S&P Capital IQ

CONTENTS

Kinsale Capital Group, Inc. NasdaqGS:KNSL

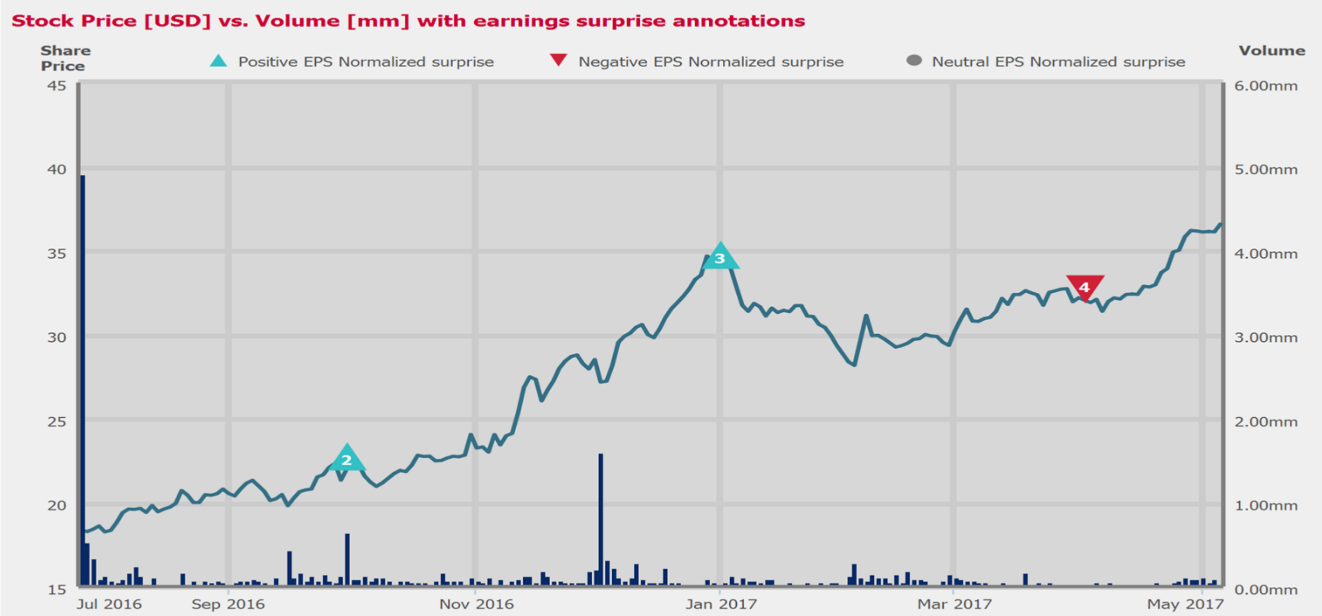
FQ2 2017 Earnings Call Transcripts

Friday, August 04, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2017-			-FQ3 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.32	0.40	▲25.00	0.38	1.39	1.68
Revenue (mm)	46.44	45.51	▼(2.00 %)	49.16	188.54	217.96

Currency: USD
Consensus as of Aug-04-2017 1:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2016	0.34	0.42	▲1 23.53 %
FQ3 2016	0.25	0.38	▲2 52.00 %
FQ4 2016	0.26	0.32	▲3 23.08 %
FQ1 2017	0.31	0.29	▼4 (6.45 %)

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

Adam Klauber
William Blair & Company L.L.C., Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

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

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2017 Kinsale Capital Group Inc. Earnings Conference Call. [Operator Instructions]

As a reminder, this conference may be recorded.

Before we get started, let me remind everyone that through the course of the teleconference, Kinsale 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 the 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 second quarter results.

Kinsale management may make reference during the call to underwriting income, which is a non-GAAP financial measure of financial results. Kinsale's underwriting income represents the pretax profitability of the company's insurance operations.

The Form 8-K and press release are 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, everybody. I'm Mike Kehoe, CEO of Kinsale. Joining me today on the call are Bryan Petrucelli, Chief Financial Officer of Kinsale; and Brian Haney, Chief Operating Officer.

After a brief introduction by me, Bryan Petrucelli will provide some detail on the financial results for the quarter. And following Bryan, Brian Haney will provide some further detail on Kinsale's underwriting operation and the broader marketplace in which we compete.

