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Kinsale Capital Group, Inc.

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Earnings Call

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Call Participants

EXECUTIVES

Brian Donald Haney
President & COO

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Michael Patrick Kehoe
Chairman of the Board & CEO

ANALYSTS

Andrew E. Andersen
Jefferies LLC, Research Division

Bill Carcache
Wolfe Research, LLC

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Unknown Analyst

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 2023 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 Chairman and CEO, Mr. Michael Kehoe. Please go ahead, sir.

Michael Patrick Kehoe
Chairman of the Board & CEO

Thank you, operator, and good morning, everyone. As is our usual approach, Bryan Petrucelli, our CFO; and Brian Haney, our President and COO, and I will each make a few comments, and then we'll move on to the Q&A.

In the first quarter of 2024, Kinsale's operating earnings per share increased by 43.4% and gross written premium grew by 25.5% over the first quarter of 2023. For the quarter, the company posted a combined ratio of 79.5% and have posted an operating return on equity of 28.9%.

The company's strategy of disciplined E&S underwriting and technology-enabled low costs, drive these results and allows us to generate attractive returns and take market share from competitors at the same time.

As just mentioned, growth in gross written premium grew in first quarter to 25.5% from 33.8% in the fourth quarter of 2023 and down from 40% growth we've experienced over the last several years. This deceleration over the last couple of quarters is mostly driven by the property markets return to a normal level of competition from the crisis-like environment in 2022 and early 2023.

Property continues to be an attractive opportunity with favorable pricing and growth rates, and we remain optimistic about this area of the E&S market looking forward.

The casualty market remains attractive as well with levels of competition varying by product line. Our growth rate in casualty differs from one line to another, but in general, we see this area as steady to slightly improving. Brian Haney will offer some additional commentary on the E&S market here in a moment.

Overall, the P&C industry continues to work through challenges around frequency and severity, catastrophes, inflation in general and rising loss cost, in particular, and expanding and at times, unpredictable Tort system, litigation financing and loss reserve adequacy, in particular, on longer-tail occurrence lines. All of these challenges and a variety of others should contribute to drive stability and growth opportunity in the market for the foreseeable future.

Beyond the industry-wide challenges noted above, it's our own business strategy here at Kinsale that drives our confidence and prospects for significant future profit and growth. It's the focus on smaller risks within the E&S market, the absolute control we exercise over our underwriting and claims management operations, the best-in-class service level and risk appetite we provide to our brokers and our technology-driven low-cost operation that differentiate Kinsale from competitors across the industry. And in many ways, the competitive advantages we have become even more significant as the market becomes more competitive in the years ahead.

And finally, just a reminder that establishing conservative reserves to pay future claims is a fundamental part of our business strategy. As we have noted before, some of the original conservatism of the 2016 through 2019 accident years, has been eroded away by inflation, although with booked ultimate loss ratios in the low 60% range, these accident years remain highly profitable. These years have developed favorably on an inception-to-date basis, except for the 2018 year, which is slightly adverse.

From the 2020 accident year looking forward, our pricing has exceeded loss cost trend, and we have been more cautious for leasing reserves, giving us full confidence that our overall reserves are in the best position in our company's history. And likewise, investors should have confidence in the strength of our balance sheet and the prospects for continued favorable reserve development in the years ahead.

And with that, I'm going to turn the call over to Bryan Petrucelli.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Thanks, Mike. Another great quarter from a profitability perspective with net income and net operating earnings increasing by 77.3% and 43.8%, respectively. The 79.5% combined ratio for the quarter includes 2.7 points from net favorable prior year loss reserve development compared to 3.7 points last year with negligible cat losses in either period.

As Mike mentioned, we're taking a more cautious approach to releasing reserves and incenting current year loss ratio picks. The expense ratio continues to benefit from higher ceding commissions from the company's casualty and commercial property proportional reinsurance agreements, as a result of growth in the lines of business ceded into those treaties. The expense ratio decreased by 1 point from 21.7% in the first quarter of 2023 to 20.7% this year, with almost all coming from lower net commissions.

