

Kinsale

3Q22: Ian Losses Elevated, But Mostly Offset By Strong Core Margins and Investment Income

Hurricane Ian losses hurt KNSL's underwriting results but were easily absorbed by favorable core underwriting margins and higher net investment income. We consider KNSL a high-quality E&S franchise and expect it to perform well through the underwriting cycle. Also, we think KNSL's financial results are likely to exhibit positive momentum over the medium term as it unwinds excess reserves on its balance sheet, writes business at favorable prices/terms, and benefits from higher interest rates. Still, we remain Neutral on the stock given its valuation as well as the risk of multiple compression when P&C pricing eventually turns (recognizing that Ian may further extend the already long running hard market).

- EPS roughly in-line.** KNSL reported 3Q22 operating EPS of \$1.64, close to our \$1.63 estimate but well above consensus of \$1.25. Compared to our model, KNSL's underwriting margins were lower (-\$0.12 per share), with elevated cat losses (\$26 million vs. \$10 million est.) partly offset by strong core margins (CoR ex. cats and PYD 76.4% vs. 80.5%E) and favorable reserve releases (\$11 million vs. \$7 million est.). However, the underwriting shortfall was more than absorbed by higher net investment income (+\$0.13), driven by growth in invested assets and higher new money rates. Net written premiums rose +38.2% from 3Q21, above our +33.0% assumption. Notwithstanding elevated catastrophe losses this quarter, KNSL's past results have consistently exceeded our expectations, and we think there could be further upside in our estimates from a lower combined ratio, higher investment income, and premium growth.
- The overall operating environment remains favorable for KNSL.** Although price increases in the broader P&C market have slowed in recent years since hitting a peak in 2020, KNSL has consistently reported price increases in the low-double-digit range over the same timeframe. In our view, this is partly due to the small account focus of KNSL, a market that has historically been more insulated from the boom-bust pricing cycles of larger accounts. If large account pricing continues to trend down, small account pricing could follow suit. However, we think that that losses from Hurricane Ian (and its implication for reinsurance pricing) could be another catalyst to extend the hard market. KNSL reported an average policy size (a proxy for pricing trends) of \$14,700 in 3Q22, up 13% from \$13,000 in 3Q21.
- Other points of interest from the quarter:** (1) Although not disclosed by KNSL, the magnitude of catastrophe losses in 3Q22 seems to suggest a close to full retention loss from Ian (KNSL has a \$25 million per event retention). Given KNSL's push into property lines and its faster growth in Florida in recent years, management's approach to writing catastrophe-exposed property could be an area of focus with investors. (2) There could be questions about the sustainability of the 3Q22 AY loss ratio of 57.2%, which declined 62 bps from 3Q21 and a much larger 410 bps from 2Q22. (3) The COVID accident years (2020 and 2021) continue to develop favorably against initial loss picks.

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Neutral

KNSL, KNSL US

Price (27 Oct 22): \$272.01

▲ Price Target (Dec-23): \$250.00
Prior (Dec-23): \$230.00

Insurance - Life & Nonlife

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Key Changes (FYE Dec)

	Prev	Cur
Adj. EPS - 23E (\$)	8.16	9.06

Quarterly Forecasts (FYE Dec)

Adj. EPS (\$)	2021A	2022E	2023E
Q1	1.11	1.63A	
Q2	1.28	1.92A	
Q3	1.59	1.64A	
Q4	1.76	2.03	
FY	5.74	7.20	9.06

Style Exposure

Quant Factors	Current		Hist %Rank (1=Top)			
	%Rank	6M	1Y	3Y	5Y	
Value	99	98	94	100	98	
Growth	5	5	6	7	1	
Momentum	5	5	80	2	11	
Quality	11	6	9	15	14	
Low Vol	73	80	44	64	84	
ESGQ	80	78	75	82	-	

3Q22 Results

EPS: \$1.64A vs. \$1.63E

NPW growth: +38.2% vs +33.0%E

Comb. ratio: 83.6% vs. 82.0%E

Positives

Premium growth

Investment income

Core underwriting margins

Negatives

Elevated catastrophe losses

See page 11 for analyst certification and important disclosures.

