S&P Capital IQ

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Kinsale Capital Group, Inc. NasdaqGS:KNSL

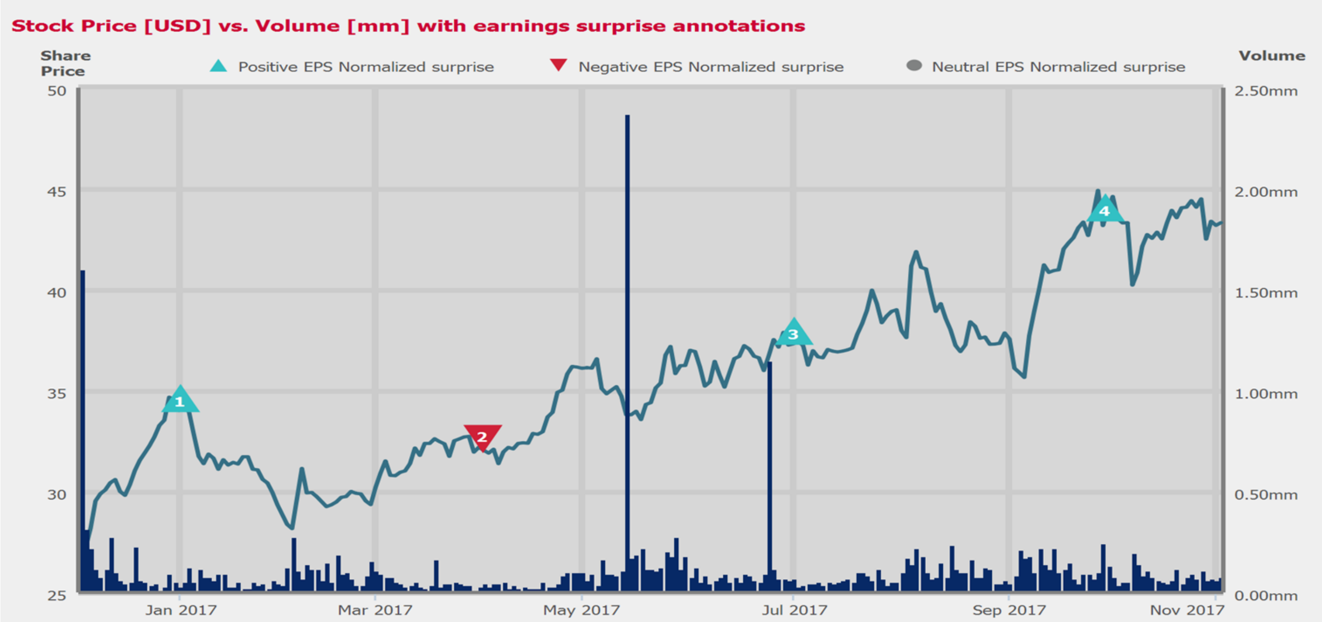
FQ4 2017 Earnings Call Transcripts

Tuesday, February 27, 2018 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.39	0.36	(7.69 %)	0.39	1.27	1.52
Revenue (mm)	49.39	50.74	2.73	50.66	185.54	186.78

Currency: USD
Consensus as of Feb-26-2018 11:36 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	0.26	0.32	1 23.08 %
FQ1 2017	0.31	0.29	2 (6.45 %)
FQ2 2017	0.32	0.40	3 25.00 %
FQ3 2017	0.36	0.44	4 18.92 %

Call Participants

EXECUTIVES

Brian D. Haney
Chief Operating Officer and Senior Vice President

Bryan P. Petrucelli
Chief Financial Officer, Senior Vice President and Treasurer

Michael P. Kehoe
Founder, CEO, President & Director

ANALYSTS

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Q4 2017 Kinsale Capital Group Inc. Earnings Conference Call. [Operator Instructions]

As a reminder, this conference is being recorded. 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 2016 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 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 P. Kehoe
Founder, CEO, President & Director

Thank you, operator. Good morning, everyone, and thanks for participating on our call. With me today are Bryan Petrucelli, Kinsale's Chief Financial Officer; and Brian Haney, Kinsale's Chief Operating Officer.

The Kinsale strategy is to combine disciplined underwriting and claim handling with advanced use of technology and low cost to deliver steady profits and growth to our stockholders, even in competitive markets like we have today.