Last night, Kinsale reported favorable results for the second quarter. Some of the highlights of the quarter include the following: net income of $8.5 million, annualized ROE of 15.4%, a combined ratio of 75.2%, underwriting profit of $10.7 million and premium growth of 15.3%.

As a recap, Kinsale's strategy is to combine disciplined underwriting and claim handling with a low-cost operation, a strategy, we believe, is an endgame winner every time. Kinsale's expenses run between 20% and 40% below many of our competitors.

Kinsale writes exclusively in the excess and surplus lines market, where historically returns have been higher compared to the broader standard market. Unlike all of our competitors, we don't delegate underwriting or claim authority to outside parties. We maintain absolute control over both the underwriting and the claims in order to drive better results. And finally, we work very hard to maintain an owner/operator business culture, where most of our employees and all of our senior managers are heavily invested in the company, which creates an unusual and powerful alignment of interests between employees and stockholders.

In sum, the Kinsale model provides a powerful competitive advantage that should allow us to deliver on both our profit and our growth goals over time, even in a competitive market like we find ourselves in today.

And with that, Bryan Petrucelli, I'll turn it over to you.

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

Thanks, Mike.

As Mike noted, we continue to deliver strong earnings in the second quarter and first half of 2017 as a result of solid premium growth, favorable loss development and diligent expense management. As a reminder, the company's goal is to consistently generate a mid-80s or lower combined ratio and to produce a return on equity in the mid-teens over the long term.

We reported net income of $8.5 million for the second quarter of 2017, representing an increase of 40.3% over the second quarter of 2016.

The company generated underwriting income of $10.7 million and a combined ratio of 75.2%, an increase of 36.4% from the second quarter of 2016.

Underwriting income in the second quarter of 2017 benefited from $3.8 million of net favorable prior year loss reserve development.

Annualized ROE was 15.4% for the quarter and 13.5% for the first half of 2017, up from 11.8% in Q1 and in line with our expectations as we continue to absorb the new capital from last year's IPO.

Gross written premiums were $57.8 million, representing a 15.3% increase over the second quarter of 2016. Year-to-date, written premiums have increased 18.7% over last year. Premium growth continues to be generated from an overall increase in underwriting activity across most lines of business and, most notable, in our small business, construction, energy, product liability and personal insurance divisions.

No significant changes on the investment side. Approximately 90% of total investments are in fixed-income securities with a AA average credit rating and a weighted average duration of approximately 3.4 years. Investment income increased by 33.7% over the second quarter of 2016 as a result of continued growth in the investment portfolio. Gross investment returns continue to be in the low 2% range.

For the second quarter, basic and diluted EPS was $0.41 and $0.40 per share, respectively, compared to $0.30 and $0.29 per share, respectively, in Q1 this year.

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

Brian D. Haney
Chief Operating Officer and Senior Vice President

Thanks, Bryan.

Overall, the market continues to be very competitive. The main spot is we are seeing overly aggressive competition, and that creates an obstacle for us because we aren't going to lose money just to grow. On the other hand, there are still pockets of dislocation and opportunity for us, so we can always find some new business to write. The improving economy has also helped, both in terms of more revenues for our insureds as well as more businesses to insure.

The 15.3% growth rate in the second quarter was below the pace in the first quarter but above the pace from last year and generally consistent with the growth rate we've seen in submissions. The submission growth rate for the quarter was in the high teens, which gives us optimism about our growth prospects going forward.

Most of our 17 divisions grew year-over-year.

We've begun our annual rate reviews of each division and have made several adjustments to our technical rates. The net effect of these technical rate changes would average out to a rate increase somewhere in the low single digits.

As a reminder, we have a different focus than many of our competitors. First, we are 100% E&S. Also, we focus on smaller accounts and accounts that are hard to place. Unlike the vast majority of our competitors, we never outsource underwriting our clients' decisions to third parties. In particular, we don't write and have never written programs.

Another area where we are different is that we have a very cautious approach to commercial auto. We could write a lot more of this if we thought the rates are where they needed to be, but we don't think that's the case at the moment. We'll continue to keep an eye on that market, but at this point, our exposure to commercial auto is still very limited.