On the investment side, net investment income increased by 59.1% over the last year, as a result of the continued growth in the investment portfolio generated from strong operating cash flows and higher interest rates, with a gross return of 4.3% for the year compared to 3.7% last year. We haven't made any significant changes to our investment strategy and continue to monitor inflation, interest rates and related Fed policy commentary and will adjust as circumstances warrant.

New money yields are averaging in the low- to mid-5% range and an average duration of 2.8 years consistent with year-end. And lastly, diluted operating earnings per share continues to improve and was $3.50 per share for the quarter compared to $2.44 per share for the first quarter of 2023.

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

Brian Donald Haney
President & COO

Thanks, Bryan. As mentioned earlier, premium grew 25.5% in the first quarter. We continue to see growth in most of our divisions. Casualty and Property continue to grow, and we are seeing particularly strong growth in our Small Property, Entertainment and General Casualty divisions, as well as in some of our newer divisions like High Value Homeowners and Commercial Auto.

We operate in a wide range of markets, not one monolithic market. And there are some areas where there's much more competition and growth is harder to come by, such as our Life Sciences and Management Liability divisions. Submission growth continues to be strong in the low 20s for the quarter, consistent with most of 2023. This number is subject to some variability, but in general, we view submissions as a leading indicator of growth, and so we see the submission growth rate as a positive signal.

Turning to rates. We had in past quarters reported what we call real rate changes, which are nominal rate changes adjusted for trend. While we felt that, that was a better measure of how rate adequacy was changing, given that the rest of the market reports nominal rate change, we felt that our approach created the potential for confusion. That being the case, we are pivoting back to reporting nominal rate changes. So we see rates being up around 7% on a nominal basis, down from around 8%, again, on a nominal basis last quarter.

It's important to keep in mind, as I said earlier, the market isn't a monolith. In some areas, our rate rates are going up higher than 7%; in some areas, they're going up less; and in some targeted areas, we made in cut rates because the margins are so high that we feel the trade-off between rates and growth is worthwhile. But overall, that 7% still puts us ahead of trend and we feel that the business we're putting on our books is the best price business in our history.

Turning to inflation. We feel that the adverse development you see in some -- in the industry on some longer tail casualty lines is due at least in part to a spike in inflation. The difficulty with long-tail lines is that you set prices in initial reserves with the knowledge you have at the time, but then there's a long lag between the pricing of the business and the paying of the claims, during which unforeseen events can affect the value of those claims.

It's fair to assume no one in the industry saw the pandemic coming, and few could have foreseen the significant expansion of the money supply followed, that additional money in the economy set up a wave of inflation that disproportionately hit some cost more than others, such as construction costs.

This had the effect of effectively repricing the reserves for the longer-tailed casualty lines. The uncertainty created by this longer payout pattern in some lines reinforces the wisdom of our conservative approach to reserves that Mike referred to earlier. There are a lot of unknowns in setting reserves, there's a lot that can happen in between the setting of those reserves and the paying of the claims. So it's incumbent on us to err on the side of caution.

And while inflation has moderated somewhat from its highs, it would seem that it will take longer to get back to the Fed's target of 2% that many prognosticators had forecast. And then may continue to cause reserving issues for those of our competitors in a weaker financial position. This gives us a sense of optimism, particularly around the [Technical Difficulty] biggest market. This was another good quarter, and again, we are happy with the results.

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

Michael Patrick Kehoe
Chairman of the Board & CEO
Okay. Operator, we're ready for any questions in the queue.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Michael Zaremski from BMO Capital Markets.

Unknown Analyst

This is [Jack] on for Mike. Our first question is on the loss ratio. So historically, we've seen a pattern of the seasonality in that reserve releases tend to be higher in the early part of the year and then decelerate, then the opposite trend occurs for the underlying asset, your loss ratio and then it starts out higher and then improves. So I guess, given your comments about adding conservatism to reserves in light of inflationary trends, do you expect that to change the historical seasonality pattern?

Michael Patrick Kehoe
Chairman of the Board & CEO

I don't think we expect it to change. I think the starting point is just slightly higher because we're setting slightly higher loss picks, and we're releasing reserves at a slightly slower pace. And that's purely kind of an additional measure of conservatism against a backdrop of inflation, et cetera, in the economy.

