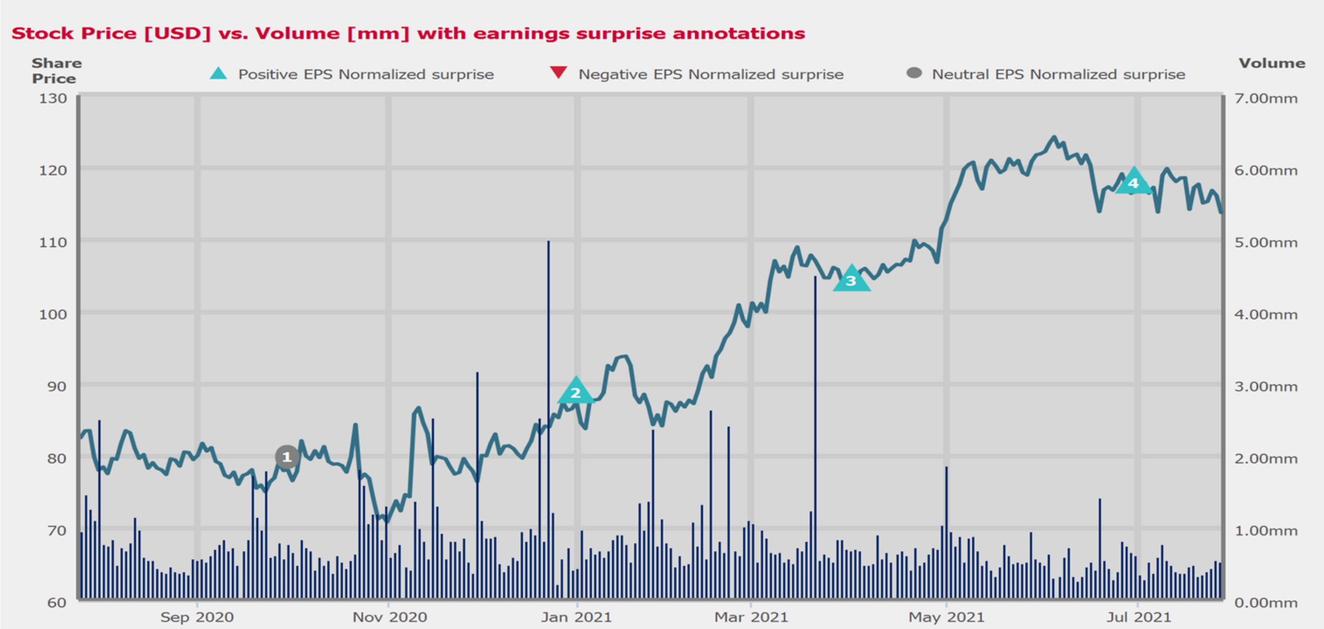
Cincinnati Financial Corporation NasdaqGS:CINF FQ2 2021 Earnings Call Transcripts

Thursday, July 29, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.98	1.79	82.65	0.98	4.90	NA
Revenue (mm)	1716.07	2295.00	33.74	1733.75	7428.20	NA

Currency: USD
Consensus as of Jul-29-2021 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	0.39	0.39	0.00 %
FQ4 2020	1.20	1.61	34.17 %
FQ1 2021	1.10	1.37	24.55 %
FQ2 2021	0.98	1.79	82.65 %

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Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Steven Justus Johnston
Chairman, President & CEO

ANALYSTS

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Mark Alan Dwelle
RBC Capital Markets, Research Division

Presentation

Operator

Good day, and thank you for standing by, and welcome to the second quarter 2021 earnings conference call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Dennis McDaniel, Investor Relations Officer. Please go ahead.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our second quarter 2021 earnings conference call. Late yesterday, we issued a news release on our results, along with our supplemental financial package, including our quarter end investment portfolio. To find copies of any of these documents, please visit our investor website, cinfin.com/investors. The shortest route to the information is the quarterly results link in the navigation menu on the far left.