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Price Performance



Company Data

Shares O/S (mn)	23
52-week range (\$)	285.66-160.92
Market cap (\$ mn)	6,235.70
Exchange rate	1.00
Free float(%)	94.4%
3M - Avg daily vol (mn)	0.14
3M - Avg daily val (\$ mn)	37.4
Volatility (90 Day)	37
Index	RUSSELL 2000
BBG BUY HOLD SELL	3 4 0

Key Metrics (FYE Dec)

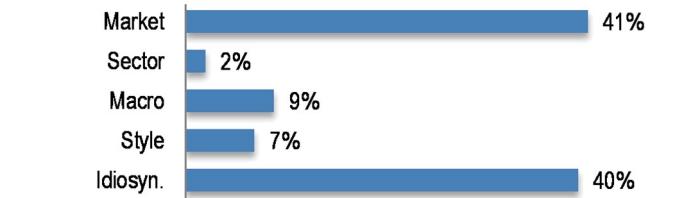
\$ in millions	FY21A	FY22E	FY23E	FY24E
Financial Estimates				
NEP (Premium)	583	799	1,041	1,263
Underwriting income	134	162	208	249
Net investment income	57	12	60	64
Operating income	190	174	268	313
Adj. PBT	189	170	261	306
Adj. net income	132	167	211	248
Adj. EPS	5.74	7.20	9.06	10.60
BBG EPS	5.36	6.85	8.17	9.58
DPS	0.44	0.50	0.60	0.68
Investments	697	661	858	1,090
BVPS	30.63	28.95	37.39	47.28
NAVPS	-	-	-	-
Margins and Growth				
Adj. EPS growth	81.4%	25.4%	25.8%	17.0%
Ratios				
Adj. tax rate	19.1%	18.0%	19.0%	19.0%
Loss ratio	55.7%	59.3%	59.5%	59.8%
Combined ratio	77.1%	79.7%	80.0%	80.3%
Invest inc. % of Investments	-	-	-	-
Regulatory solvency ratio	-	-	-	-
Leverage (Debt/Debt+Equity)	-	-	-	-
ROE	20.8%	24.5%	27.7%	25.4%
Valuation				
Dividend yield	0.2%	0.2%	0.2%	0.2%
Adj. P/E	47.4	37.8	30.0	25.7
P/BV	8.9	9.4	7.3	5.8

Summary Investment Thesis and Valuation

Investment Thesis

KNSL is the only publicly traded P&C insurer that operates exclusively in the E&S insurance market with a focus on small commercial accounts. Our long-term outlook for KNSL is upbeat given its large addressable market, superior technology platform, and low cost base, which we view as a sustainable competitive advantage. Still, the stock's valuation seems full and we are concerned about the risk of multiple compression as the P&C pricing cycle continues to turn.

Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI US	0.72	0.63
Sect: Financials	-0.17	-0.32
Ind: Insurance	0.15	-0.19
Macro:		
Economic Surprise	0.25	0.37
Credit Spread	0.43	0.28
US 10yr yield	-0.21	-0.26
Quant Styles:		
Quality	0.33	0.33
Momentum	0.42	0.33
LowVol	0.44	0.31

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Investment Thesis

Please see Page 5 for tables summarizing 3Q22 results.

KNSL will hold its earnings conference call at 9:00 AM Eastern on October 28, 2022.

The dial-in number for the call is 888-660-6493; code: 3573726.

The call replay will be available on <https://ir.kinsalecapitalgroup.com>.

We affirm our Neutral rating. We expect KNSL's premiums and margins to benefit from favorable trends in the E&S market, which continues to generate outsized growth at attractive pricing/terms. Also, we think that Kinsale's low-cost operating model is a sustainable competitive advantage across the pricing cycle, especially against higher cost competitors like Lloyd's writers. On the other hand, the stock's valuation is full compared to commercial peers and specialist names even after accounting for KNSL's growth potential and above-average margins. Further, while favorable P&C market conditions are likely to persist through 2023 and will have positive implications for KNSL's reserves and future earnings, the eventual turn in the P&C pricing cycle is a downside risk to its above-average multiple.

