lot of NGAs, but we always have. So kind of in some ways, business as usual.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

You had mentioned the reported losses coming in slower than expected. I wonder if you could kind of walk us through -- the COVID 2020 certainly saw a decline in frequency. And then when we think about how that developed in 2021 and 2022 here to start with. Are we still at a depressed level. I wonder if you could just give some perspective on that trajectory.

Michael Patrick Kehoe
President, CEO & Director

I think the best way to look at that, Mark, is if you pull our statutory statement and look at our Schedule P information, I think you'll see that at least for most lines of business, our IBNR is at a higher percentage of the total incurred loss in the more recent accident years. I think you're seeing it's a way to kind of quantify, right, as the reported loss component has come down, the IBNR has gone up, which is the point I was trying to make before, hey, we're not realizing the benefit of this slowdown in reported losses, perhaps it's temporary, perhaps it's not. We don't really know right now, but I think we're well positioned. If the loss activity were to bounce back for those accident years. And if it doesn't, then, hey, some of that redundancy will come out year by year in the future.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

It is -- the 2022 starting out to be at least similar to what you saw in 2021 on that front?

Michael Patrick Kehoe
President, CEO & Director

Yes. I think 2022 is similar to what we've seen in the last '21 and '20.

Operator

Your next question is a follow-up from Pablo Singzon from JPMorgan.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

So are you able to offer some estimate of how much your net investment income could benefit from higher interest rates, I guess, over the next several years. It seems like your new money yield is already higher than where your portfolio yield is.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Yes. What I would say, I think in the fourth quarter, Pablo, I think our new money yield was somewhere in the 3% range and it's probably closer to 4.5% now.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Got it. Okay. And I guess the benefit will just sort of trickle in. I think your duration is about 4 to 5 years, right? So assuming no change.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Right.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Right. Okay. and then last one for me. Just from a capital perspective, is the plan still to issue debt later this year to fund growth? I suppose interest rates will be a little higher now, but I don't think it will be material to you, but if you could just sort of confirm your thinking on capital.

Michael Patrick Kehoe
President, CEO & Director

Pablo, I don't think that I would look at that. Okay. I'm sorry, we got distracted with your -- yes. Just give me a favor, repeat the question, yes?

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Yes. Sorry about that. Yes, I'm not sure what happened there. So just from a capital perspective, is the plan still to issue debt later this year to fund growth and I suppose.

Michael Patrick Kehoe
President, CEO & Director

Absolutely.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Okay. Yes. interests are higher, but I don't think it will be material to you, but okay.

Operator

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

Rowland Juran Mayor
RBC Capital Markets, Research Division

I saw the duration of the portfolio was extended to 4.6 years from 4.3 years at year-end. I just wanted to ask if there was anything to read into that? Or is that just, of course, the investments took in the quarter?

Michael Patrick Kehoe
President, CEO & Director

Yes. I think I wouldn't read a lot into it. If anything, I'd expect it to come in a little bit just with the uncertain interest rate environment right now.

Rowland Juran Mayor
RBC Capital Markets, Research Division

And then within that portfolio, can you break out the percentage that has a maturity of less than 1 year? I'm just trying to get an understanding of how much the portfolio can turn over in the next year at higher rates.

Michael Patrick Kehoe
President, CEO & Director

It's probably, I would guess, around 10%. But I think the 1 thing that kind of positively impacts that is we've got a very strong flow of cash. I think last year, our cash flow was a little bit over $400 million, which is a big number relative to the size of the portfolio. And I think given the premium growth this year, we would expect that number to grow at a pretty good clip. So it's the new money plus the maturities and paydowns and the like.

Operator

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Michael Kehoe for any further remarks.

Michael Patrick Kehoe
President, CEO & Director

Okay. Thanks, operator. Thank you, everybody, for joining us, and we look forward to speaking with you again here in a few months.

Operator
Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.