Unknown Analyst

Got it. And then second question, so Kinsale has opportunistically grown in property in recent years and that's paid off well for shareholders. I guess if property pricing decelerates, will it consider to look to grow less in those lines of business or absolute margin is still excellent even if pricing is less positive? And I guess relatedly, is any property business expected to lead the E&S marketplace? And if it does, can Kinsale access it in the standard or non-E&S marketplace as well?

Michael Patrick Kehoe
Chairman of the Board & CEO

I would say that property pricing is probably at a 20-year high. And as we said in our prepared remarks, we see that as a very attractive opportunity for growth. We're always going to prioritize profitability over growth. So depending on where the market trends in the future, we'll probably have a lot to do with how rapidly that line of business grows. We're very optimistic. I don't know, we're not seeing any kind of inroads from standard companies at the moment.

Brian Donald Haney
President & COO

We're not. And I think, yes, [Jack], I might explain, the business is really attractive right now. And so we're still growing. To specifically answer one question you had, we do not have an admitted company. So no, we would not write admitted business.

Operator

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

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Mike or Brian or Bryan, what do you make of the state E&S data that seem to show a meaningful deceleration, particularly in March? What do you make of that? And did you see anything like that in your own experience? Any kind of volatility at the end of the quarter?

Michael Patrick Kehoe
Chairman of the Board & CEO

I don't know what to make of it, Mark, other than the E&S market has grown at a double-digit clip for 6 years in a row. And so I think the 7% growth in Q1 is not a surprise. I don't know how if there can be lags in the reporting of some of that data or not. So I don't really have anything additional there.

Our overall growth slowed slightly compared to where it's been. But given the dramatic growth of 40%, give or take, over a 6-year period, it was not unexpected, right? We're still growing at a very rapid rate, and we're still very optimistic about growth prospects looking forward.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Are you able to share the breakout in terms of growth, the growth rates in property versus the growth in casualty in the quarter?

Michael Patrick Kehoe
Chairman of the Board & CEO

We don't break it out, but it's -- it varies quite a bit from one division to the next. We've got 24 different underwriting divisions, each of which is organized either around an industry segment or a coverage. And so you see a rapid growth or pretty material variance from one to the next.

As Brian was indicating, it's really a mistake to look at E&S as one monolithic market. There's a lot of submarkets within that. And that's, I think, reflected in the relative growth. He hit on some of the divisions that are growing more rapidly and some that are growing more slowly already.

Brian Donald Haney
President & COO

Yes. I mean they're even -- one exercise you could go through is to look at the statutory data, and that would show kind of the pattern Mike was talking about where property, one of the reasons the growth rate was 40% for as long as it was, was property just had this extreme crisis market. And so the underlying casualty market has been strong all along, and that as Mike said, continues to be strong.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. How should we think about the 2Q? You had such a strong growth rate in this quarter last year. Should we assume that you're going to renew all that business and grow on the side as well or does this present an unusual comparison and so Q2 might be slower just because of the tough comp?

Michael Patrick Kehoe
Chairman of the Board & CEO

We don't forecast growth. We don't offer growth guidance, but I think that's an interesting observation, Mark. Tough comp.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Very good. Yes. And then finally, the tax rate, what's a good full year tax rate?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Yes. So, I think Mark, if you take a look at our tax rates sort of over a 12-month period that would give you a better sort of guide as to what to pick. There were a fair amount of stock options exercised in the first quarter, so that drove it down. But I think if you go back and look at the past 4 quarters, then you could come up with a pretty good pick from that.

Operator

Your next question comes from the line of Andrew Andersen from Jefferies.

Andrew E. Andersen
Jefferies LLC, Research Division

I think on the 4Q call, recognizing you're not really trying to give guidance, but I think you said you wouldn't take issue with thinking flat underlying loss ratios for '24. Does that still stand or does the increase in accident year picks this quarter? Now I mean full year '24 could perhaps be 1 point higher compared to '23's, 57.4?

Michael Patrick Kehoe
Chairman of the Board & CEO

Yes. I think -- Andrew, this is Mike. We're looking every quarter at actual loss activity and obviously reevaluating all the actuarial assumptions we make. And so I would say that this past quarter, consistent with prior years, our actual loss activity was below expectations. It's just that we're looking at a backdrop of inflation, loss cost trend, et cetera, and we always want to position the company to be in a very conservative posture. So I think the 1 point observation that you had is a good one.