In general, we are very happy with our growth rate, in particular because we are growing in spite of market conditions, not because of them, and because we are growing while maintaining our underwriting discipline.

But whatever the growth rate is in a particular quarter, we feel optimistic because over the long run, our expense ratio advantage is going to drive business to us. The buyer wants a low price and competitors that are burdened with high expenses can't provide that, at least not over the long run, because they need high prices to cover their heavy expense loads. Some companies we compete against have expense ratios 40% or higher. Our expense ratio is more than 1/3 lower than that. This means we can give a buyer a lower price and still produce a superior return.

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

Michael P. Kehoe
Founder, CEO, President & Director

Thanks, Brian.
Operator, we're now ready to take questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Mark Hughes from SunTrust.

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

Your expense ratio really dropped down pretty nicely on a sequential basis. Anything unusual in that? Or is that just leverage efficiency, et cetera?

Michael P. Kehoe
Founder, CEO, President & Director

This is Mike Kehoe. Yes, we were pleased to see the drop. You'll recall we were at a 27.9% in Q1, down to a 24.4% in Q2. I think a big part of that kind of goes back to some seasonality in expenses that, if you will, kind of pushed the first quarter number up a little bit higher than we would have liked. I think there's also in that number a lot of management focus on managing that number as aggressively as we can. And I think the growth in the earned premium is also helping a little bit as we achieved some modest economies of scale. But I think it's best to focus on the 6-month number. There's a little bit more stability in that. And we are at a 26.1%, which I think compares favorably to the year-end number from 2016, which is a 26% spot.

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

Right. Is that 26.1% a good number for Q3, Q4, considering seasonality in those quarters?

Michael P. Kehoe
Founder, CEO, President & Director

I think so.

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

Okay. And then the submission flow, high teens in the quarter, could you kind of break that out? How much of it is kind of expanded net more distribution? What do you think the underlying growth is in terms of the submission count in E&S? That seems like a strong number?

Michael P. Kehoe
Founder, CEO, President & Director

Brian, do you want to take that?

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, this is Brian Haney. While we don't -- I would say most of it is just continued marketing efforts and just organic growth. We're still a small company, so we're still getting some benefit from more people knowing who we are. And we are getting some benefit from appointing new agents. We're getting some benefit from new products, getting some benefit from geographic expansion in our Aspera unit. So I would say each of those is probably incrementally taking in a few points.

Michael P. Kehoe
Founder, CEO, President & Director

And then, of course, growth in the E&S market in general, Mark, I think you've done some analysis pointing out 6-month growth rates in the E&S segment versus the standard market. And clearly, we're benefiting from that as well.

Operator

[Operator Instructions] And our next question comes from the line of Adam Klauber from William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

The -- for the quarter, the accident year loss ratio really took a nice dip down, and I know that's going to move quarter-to-quarter. It's not a lockstep. But still, it was down 700 basis points from first quarter. Just any color on that would be helpful.

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, Adam, it's Brian. Nothing really there other than just losses coming in lower than expected. I think a couple points of variability in that current accident year loss ratio is probably well within what we would expect from quarter-to-quarter. But nothing specific that we can point to.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. So just normal quarterly volatility. I guess how's your -- I know you've grown Aspera. How's your appetite for property? How big is property as a percent of the overall book right now?

Michael P. Kehoe
Founder, CEO, President & Director

Property continues to be kind of mid to upper single digits. We write property in a couple different areas. We've got a commercial property unit. We've got an inland marine unit we started about 1.5 years ago. And of course, we have our personal lines division, which is predominantly a Southeastern property. But we see it as a good opportunity. There's some volatility that goes with a business that's cat oriented. And of course, we manage the catastrophe exposure very carefully in terms of the quality of the data we collect, the limits on concentration in any given area, the amount of reinsurance we buy, the monthly modeling of that portfolio. So we like the cat business. We're mindful of the volatility, and we manage it fairly conservatively.

Adam Klauber
William Blair & Company L.L.C., Research Division

Right. And a lot of other companies in this quarter had some storm-related losses. Did you have any tailwind-type storm losses? Or, I mean, again, your numbers are very strong, but did any of that filter through into the numbers?