Well-Positioned to Capitalize on Favorable P&C Market

We expect the overall E&S market, where KNSL operates exclusively, to see strong but moderating new business flows and price hikes over time, partly due to more underwriters focusing on growth and greater appetite from admitted markets. Still, we think KNSL can grow premiums at a healthy pace because of its relatively small base as well as the fragmented nature of the pricing cycle whereby certain lines (property, marine) are only beginning to benefit from harder prices despite a slowdown in other lines and/or the broader market. With respect to profitability, we expect the combination of price hikes – historical and prospective – and conservative reserving to support healthy margins at KNSL over the medium term.

Low Expenses a Durable Competitive Advantage

KNSL operates with a proprietary and fully integrated technology platform that it built from the ground up, in contrast to many of its peers that use unwieldy hybrid systems consisting of legacy platforms and newer technologies. The net result has been an operating model that has the capacity to take on significant business volumes without sacrificing customer responsiveness, underwriting quality, and expense efficiency. With this model, our view is that KNSL will outperform higher cost competitors (especially Lloyd's which is more than 20% of the E&S market) through the pricing cycle. During softer markets, KNSL can grow premiums as others pull back while maintaining above-average profitability. In hard markets, Kinsale can operate as a price taker and generate an even larger excess return.

Eventual Turn in Pricing Cycle Is a Risk

The P&C industry is well into the current hard market and we expect overall price hikes to moderate over time as re/insurers re-position themselves for growth (property and catastrophe coverage likely to be the exception to this rule in the near term). Given this, we see multiple compression as a risk as pricing/volume swings tend to be more volatile in E&S given its function as a safety valve for P&C. While we believe that some portion of recent market share gains by the E&S industry are permanent and that KNSL will thrive even if prices soften, our view is that a reasonable valuation analysis will have to look several years out because of KNSL's above-average growth profile and would therefore have to account for how conditions in the P&C market are likely to be at that future time.

3Q22 Summary Results

The following tables and charts summarize KNSL's 3Q22 results as well as its operating performance over the past several years:

Table 1: 3Q22 Earnings: Actual versus Expected

\$ in millions, %, and bps

	JPM 3Q22E	Actual 3Q22	Actual v. Expected
<u>Underwriting Results</u>			
Net premiums written (\$)	226.9	235.9	3.9%
Net premiums earned (\$)	206.8	209.3	1.2%
Loss ratio			
AY loss ratio	61.5%	64.4%	291 bps
Catastrophe losses	60.0%	57.2%	-282 bps
Unfavorable (favorable) PYD	5.0%	12.5%	749 bps
Unfavorable (favorable) PYD	-3.5%	-5.3%	-175 bps
Expense ratio	20.5%	19.2%	-132 bps
Combined ratio	82.0%	83.6%	160 bps
AY combined ratio ex. cats	80.5%	76.4%	-414 bps
<u>Summary Income Statement</u>			
Underwriting income	37.2	34.3	(\$0.12)
Net investment income	10.9	13.9	\$0.13
Taxes and other	(10.2)	(10.2)	(\$0.00)
Operating income	37.9	37.9	\$0.00
Average diluted shares	23.3	23.1	\$0.01
Operating EPS	\$1.63	\$1.64	\$0.01

Source: Company reports and J.P. Morgan estimates.