Kinsale had a strong fourth quarter with a combined ratio of 83.1%, and an adjusted return on equity of 13.3%. Notwithstanding some choppiness on the loss side with some cat activity and a small amount of adverse development of prior year reserves, Kinsale reported net income of $5.9 million for the fourth quarter, compared to $6.9 million in the fourth quarter of 2016. The drop in income was due to a charge of $1.9 million related to the Tax Cut and Jobs Act. Adjusting to exclude this charge, net income was $7.8 million for the quarter, an increase of 14% over the prior year. And gross written premium grew 20% in the quarter compared to the fourth quarter of 2016, continuing the trend of robust growth that we have seen throughout 2017.

So for further details, I'm going to pass it over to Bryan Petrucelli.

Bryan P. Petrucelli
Chief Financial Officer, Senior Vice President and Treasurer

Thanks, Mike. As Mike noted, the results for the fourth quarter and for the full year were in line with expectations. The 83.1% combined ratio for the quarter, and 84% combined ratio for the year are consistent with our 85% or lower goal, and we believe, demonstrates the strength of our low-cost model, particularly in periods of intense price competition and in consideration of this year's cat activity.

I should probably start by acknowledging the enactment of the Tax Reform Act in December, which among other things, reduces the corporate tax rate from 35% to 21% effective January 1, 2018. Although, we're not able to provide an exact estimate of the impact of Tax Reform on our 2018 effective tax rate, we expect to see a significant decrease from our historical reported effective tax rate.

Additionally, as the law was enacted in December, we were required to remeasure our net differed tax asset using the lower rate, and our fourth quarter and year-to-date results reflect the related $1.9 million charge that Mike previously mentioned. The fourth quarter and year-to-date effective tax rates of 47.2%

and 35.4% respectively are elevated as a result of the charge. Excluding the impact of the charge, those rates are 30.2% and 30.4% for the fourth quarter and full year respectively.

Now I'll give the results for the quarter. We reported net income of $5.9 million for the fourth quarter of 2017, down from $6.9 million for the fourth quarter of 2016. Excluding the impact of tax charge, our adjusted net income was $7.8 million and 14% higher than the fourth quarter of 2016. The company generated underwriting income of $8 million and a combined ratio of 83.1% compared to $9.5 million and 75.3% for the fourth quarter of 2016.

The combined ratio for the fourth quarter of 2017 included 1.8 points from cat losses and 1.1 points of net unfavorable prior year loss reserve development, compared to 2.6 points of cat losses and 10 points from net favorable loss reserve development last year. On a year-to-date basis, the company generated underwriting income of $28.2 million and a combined ratio of 84% compared to $34.3 million and 74.3% for the same period last year. The year-to-date combined ratio included 5.1 points from cat losses and benefited from 6.4 points of net favorable prior year loss reserve development, compared to a negligible percentage from cat losses and 9.5 points from net favorable loss reserve development last year.

Our gross written premiums were $56.9 million, representing a 21 -- a 20% increase over the fourth quarter of 2016. Year-to-date written premiums has increased 18.4% over last year, with growth continuing to be generated from an overall increase in underwriting activity across most lines of business, and Brian Haney will discuss in a little more detail here in a bit.

On the investment side, investment income increased by 47% over the fourth quarter of 2016 as a result of continued growth in the investment portfolio. Annualized gross investment returns increased slightly to 2.4% from 2.2% last year. We continued to modestly increase our allocation to equities, both preferred and common and structured securities over the course of this year.

Additionally, given our cash position, we believe we are in good shape to react to changes in the interest rate environment in 2018. For the fourth quarter, basic and diluted EPS was $0.28 and $0.27 per share, respectively. Year-to-date basic and diluted EPS was $1.19 and $1.16 per share, respectively. Excluding the impact of tax reform charge, diluted EPS was $0.36 and $1.25 per share for the fourth quarter and full year, respectively.

And with that, I'll pass it over to Brian Haney.

Brian D. Haney
Chief Operating Officer and Senior Vice President

Thanks, Bryan. As noted earlier, premium grew 20% in the fourth quarter. The growth is widely spread with most of our 17 divisions showing positive change. Particularly notable was the growth in our small business, construction and energy divisions. We also had nice growth in our environmental and life science divisions. Our Aspera business was up 31% for the quarter. Submissions in the fourth quarter were around 21% higher than the fourth quarter of last year. The growth in submissions is, like the growth in premium, widespread across most divisions. The growth rate in submissions continues to gradually accelerate.