On this call, you'll first hear from Chairman, President and Chief Executive Officer, Steve Johnston; and then from Chief Financial Officer, Mike Sewell. After their prepared remarks, investors participating on the call may ask questions. At that time, some responses may be made by others in the room with us, including Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance's Chief Insurance Officer, Steve Spray; Chief Claims Officer, Marc Schambow; Senior Vice President, Corporate Finance, Theresa Hoffer.

First, please note that some of the matters to be discussed today are forward-looking. These forward-looking statements involve certain risks and uncertainties. With respect to these risks and uncertainties, we direct your attention to our news release and to our various filings with the SEC. Also, a reconciliation of non-GAAP measures was provided with the news release. Statutory accounting data is prepared in accordance with statutory accounting rules and therefore, is not reconciled to GAAP.

Now I'll turn over the call to Steve.

Steven Justus Johnston
Chairman, President & CEO

Thank you, Dennis, and good morning, and thank all of you for joining us today to hear more about our second quarter results. We had another quarter of strong operating performance as we remain focused on steady progress towards profitably growing our insurance business over time. Financial results benefited from several areas, including excellent investment management and ongoing efforts to continually improve insurance operations.

Net income for the second quarter of 2021 decreased by $206 million compared with the second quarter of last year, primarily due to $439 million less benefit on an after-tax basis in the fair value of securities held in our equity portfolio. Equity portfolio fair value changes caused significant earnings volatility for several quarters since early 2020. And net income for the first 6 months of 2021 increased by $1.6 billion from a year ago.

Non-GAAP operating income was up $221 million or 311% for the quarter, with lower catastrophe losses on an after-tax basis, contributing $136 million of the increase. Our 85.5% property casualty combined ratio was 17.6 percentage points better than a year ago, with decreased catastrophe losses in the second quarter representing 12.6 points of the improvement.

The current accident year combined ratio before catastrophe loss effects also continued to improve and was 2.0 percentage points better than last year for the second quarter and 3.5 points better on a 6-month basis. Our underwriters emphasize segmentation of risks, working to retain more profitable accounts and obtaining better pricing on business that we identify as less profitable. At the same time, we are diversifying risks by product line and geography while excellent service from our claims operation also helps grow our business.

Premiums grew at an impressive rate for the second quarter in a row, reflecting expertise and focus by our associates and great production by the premier independent agents who represent Cincinnati Insurance.

Consolidated property casualty net written premiums rose 10% in the second quarter of 2021. We continue to believe we are growing profitably by combining data and judgment as we underwrite and price business. We also recognize the importance of remaining disciplined and walking away from opportunities when we determine pricing is inadequate.

Renewal pricing during the second quarter continued to be ahead of our estimate for prospective loss cost trends for each property casualty segment. Our commercial and personal lines insurance segments, again experienced mid-single-digit percentage range estimated average price increases, while the excess and surplus lines insurance segment continued in the high single-digit range.

Each insurance segment grew its business and produced improved profit compared with the second quarter a year ago. Our commercial lines segment had superb results with its 84.2% combined ratio improving by 14.9 percentage points compared with the second quarter a year ago and growing net written premiums by 8%.

For our personal lines segment, second quarter net written premiums grew 4%, continuing to benefit from planned expansion of high net worth business produced by our agencies. Its combined ratio of 92.7% also improved significantly, down 19.6 percentage points from the second quarter a year ago.

Our excess and surplus line segment produced a combined ratio below 90%, while also growing net written premiums by an impressive 26% and posting favorable reserve development on prior accident years for the third time in the past 4 quarters.

Cincinnati Re continued its strong, diversified and profitable growth as net written premiums grew 62% in the second quarter, with an excellent combined ratio of nearly 80%. Its seasoned, talented team, is taking advantage of firmer reinsurance pricing, while at the same time, maintaining underwriting discipline as they typically decline 3 out of 4 opportunities to write new reinsurance contracts among hundreds that they are routinely submitted in a quarter.

Cincinnati Global again produced a fine underwriting profit with an exceptional loss and loss expense ratio as favorable reserve development on prior accident year catastrophes offset most of its other losses. Its net written premiums decreased a little as underwriters have been reducing catastrophe loss risk while growing some newer lines of business.