Table 2: Historical Operating Performance

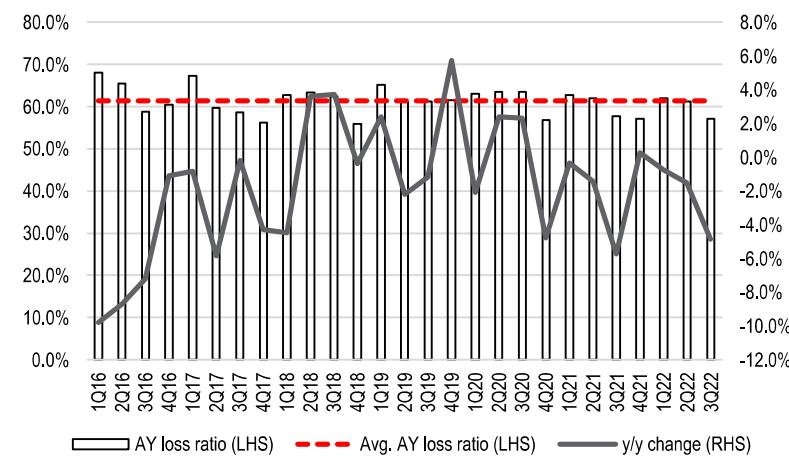
\$ in millions and %

	2016	2017	2018	2019	2020	1Q21	2Q21	3Q21	4Q21	2021	1Q22	2Q22	3Q22
Premium Trends													
Gross written premiums	188.5	223.2	275.5	389.7	552.8	168.9	194.1	197.6	203.8	764.4	245.5	277.0	284.1
% ceded	11.3%	15.1%	14.5%	12.2%	13.5%	14.6%	13.6%	13.6%	12.9%	13.6%	11.8%	12.5%	17.0%
Net written premiums	167.3	189.5	235.6	342.1	478.2	144.3	167.8	170.7	177.5	660.2	216.5	242.3	235.9
% growth y/y	99.1%	13.3%	24.4%	45.2%	39.8%	33.5%	42.6%	39.6%	36.2%	38.1%	50.0%	44.5%	38.2%
Net earned premiums	133.8	176.1	212.7	283.0	412.8	123.0	137.7	156.9	165.3	582.9	178.6	190.2	209.3
% growth y/y	80.0%	31.6%	20.8%	33.0%	45.9%	37.1%	42.0%	44.9%	40.3%	41.2%	45.1%	38.1%	33.4%
Underwriting Results													
AY loss ratio	63.0%	60.2%	60.9%	62.2%	61.5%	62.8%	62.0%	57.8%	57.1%	59.7%	62.0%	61.3%	57.2%
Catastrophe losses	0.0%	5.0%	2.6%	1.1%	5.6%	0.1%	2.1%	3.7%	-0.1%	1.5%	0.0%	0.0%	12.5%
Unfavorable (favorable) PYD	-10.0%	-6.4%	-3.3%	-3.3%	-3.2%	-5.7%	-6.6%	-5.9%	-4.0%	-5.5%	-4.7%	-5.0%	-5.3%
Loss ratio	53.0%	58.9%	60.2%	59.9%	63.9%	57.1%	57.5%	55.7%	53.1%	55.7%	57.4%	56.3%	64.4%
Expense ratio	21.3%	25.1%	25.1%	24.8%	22.8%	22.9%	21.7%	20.1%	21.4%	21.4%	21.6%	20.5%	19.2%
Combined ratio	74.4%	84.0%	85.3%	84.7%	86.8%	80.0%	79.2%	75.7%	74.5%	77.1%	79.0%	76.8%	83.6%
AY combined ratio ex. cats	84.4%	85.3%	86.0%	87.0%	84.4%	85.7%	83.7%	77.9%	78.6%	81.1%	83.6%	81.8%	76.4%
Investment Results													
Net investment income	7.5	10.6	15.7	20.1	26.1	6.9	7.4	8.1	8.6	31.0	9.1	10.6	13.9
% growth y/y	32.7%	41.2%	48.4%	28.3%	29.7%	16.5%	11.8%	15.5%	32.1%	18.9%	30.9%	42.6%	71.2%
Duration	3.7	3.9	3.9	4.3	4.3	4.3	4.3	4.4	4.3	4.3	4.6	4.2	3.9
Gross yield ex. cash (YTD)	2.2%	2.4%	3.0%	3.1%	2.9%	2.6%	2.6%	2.5%	2.5%	2.5%	2.5%	2.6%	2.7%
Cash and invested assets	480.3	561.1	643.1	908.2	1,300.0	1,400.0	1,500.0	1,600.0	1,700.0	1,700.0	1,700.0	1,800.0	1,900.0
% growth y/y	16.8%	14.6%	41.2%	43.1%	46.6%	36.4%	33.3%	30.8%	30.8%	21.4%	20.0%	18.8%	

Source: Company reports and J.P. Morgan estimates.