Michael P. Kehoe
Founder, CEO, President & Director

Brian Haney?

Brian D. Haney
Chief Operating Officer and Senior Vice President

This is Brian Haney. Yes, we had negligible property cat losses in the quarter.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay, okay. Again, top line has been -- gross premium written has been very strong in the first half. But having said that, have you added any new teams recently? Or would you likely add any new teams by the end of the year?

Michael P. Kehoe
Founder, CEO, President & Director

No, we haven't added any new teams. Brian Haney?

Brian D. Haney
Chief Operating Officer and Senior Vice President

I was going to say the same thing. We haven't added any new teams, and I'm not sure that we are -- there's any new teams in the immediate future.

Operator

And we do have a follow-up question from the line of Mark Hughes from SunTrust.

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

The low single-digit rate increase, I think, sounds like that's aggregate across the book. Is that enough to keep up with loss inflation?

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, this is Brian Haney. We would estimate loss trends probably somewhere in the 2% to 3% range. And between the rate increases and just exposure trend, we think we're probably right at loss cost trend. If we're below it, we're only where it's a very small amount or below it.

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

Any commentary on just the emergence of losses in the book? Any change there? Any reason to think of any inflation? Or is it kind of steady as she goes compared to your historical experience?

Brian D. Haney
Chief Operating Officer and Senior Vice President

We haven't seen anything unusual or out of -- inconsistent with what we've seen in previous quarters.

Operator

And our next question comes from the line of Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I apologize if you may have covered this at all because I did miss the very beginning of the call. I was trying to get a sense. Obviously, your growth in the quarter was pretty good. As we listen to other conference calls, we've heard about a lot of fairly competitive market conditions. I'm just trying to get a sense of -- are you seeing any different competitors? Are you seeing guys who normally write larger come down into your smaller space? Just trying to get a sense of what some of those dynamics might look like.

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, this is Brian Haney.

Michael P. Kehoe
Founder, CEO, President & Director

I think it's -- okay, go ahead. Go ahead, Brian.

Brian D. Haney
Chief Operating Officer and Senior Vice President

No, go ahead, Mike. Sorry.

Michael P. Kehoe
Founder, CEO, President & Director

I was go to start by just saying it's a fairly common dynamic that there can be an ambiguous line between where the standard market ends and the E&S market begins, right. And it's typically defined by your standard company because they underwrite more aggressively in terms of price, they tend to offer broader coverage. And so there -- that tension between the 2 markets, that never goes away. And of course, in a highly competitive period in the insurance cycle, that's going to be a little bit more pronounced than not. So I'd say that's a pretty standard part of the dynamic. The program market, where carriers delegate underwriting authority, a lot of times those programs tend to be fairly aggressive in how they price risk, so we find that to be tough competition. There's constantly new markets coming in to battle for business. But as Brian Haney said earlier, there's also programs that fade away, and it creates pockets of dislocation. To me, that business is normal, but -- or business as usual, but it is a fairly competitive marketplace at the moment. Brian, did you want to add to that?

Brian D. Haney
Chief Operating Officer and Senior Vice President

Yes, I was just -- I would just add that the names of the people that are coming and going change every quarter, but the overall level of churn, I think, is pretty much the same as we've seen in the last few quarters.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

So you're not really seeing anything that is a building headwind to kind of continued growth in the areas that you like to be, and it's -- you don't see a wall starting to emerge. It's just it's a crowded field and you're fighting your way through the line as best you can?

Brian D. Haney
Chief Operating Officer and Senior Vice President

That's fair.

Michael P. Kehoe
Founder, CEO, President & Director

Yes, I think that's fair.

Operator

And I'm showing no further questions over the phone lines at this time. I would like to turn the call back over to Michael Kehoe for closing remarks.

Michael P. Kehoe
Founder, CEO, President & Director

Okay, thank you, operator.

I just want to quickly acknowledge all the employees of Kinsale. I think it's true that the number one thing that distinguishes Kinsale or any company from its competition is the quality of the people and that -- the efforts that they put forth every day. So just quick acknowledgment to the employees.

And thank you for joining us today, and we look forward to speaking with you in a few months at the end of the next quarter. Have a good day.

Operator

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