Our life insurance subsidiary had another good quarter, reporting second quarter net income up 17% from a year ago and growing life insurance earned premiums by 2%.

I'll conclude with the value-creation ratio, our primary measure of long-term financial performance. Strong operating results and favorable securities markets produced an excellent VCR at 7.3% for the second quarter and 11.6% for the first half of the year. The contribution from operations measured as net income before investment gains was 4.8% for the first 6 months of 2021, up 2.7 percentage points from a year ago.

Now our Chief Financial Officer, Mike Sewell, will comment on a few other important areas of our financial performance.

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Thank you, Steve, and thanks for all of you joining us today. Our investment portfolio continued to perform very well during the second quarter of 2021, including investment income growth of 5%. Dividend income was up 13% for the second quarter compared with the same quarter a year ago.

For the first half of the year, net purchases for the equity portfolio totaled $42 million. Interest income from our bond portfolio grew 3% and the pretax average yield was 4.02%, down 9 basis points from the second quarter a year ago. The yield on a 6-month basis matched last year's first half.

The average pretax yield for the total of purchased taxable and tax-exempt bonds during the second quarter of 2021 was 3.33%. Investing in the fixed maturity portfolio continues to be a priority, with net purchases during the first 6 months of the year totaling $465 million. Investment portfolio valuation changes for the second quarter of 2021 were favorable for both our stock portfolio and our bond portfolio. The overall net gain was $652 million before tax effects, including $489 million for our equity portfolio and $141 million for our bond portfolio.

At the end of the second quarter, total investment portfolio net appreciated value was approximately $6.9 billion, including $5.9 billion in our equity portfolio. We had another quarter of strong cash flow, again, contributing to investment income. Cash flow from operating activities for the first 6 months of 2021 generated $917 million, up 49% from a year ago.

Expense management is always an important matter as we work to achieve a good balance between strategic business investments and expense controls.

The second quarter of 2021 property casualty underwriting expense ratio was 0.6 percentage points lower than last year's second quarter which included a stay-at-home policyholder credit for personal auto policies and higher credit losses due to uncollectible premiums. The second quarter ratio was higher than the first quarter of this year, largely due to higher accruals related to profit sharing in the second quarter and lower expenses in the first quarter that benefited from less business travel.

Next, I'll highlight a few items regarding loss reserves and reinsurance. Our approach to reserving remains consistent and aims for net amounts in the upper half of the actuarially estimated range of net loss and loss expense reserves. During the second quarter of 2021, we experienced $119 million of property casualty net favorable development on prior accident years. The combined ratio effect was 7.8% for the quarter.

As we do each quarter, we consider new information such as paid losses and estimate ultimate losses and loss expenses by accident year and line of business. Based on our study of new data during the year, we update estimates as needed. Together, our workers' compensation and commercial casualty lines of business represent about half of our $7 billion quarter-end total gross property casualty loss and loss expense reserves and they had the largest amounts of second quarter favorable net reserve development.

Workers' compensation has the longest tail as claims can remain open for many years. While the amount of reserve release for any given accident year was relatively small, the aggregate amount was $27 million. Commercial casualty paid loss development by accident year over time is an important factor in estimating ultimate losses. Calendar year basis data is not as useful. For example, while the second quarter 2021 paid loss total for commercial casualty was higher than a year ago, for the first 6 months of 2021, it was 15% less than what we saw prior to the pandemic in the first half of 2019 despite earned premiums that were 13% higher in 2021.

Net favorable reserve development during the second quarter was concentrated in the 4 most recent accident years, including a little more than 2/3 for accident years 2017 through 2019. On an all-lines basis by accident year, net reserve development for the first half of the year was favorable by $170 million for 2020, $26 million for 2019, $15 million for 2018 and $18 million in aggregate for accident years prior to 2018. Nearly 80% of the 2020 amount was for property or auto lines of business, which have a much shorter tail than workers' compensation or commercial casualty.

Regarding reinsurance, we disclosed in our 10-Q that we nonrenewed our combined property catastrophe occurrence excess of loss treaty that provided up to $50 million of coverage for business written on a direct basis and by Cincinnati Re. And we restructured the reinsurance program in place for Cincinnati Re only that provides property catastrophe excess of loss coverage now with a total available aggregate limit of $48 million.