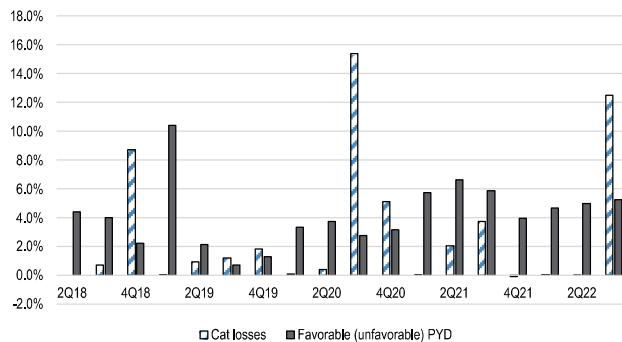
Figure 1: Historical AY Loss Ratio Trends

% of net earned premiums



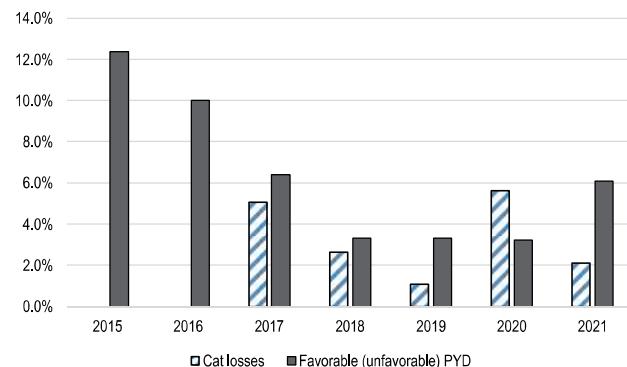
Source: Company reports and J.P. Morgan estimates.

Figure 2: Historical Catastrophe and PYD Trends (Quarterly)
 % of net earned premiums



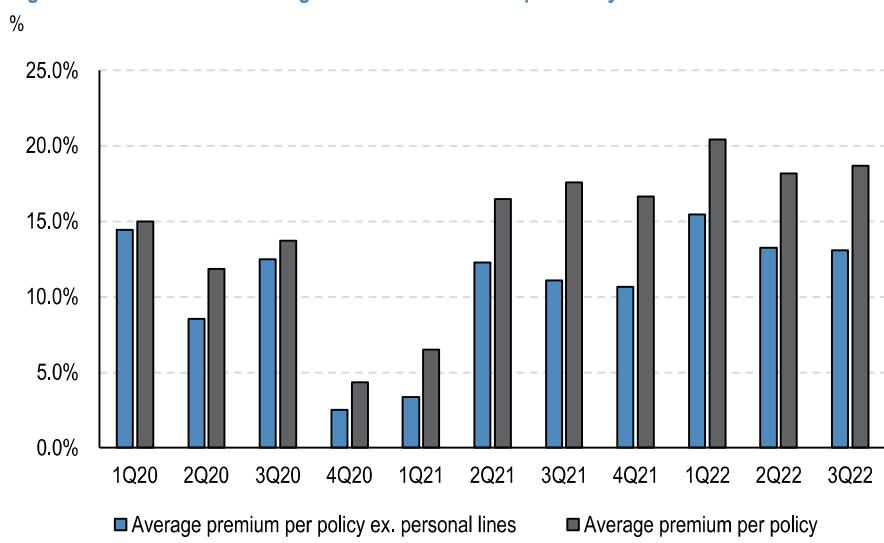
Source: Company reports and J.P. Morgan estimates.