Andrew E. Andersen
Jefferies LLC, Research Division

Okay. And I think you mentioned some new divisions kind of launching for growth commercial auto and homeowners. Where are we in the development for that? Is that contributing meaningfully to growth currently? And I think the Commercial Auto comment was new. Is that correct?

Michael Patrick Kehoe
Chairman of the Board & CEO

No, it's not new. We've been in that for a while. If you look at the 10-K, we break out production by underwriting division on an annual basis, but we don't do it quarterly. But the annual numbers will give you a pretty good insight into...

Brian Donald Haney
President & COO

And I would say they're not -- to the total, they're not contributing meaningfully now. But if you look at kind of the way product kind of works, we start out slowly, we don't try to corner a market and then we grow over time. And then so maybe 3, 4, 5 years down the road, it starts becoming more and more meaningful. So if you look at -- we probably added, I think, 14 divisions since we started the company, and they all have that sort of trajectory.

Operator

[Operator Instructions] Your next question comes from the line of Bill Carcache from Wolfe Research.

Bill Carcache
Wolfe Research, LLC

As the industry is low-cost producer, do you think Kinsale is leveraging its competitive advantage to the extent possible? How much room is there for Kinsale to potentially nudge pricing a little bit lower to sustain longer growth? And your operating ROEs are certainly very strong, but is there room for you to sort of accept a slightly lower ROE in exchange for incremental growth and that kind of just -- there's a lot there, but it sort of raises questions around how you think about the trade-off between returns, growth and pricing?

Brian Donald Haney
President & COO

Bill, this is Brian Haney. So yes, obviously, what we're trying to do is maximize the wealth building for the investors, and I think that starts with maximizing underwriting profit. And so what we're really trying to solve for is what combination of ROE and growth is the right number to maximize that?

I think you're absolutely correct: We don't have to have a 30-ish ROE to maximize book value. So in certain areas, we are looking at cutting rates to grow faster. In certain areas, in some of the casualty lines, we don't need to do that because we're growing fast enough as it is. So yes, division by division, we're looking at that exact calculation regularly. And again, the goal is not to have a certain -- the goal is to drive as much value to the company and the investors as we can. But there is definitely room. And you're right, being a low-cost operator provide us a leeway, I think that our competitors don't have.

Michael Patrick Kehoe
Chairman of the Board & CEO

And just following up on that. That's why I made the comment earlier about the fact that in a more competitive market, that low-cost feature of our business model becomes even more powerful.

Bill Carcache
Wolfe Research, LLC

That's very helpful. And as you think about sort of the longer term sustainability of the growth of the revenue stream for the business, how do you view the possibility of possibly unlocking a new market opportunity perhaps in the specialty admitted space? Just curious whether that's a potential vehicle for longer-term growth?

Michael Patrick Kehoe
Chairman of the Board & CEO

Yes, Bill, this is Mike. I would say in the next couple of years, we're going to continue to just execute the current plan, focusing on building out our position in the E&S market. We're doing a lot of work with new product development and we're doing a lot of work with system enhancements. If you go out several years, I think it's highly likely we'll be in the specialty admitted space, but not the next couple of years.

Bill Carcache
Wolfe Research, LLC

Understood. And if I could squeeze in one last one. I guess one could argue that many of the top carriers in the E&S space are also the same players writing admitted business. They have a little of a gain from seeing that business migrate back to the admitted markets. Maybe could you speak to whether you're seeing any evidence of admitted carriers trying to use pricing to win business back from E&S?

Brian Donald Haney
President & COO

The short answer is, no. We're not seeing business flow out of E&S into admitted. And I think you're correct, most of the big admitted companies also have big E&S operations. To the extent we're seeing increased competition or where we're seeing increased competition, it's not from admitted, it's generally from MGAs.

Operator

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

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

First one, just about the conservatism you're adding to your accident year loss pick? I'm curious, is that justified by the data you're seeing today? In other words, are you sort of assuming a better spread between nominal pricing and loss trends or are you just adding an extra level of conservatism beyond what you're actually seeing in the data and the loss results now?