Another reinsurance detail we disclosed pertain to cyber insurance that we offer as an affirmative coverage option on various policies. Some recent industry reports indicate that on a direct written basis -- premium basis, Cincinnati insurance is among the 20 largest cyber insurers in the U.S. Premiums for those policies are ceded to a reinsurer, therefore transferring substantially all of that risk.

I'll briefly comment on capital management. Our approach remains consistent, and we ended the quarter with outstanding financial strength and financial flexibility.

In typical fashion, I'll wrap up my prepared remarks [Technical Difficulty] of our value-creation ratio. Property casualty underwriting increased book value by $1.08. Life insurance operations increased book value $0.07. Investment income other than life insurance and net of noninsurance items added $0.80. Net investment gains and losses for the fixed income portfolio increased book value per share by $0.69.

Net investment gains and losses for the equity portfolio increased book value by $2.40. And we declared $0.63 per share in dividends to shareholders. The net effect was a book value increase of $4.41 per share during the second quarter to a record high $73.57 per share.

And now I'll turn the call back over to Steve.

Steven Justus Johnston
Chairman, President & CEO

Thanks, Mike. It's satisfying to see the steady execution of our initiatives producing these strong results. In June and July brought a return of business travel and a return of our headquarters associates working together in person. It's wonderful to see so many familiar faces in the hallway and to be able to get out from behind our desks to visit with agents and our field teams across the country. This return to a bit of normalcy has produced an energy that you can feel across our organization, bringing with it lots of optimism for the future of Cincinnati Financial.

As a reminder, with Mike and me today are Steve Spray, Marc Schambow, Marty Hollenbeck and Theresa Hoffer. Polly, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Derek Han with KBW.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

I just had a question on the commercial growth. You've obviously had impressive commercial growth in the second quarter of 7.6%. But just given the rapid economic normalization that you've talked about, I would have maybe expected the premium growth to be a little higher. Was that just a function of prudent cycle management that you've had in the past, maybe nonrenewing some of the unprofitable businesses?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Derek, this is Steve Spray. Yes, I think it's a great question. Our new business for commercial lines has continued to improve throughout the first half of this year, getting back post, I guess, pre-COVID. And it's always a balance between the growth and the profitability. And the way our new business underwriters in the field and our headquarters underwriters here are executing on pricing sophistication, pricing segmentation and just balancing that with new business growth, we're pretty pleased with where we are now and candidly feel like we've got a good runway ahead of us to continue as we get back to calling on our agents face-to-face and taking advantage of those opportunities.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Got you. That's helpful. And just on a related note, you previously guided for 6% or higher top line growth for this year. Your first half is obviously well above the 6% mark. And the second quarter growth of 9.9% wasn't really driven by easier comps. So how should we think about the growth in the second half, including commercial?

Steven Justus Johnston
Chairman, President & CEO

Yes. Thanks, Derek. This is Steve Johnston. And we feel good about the growth in total, and it's coming really from all of our segments. I would point out that Cincinnati Re represented 5 percentage points of the 11% growth for the first half. And I think we hope that market conditions continue to be just as they are with the reinsurance market, but there's always a chance that, that can change. I guess there's just uncertainty, the economy could weaken. So there are things that could impact the growth, but we really do feel good about our growth, good about our growth prospects, really confident in the business that Cincinnati Re is bringing to us with their growth and really across every one of our operational areas.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And if I can squeeze just one more question in. Within workers' comp, you had material favorable reserve development, but the core loss ratio kind of picked up higher sequentially. Is there a driver behind that?

Steven Justus Johnston
Chairman, President & CEO

I think with the workers' comp just there's been rate pressure. Throughout the industry, there's been a lot of talk of it kind of maybe bottoming out and so forth. That has had an impact. And I think our team has just done a great job with the workers' compensation in terms of pricing, underwriting, segmenting the business. And so we feel good about our prospects and workers' compensation over the little bit longer term.