Moving on to rates. We are seeing rate increases in the market accelerating, but it's uneven. There are lines of business seeing more increases than others, and some don't seem to be showing increases at all.

In the last 90 days, we've specifically pushed up technical rates on some of our casualty business and our personal insurance business. We'd say the overall effect of the technical rate change would be about 3% to 4%. I would also note that the recently passed Tax Reform Act was the equivalent of roughly a 5% to 6% increase in our rates above and beyond the 3% to 4%. So the combined net effect is that our rates in 2018 are materially stronger than they were in 2017.

The commercial property market continues to experience dislocation, which is driving a big increase in submissions for us. New business submissions in the fourth quarter for commercial property were up more than 50% over the same period last year. Our renewal rate increases in commercial property have been running around 7% to 9%. We also just recently launched a new property product, focused on small business risks which will target a much smaller account size than our commercial property division currently does.

Looking at the market from a macroeconomic perspective, there are number of things happening that give us reason for optimism. The oil and gas industry resurgence continues, which has been helpful in particular to our energy division. The high level of confidence of small business owners around the country seems to be helping as well. Small businesses are the core of what we do, and when small businesses are flourishing, we tend to benefit.

Also, the tax reform is obviously an immediate boon to us in terms of lower taxes, but there's another secondary benefit we get from tax reform. It will raise the effective tax rate of many of our offshore competitors. I mentioned earlier, the tax reform was, for us, the equivalent of a 5% to 6% premium rate increase, but for many of our competitors, however, it was effectively a price cut, and they will have to increase their prices just to get back to where they were which will ultimately benefit us.

And with that, I'll turn it back over to Mike.

Michael P. Kehoe
Founder, CEO, President & Director
Thanks, Bryan. Operator, we're ready now to open the call to -- for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Mark Hughes from SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Your point about the competitors, you're essentially seeing a price cut with the tax reform, but they're going to have to increase prices to account for that. Could you go into a little more detail? And any way to size up what percentage of your competitors are we talking Lloyd's here, in particular? Just a little more on that.

Michael P. Kehoe
Founder, CEO, President & Director

I was thinking of the Bermuda offshore competitors than Lloyd's.

Bryan P. Petrucelli
Chief Financial Officer, Senior Vice President and Treasurer

I think if you look at like the top 25 E&S groups, it's almost 60% are overseas domiciled, so you have to assume there's probably some intercompany reinsurance underway there that may be impaired by the new Tax Act.

Bryan P. Petrucelli
Chief Financial Officer, Senior Vice President and Treasurer

And if you looked at just public data of some of those competitors, many of them had tax rate -- effective tax rates, they were 10% or in some cases lower. So I mean our tax rate is going to come down significantly, while in theory, theirs would go up closer to ours.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Understood. The submission increase, I think you suggested is accelerating. Any more detail you can provide on that, is that new businesses? Business from the admitted market coming to E&S, what are you seeing there?

Michael P. Kehoe
Founder, CEO, President & Director

Well, some of this it's being driven by dislocations. We mentioned commercial property. Those submissions were up a lot. The allied health market, submissions were up a fair amount in that. Whether or not it's business coming from the admitted market, it's tough to tell. I would say a lot of it is business that has had a problem or might be business that was insured under a binding authority arrangement or a program arrangement that's mere experiencing some difficulty. So I would just, in general, characterize it as market dislocation.

Michael P. Kehoe
Founder, CEO, President & Director

And then one add-on there, Mark , is Bryan talked about the economic outlook, and when new business formations are up, that's typically an E&S rate, right? You've got a brand-new business without the track record to qualify for a standard company. They will come into the E&S market for a number of years. So that might be part of it as well.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then on the reserves on the development. I think your model has been to be pretty conservative over time and try to be more likely to be redundant than deficient. What do you think happened this quarter? Is it some kind of turn in inflation? I can understand some normal variability, but it seems like there would still be enough conservatism that you might still have some gains? How should we think about it?