Michael Patrick Kehoe
Chairman of the Board & CEO

This is Mike, Pablo. Our actual losses are coming in below expectations, okay? And that's this quarter, and that's been a trend for a number of years. On the other hand, there's a lot of assumptions in our actuarial model that are forward-looking, loss cost trend and the like. And given the heightened inflation in the economy, I think it just injects a little bit more uncertainty. And so we're offsetting that uncertainty with a little bit more conservatism.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Understood. And then just a follow-up, Mike, on your comment about actual losses running light here, right? So I think one area where you see that is in your [indiscernible] which has been running low for several years already. And I think that's part of the reason why you've been releasing reserves from more recent accident years.

I guess just sort of like a pushback question here, realizing that the losses have been good, but what gives you the confidence that you're not releasing too prematurely, right? Because I think if you ask most other insurers, they're not touching the more recent accident years yet, right, even if everyone had a good run in pricing. So just your thoughts on what you're trying to do there?

Michael Patrick Kehoe
Chairman of the Board & CEO

Yes. I would just say we're releasing reserves more slowly than we have in the past. We've called out the 2016 through '19 accident years repeatedly, as an area where not overall, but on our long-tail occurrence business, a lot of its construction related, we've seen those accident years develop later than we would have anticipated.

And of course, we react to that. There's a whole range of actuarial assumptions you make as we post our financials every quarter. And we're always looking at actual loss activity and going back and reviewing and testing those actuarial assumptions. And if there's an area where, hey, we haven't been cautious enough, we correct for that.

But in general, on a call like this, where we can't get into too much granularity because it gets to be such a complex topic, I think it's really important for investors to know that it's an enormous priority for the management team to post loss reserves today to pay claims in the future, to do that in a conservative fashion so that it's very likely we have more than enough money set aside. That's our goal. We don't -- we haven't batted 1,000 on that, but we've been very good at it over the -- if you will, this is our 15th year in business. So we're trying to extend that good track record even in the face of kind of heightened uncertainty with inflation and the like.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Yes. Understood. And last one, Mike, I'm going to ask you some thoughts to give a bit here, but just given all the reserving issues that are sort of bubbling under the surface now and slowly emerging, do you think that creates another pricing leg for casualty? Like clearly, last year was property, but do you think this creates more opportunities in casualty?

Brian Donald Haney
President & COO

Yes. I think we're seeing that right now in the deals we're looking at in casualty.

Michael Patrick Kehoe
Chairman of the Board & CEO

Yes. And I think there's also this enormous expansion in the delegated underwriting authority market over the last number of years is kind of an interesting anomaly, if you will, in that normally hard markets are associated with a contraction in delegated underwriting. In this market, we've had this hard market the last several years at a time when we've had an expansion in delegated underwriting authorities.

And clearly, some of those are very well managed, and we're not inditing that model of business even though we're not engaged in it. But there's a lot of those delegated underwriting authorities that can be wildly aggressive in their underwriting and pricing. And we see that as an area for likely future contraction, which I think is bullish for the market and I think it's bullish for Kinsale.

Operator

Your next question comes from the line of Andrew Andersen from Jefferies.

Andrew E. Andersen
Jefferies LLC, Research Division

Just wanted to go back to the rate increase number of 7%. Just to be clear, that's what we can think of as a pure rate number, and then we could perhaps add on a few points of exposure that acts as rate.

Brian Donald Haney
President & COO

Yes. That's correct.

Andrew E. Andersen
Jefferies LLC, Research Division

And the loss trend against a 7%, plus a few points would be approximately 8%?

Brian Donald Haney
President & COO

I'm sorry. Can you ask that question again?

Andrew E. Andersen
Jefferies LLC, Research Division

The loss trend that we could apply against the 7% rate plus perhaps a few points of exposure. I think in the past...

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Somewhere in the neighborhood -- somewhere 4% to 5%.

Operator

And there are no further questions at this time. I will now turn the call back over to Michael Kehoe for some final closing remarks.

Michael Patrick Kehoe
Chairman of the Board & CEO

Okay. Well, thanks, everybody, for joining us, and we look forward to speaking with you again here soon. Have a great day.

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