Figure 3: Historical Catastrophe and PYD Trends (Annual)
 % of net earned premiums



Source: Company reports and J.P. Morgan estimates.

Figure 4: Year-on-Year % Change in Written Premiums per Policy



Source: Company reports and J.P. Morgan estimates.

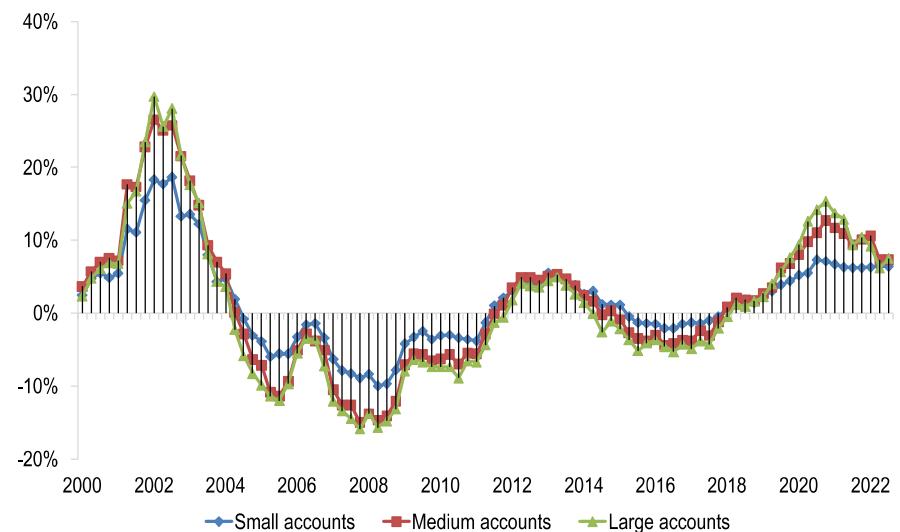
Table 3: KNSL's Historical New Business Metrics

	2015	2016	2017	2018	2019	2020	2021
Submissions	148,691	186,377	226,000	288,000	380,000	461,000	520,000
Quotes	47,204	80,933	116,000	167,000	234,000	300,000	347,000
Bound policies	8,533	10,929	14,000	18,000	25,000	31,000	36,000
Quotes / submissions	31.7%	43.4%	51.3%	58.0%	61.6%	65.1%	66.7%
Bound / quotes	18.1%	13.5%	12.1%	10.8%	10.7%	10.3%	10.4%
Bound / submissions	5.7%	5.9%	6.2%	6.3%	6.6%	6.7%	6.9%
Growth Rate							
Submissions		25%	21%	27%	32%	21%	13%
Quotes		71%	43%	44%	40%	28%	16%
Bound		28%	28%	29%	39%	24%	16%

Source: Company reports and J.P. Morgan estimates.

Figure 5: Average Commercial Premium Rate Changes by Account Size

Year-over-year change (%)



Source: Council of Insurance Agents and Brokers and J.P. Morgan estimates.

Raising Estimates

We are increasing our EPS estimates (4Q22 from \$1.91 to \$2.03, 2022 from \$7.08 to \$7.20, 2023 from \$8.16 to \$9.06) to reflect higher investment income and modestly better underwriting margins.

Investment Thesis, Valuation and Risks

Kinsale Capital (*Neutral; Price Target: \$250.00*)

Investment Thesis

We affirm our Neutral rating. KNSL is the only publicly traded P&C insurer that operates exclusively in the E&S insurance market with a focus on small commercial accounts. Our long-term outlook for KNSL is positive given its large addressable market, superior technology platform, and low cost base, which we view as a sustainable competitive advantage. Still, the stock's valuation seems full at current levels and we are concerned about the risk of multiple compression as the P&C pricing cycle continues to moderate.