Michael P. Kehoe
Founder, CEO, President & Director

Yes, I think the best way to think of it is, it's a slight amount of development on prior accident year reserves. We went from $3.8 million favorable in the fourth quarter of last year to $550,000 unfavorable. That's consistent with a normal level of, call it, volatility or variability in a 90-day period of time. I would tell you that they are no worrisome trends. There are no concerns, none. Our loss ratio for the quarter, I think, was 59.2%. For the full year 2017, it was 58.9%, both of which are very solid numbers. Our goal definitely is to be conservative in how we reserve, and in fact, our reserves are conservatively stated. Mark, I think on an inception-to-date basis, so -- you look at the company's entire history, every single accident year has developed favorably except one, and that was the 2011 year, which obviously was right after we started the business, it was very small. So we feel very good about the reserves and about the business. And candidly, I think even with that choppy quarter, right, where you just had a slightly elevated amount of activity in terms of reported losses, we still posted, I think, a highly respectable 83.1% combined ratio. So it, kind of, speaks to the resilience and the effectiveness of our low-cost model.

Operator

[Operator Instructions] Our next question comes from Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

If we could just stick with the reserving topic for a couple more questions if you can bare them. Can you give a sense of whether -- whatever -- realizing in reserve setting and year-end reserve review, there's a number of different analyses that are involved. Was the charge the product of specific case reserves that seemed to be light? Or was it actuarial assumption changes? Just any color that you can provide, kind of, to help understand, kind of, the nature of what was contributing to the variability?

Michael P. Kehoe
Founder, CEO, President & Director

Yes, Mark, good morning. It's Mike. The best way to look at it is just -- in a 3-month period of time, there was just a slightly heightened activity in terms of case reserves. No trends, no concerns, no deficiencies in the book, just hey, the normal flow of new claims coming into the company, claims being resolved and settled. We just saw a slight uptick in case reserving. That's it.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Do these primarily relate to relatively more recent accident years or relatively more aged?

Michael P. Kehoe
Founder, CEO, President & Director

Well, keep in mind, it's like the first couple of accident years are tiny, because the book of business was -- we were a de novo start-up back in 2010, so I think they would be disproportionate in the more recent accident years, because they happen to be much larger dollar amounts.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And then any color you can shed on which lines of business were more impacted? I mean, really, just trying to understand, as the trends develop in the future, if there's areas to be more diligent on, maybe there's pricing actions to be taken or whatnot?

Michael P. Kehoe
Founder, CEO, President & Director

Yes, no. There is -- that's what I said into the prior caller. There's no specific trends or concerns. There's no line of business that's falling below our profitability thresholds or anything like that. It's just the normal flow. We get in, of course, hundreds of claims a month. We settle a hundreds of claims a month. And in that normal high-volume flow of activity, right, sometimes case reserves are going up, sometimes they're going down. And the net result in this 90-day period was a couple of million dollars higher than what it would have been the prior year, right? So it's -- that's why I say, it's kind of like a normal degree of variability or volatility that you might see in a defined period of time. But there are no trends, no concerns. The reserves are conservatively stated, and I think if you look at it on an annual basis, right, little bit less volatility in that period of time. Every year we've been in business, our reserves have developed favorably.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. And it's hard to argue with the 83% combined ratio, at least, not for too long. And maybe...

Michael P. Kehoe
Founder, CEO, President & Director

Mark, one last point I forgot to make. On a gross basis. So before reinsurance, we actually had almost $2 million of favorable development in the fourth quarter. It just happened that some of the individual cases that we settled that resulted in very material takedowns. Well, they happened to be heavily reinsured policies, so the economic benefit, if you will, of those takedowns in order to the benefit of our reinsurers. So again, it's just -- yes.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

That's helpful. Okay. Other question, I wanted to ask, really, more to some of Brian Haney's commentary. I appreciate the color on the submissions and so forth, and I realized that a lot of your business is not specifically renewal-oriented, but are you seeing improvement in exposure unit growth or, kind of, signs of a strong economy just, kind of, generally helping the overall rise of -- rising flood of premium opportunity?

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, we're seeing that. We're also seeing it in audit premiums. We're -- and we're seeing it in exposure increases as well.

Operator

And I am showing no further questions in queue. I would like to turn the call back over to Michael Kehoe for further remarks.

Michael P. Kehoe
Founder, CEO, President & Director

Okay. Thank you, operator. And just want to thank everybody for joining us on the call and have a good day.

Operator
Ladies and gentlemen, thank you for participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.