S&P Global
Market Intelligence

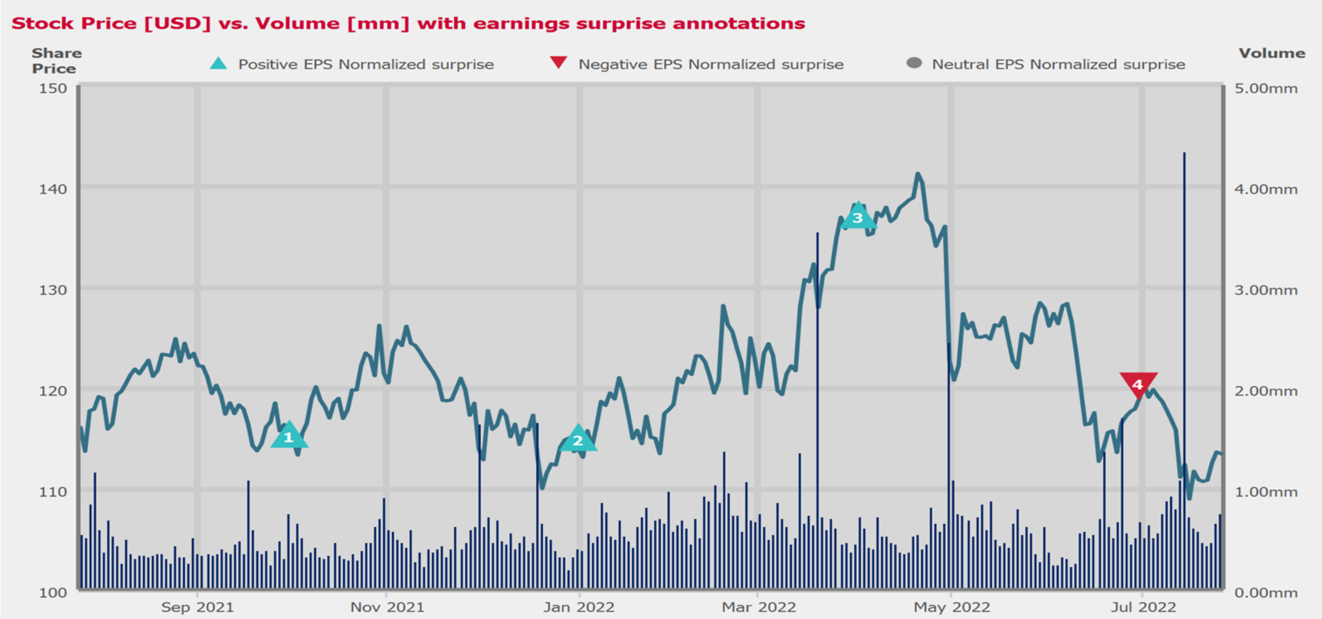
Cincinnati Financial Corporation NasdaqGS:CINF FQ2 2022 Earnings Call Transcripts

Thursday, July 28, 2022 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.04	0.65	(37.50 %)	1.00	4.60	NA
Revenue (mm)	1958.05	820.00	(58.12 %)	2004.10	7225.87	NA

Currency: USD
Consensus as of Jul-28-2022 11:33 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	0.91	1.28	1 40.66 %
FQ4 2021	1.36	1.97	2 44.85 %
FQ1 2022	1.45	1.58	3 8.97 %
FQ2 2022	1.04	0.65	4 (37.50 %)

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Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

Martin Francis Hollenbeck
Chief Investment Officer, Executive VP, Assistant Secretary & Assistant Treasurer

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

Stephen Michael Spray
President & Director

Steven Justus Johnston
Chairman & CEO

Unknown Executive

ANALYSTS

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

Mark Alan Dwelle
RBC Capital Markets, Research Division

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Hello, and welcome to the Cincinnati Financial Second Quarter 2022 Earnings Conference Call. [Operator Instructions]

Please note, this event is being recorded. I would now like to turn the conference over to Dennis McDaniel, Investor Relations Officer. Please go ahead.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel, Investor Relations Officer at Cincinnati Financial. Thank you for joining us for our second quarter 2022 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 and Chief Executive Officer, Steven Johnston; and then from Executive Vice President and 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 President, Steve Spray; Executive Vice President and Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance's Chief Claims Officer, Marc Schambow; and Senior Vice President of 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 & CEO

Thank you, Dennis. Good morning, and thank you for joining us today to hear more about our second quarter results. Increased catastrophe losses and increasing inflation affecting the industry, pressured our property casualty insurance results for this quarter. We are well positioned to improve results through continued focus on pricing and risk selection. As we have in the past, we'll follow our proven formula to successfully analyze and address challenged areas of our insurance operations.