Operator

[Operator Instructions] Your next question comes from the line of Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle

RBC Capital Markets, Research Division

A couple of questions. First, maybe looking first at personal lines. I guess it was a very good result in the quarter. I guess I was a little bit surprised that the accident year margin, actually, it was a little bit better in the second quarter than in the first quarter. It did obviously deteriorate against year ago, but not nearly by as much as we've seen with a lot of other personal lines writers given all of the increased business activity back to work, more normal driving behavior. So I was just -- I was curious to see what you were seeing in the data that might kind of outline with that?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Mark, it's Steve Spray again, and maybe Steve Johnston and I can tag team on this one. Over the last couple of years, we've really had to take some specific -- or some underwriting and pricing action in specific states. And I think that is showing up in the results. And at the same time, we've continued to build out our pricing sophistication tools, segmentation and personal lines, and you can see that showing up and improving our new business results as well. So that -- I think that -- hopefully, that gets to the question as far as just the improved results. It's on multiple fronts and specifically taking some more aggressive action in some specific states that have needed it. And you can also see that, that's putting some pressure just on the net written premium growth as well.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Within your personal lines, what percentage of the business is sort of auto related as compared to homeowners related?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Yes. We have that here for the quarter. The personal lines written premium was $166 million -- I'm sorry, the personal auto written premium was $166 million; homeowners, $211 million; and then the other personal, which would be everything that goes with the inland marine and so forth of $62 million.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Yes, so it's probably a factor as well. You've got a richer homeowners mix than many peers do. Okay. The second question that I had really related to the commercial lines. You partly addressed it earlier, but in thinking about the overall growth rate in the quarter for premiums, how would you -- if you had to just generally segment between growth that was driven by exposure unit growth at your customers, just expanded unit counts or underlying policy size versus just true price. Like is there an easy way to kind of divide that up?

Stephen Michael Spray
Senior VP, Chief Insurance Officer & Director

Yes, I think I would say it's a little bit of all of it, Mark. This is Steve Spray again. Price is certainly making an impact there, retention. And then we are seeing exposures in our commercial lines book returned to almost -- they're getting close to pre-COVID exposure basis. And it really depends on I think probably for any carrier, especially for us, just your mix as well in different segments, different industry segments are impacted differently from COVID. Just as an example, construction and manufacturing, real estate, all held up pretty well throughout COVID and in the first half of '21. And so we -- that we have a fair amount of that business on our books and some other industry segments maybe didn't fare as well and would impact us less also. So there's a lot of moving parts there.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. I appreciate that. And then 2 other questions. One, could you just provide a kind of a general update on some of the business interruption litigation that, I mean, this time it was the only thing we could talk about this time a year ago. Obviously, a certain amount of time has passed and just kind of an update on what you continue to see and what proportion of the reserves that are set up a year ago might still remain in IBNR?

Steven Justus Johnston
Chairman, President & CEO

Sure. I'll take that one, Mark. And I think it's fair to say that our BI litigation continues to progress pretty well. During the quarter, we received the first appellate court decision that considered our policy language and it confirmed that there was no coverage. And the overwhelming majority of trial courts from across the country continue to apply the policy language as we had anticipated. We've said before that we believe our policy language requires direct physical loss or damage to property to trigger coverage is clear and that the virus does not cause direct physical loss or damage to property. So we think that the BI litigation continues to progress pretty well. In terms of the amounts, they have been relatively consistent with really no material changes during the quarter.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. And then just one last question. Within -- and this is just kind of getting used to these new business units. Within Cincinnati Re and Cincinnati Global, are either of those businesses likely to have exposure to some of the flooding that has been occurring in Europe recently?

Steven Justus Johnston
Chairman, President & CEO

We've been keeping a close eye on that, and we don't think that there's a material exposure there. It's still early. From everything we can tell to this point, no material damage there.

Operator

And at this time, there are no further audio questions. We'll now turn the call back over to Mr. Steve Johnston for closing remarks.

Steven Justus Johnston
Chairman, President & CEO

Thank you, Polly. And thanks for all of you for joining us today. We look forward to speaking with you again on our third quarter call. Have a great day.

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