Valuation

We are raising our December 2023 price target from \$230 to \$250 given the increase in our EPS estimates. Our price target assumes a 4.3x P/BV target multiple on 2025 book value and a 21x P/E target on 2025 EPS. These target multiples are well above peers', which we believe is supported by KNSL's above-average premium growth (long-term low-to-mid teens growth versus mid-to-high single-digit growth for most large commercial peers) and margin profile (80-85% combined ratio versus 85- 90% for peers). KNSL trades at 10.1x book value, well above the specialty peer average (ex. PLMR) of 2.2x and commercial peers at 1.6x.

Risks to Rating and Price Target

We believe the main upside risks to our rating and price target are:

- **The hard P&C market lasts longer than expected.** Kinsale is seeing higher prices and greater submission flow because of dislocation in the P&C market. If current conditions persist longer than we assume, there could be upside to our forecasts and investor sentiment would likely improve.
- **Premium growth surpasses already elevated expectations.** In our view, part of KNSL's premium valuation is attributable to its above-average growth. We would expect KNSL's valuation multiple to expand if it consistently exceeds growth expectations in the next few years.
- **Margin improvement is greater than assumed.** The combination of earned pricing exceeding loss cost trends and management's conservative reserving suggests margin improvement in the next few years. If KNSL's margin improvement tracks higher than expectations, there could be upside to forecasts.

We believe the main downside risks to our rating and price target are:

- **Increased competition and/or push back from insurance clients dampens the pricing cycle.** The insurance industry is well into the hard market and clients are beginning to push back more strongly on price hikes while more insurers are deploying capital and positioning themselves for growth. If the cycle begins to turn, we believe there is a risk of multiple compression for insurers that have seen an outsized benefit from higher prices.
- **Adverse loss trends or social inflation re-emerge in casualty reserves.** Although unlikely to be a material risk for KNSL given its specific exposures and low limits, the re-opening of the court system could drive a surge in pent-up liability claims.

- **Unfavorable loss experience emerges from new lines of business.** Kinsale has a strong underwriting track record and it is entering new lines of business in a strong part of the cycle. Still, given the long-tail nature of casualty coverage, the impact of badly underwritten risks is likely to persist.

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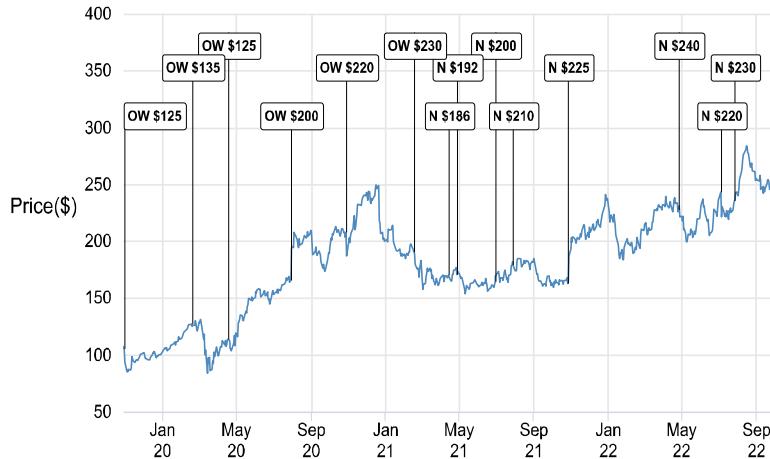
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Kinsale (KNSL, KNSL US) Price Chart



Date	Rating	Price (\$)	Price Target (\$)
01-Nov-19	OW	105.72	125
20-Feb-20	OW	127.74	135
20-Apr-20	OW	114.01	125
31-Jul-20	OW	165.91	200
30-Oct-20	OW	208.26	220
18-Feb-21	OW	190.72	230
16-Apr-21	N	170.28	186
29-Apr-21	N	170.98	192
01-Jul-21	N	164.77	200
29-Jul-21	N	179.44	210
28-Oct-21	N	163.26	225
28-Apr-22	N	227.90	240
06-Jul-22	N	243.47	220
28-Jul-22	N	235.85	230

Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Aug 22, 2016. All share prices are as of market close on the previous business day.

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