Our financial strength remains excellent, and we are confident we can achieve profitable growth over the long term and through all economic cycles. We reported a net loss of $800 million -- $808 million for the quarter due to the recognition of a reduction in the fair value of securities held in our equity portfolio. Non-GAAP operating income of $104 million for the second quarter of 2022 was down from last year's impressive $292 million, largely due to catastrophe losses that were $119 million higher on an after-tax basis. Our 103.2% second quarter property casualty combined ratio was 17.7 percentage points higher than the 85.5% posted second quarter of last year. That increase reflected higher catastrophe losses and less favorable results on both the prior accident year and current year -- current accident year basis.

We regularly disclose large losses exceeding $1 million for individual property casualty claims, excluding losses from catastrophes. Commercial property and commercial umbrella tend to account for the bulk of those losses, each typically about 1/3 of total large losses. We noted on our last call that commercial property large losses rose sharply in the first quarter of this year. That increase reversed in the second quarter when they declined 86% from the second quarter of 2021. For our personal lines segment, net written premiums grew 16%, sorry. However, in the second quarter, commercial umbrella losses rose significantly, prompting reserve additions that we detailed in our 10-Q. That business has a long history of profitability for us and has benefited from very strong pricing in recent years for both the industry and us.

Overall, premiums continued a healthy growth pattern with steady average renewal price increases for each of our property casualty insurance segments. We benefited from outstanding production from the finest independent agents, while our underwriters remain steadfast in seeking to retain and grow profitable accounts and address areas where they judge pricing is not adequate, segmenting opportunities on a policy-by-policy basis. Consolidated property casualty net written premium rose [15%] for the second quarter of 2022. Our commercial lines insurance segment continued to experience estimated average renewal price increases in the mid-single-digit percentage range, similar to the first quarter.

Our excess and surplus lines Insurance segment continued in the high single-digit range. Personal lines average renewal price increases were slightly higher than in the first quarter, remaining in the low single-digit range. Personal auto is an area where we plan to more aggressively raise rates in future quarters as we work to improve its loss ratio. Underwriting processes, design to help premiums keep pace with rising property values, whether from outsized inflation or other changes in insured exposure amounts are another reason for significant increases in 2022 renewal written premiums.

Our commercial lines segment grew second quarter renewal premiums by 10%, and our personal lines segment also grew second quarter renewal premiums by 10%. The commercial lines segment grew second quarter 2022 net written premiums by 10% with a combined ratio of 106.3, including higher-than-usual catastrophe losses and elevated inflation effects. For our personal lines segment, net written premiums grew 16%, mostly from our continued planned expansion of high net worth business produced by our agencies. Its second quarter combined ratio up 112.1% also included higher-than-usual catastrophe losses and elevated inflation effects. The second quarter provided another example of the benefits of improving diversification over time by product line and geography. Profitability was very good for our operations in excess and surplus lines insurance, reinsurance, global specialty insurance and life insurance. Our excess and surplus line segment had an 85.1% combined ratio and continued strong growth with second quarter 2022 net written premiums growing 17%.

Cincinnati Re and Cincinnati Global each continued a pattern of profitable growth. Cincinnati Re, grew net written premiums by 31% for the second quarter of 2022, with a combined ratio in the low 80% range. Cincinnati Global, grew net written premium by 47%, with a combined ratio below 70%. Our life insurance subsidiary had another good quarter with net income of $21 million and a 91% increase in operating income, along with growth in term life insurance earned premiums of 8%.

We continue to emphasize the importance over time of the value creation ratio, our primary measure of long-term financial performance. VCR was negative 11.2% for the second quarter of 2022. Net income before investment gains or losses made a positive contribution, but was offset by lower investment valuations during the quarter.

Next, Chief Financial Officer, Mike Sewell will discuss a few more important insights regarding our financial performance.

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

Thank you, Steve, and thanks to all of you for joining us today. Investment income continues to grow and was up 11% for the second quarter of 2022 compared with the second quarter of last year. Dividend income rose 20% for the quarter, aided by a $5 million special dividend from one of our stock holdings.

Net equity securities purchased during the first half of 2022 totaled $40 million. Bond interest income grew 6% in the second quarter. The pretax average yield of 4% for the fixed maturity portfolio was down 2 basis points from a year ago. The average pretax yield for the total of purchased taxable and tax-exempt bonds during the second quarter of 2022 was 4.75%. We again purchased additional fixed maturity securities with net purchases totaling $240 million during the first 6 months of the year. Valuation changes for our investment portfolio during the second quarter of 2022 were unfavorable in aggregate, for both our stock and bond holdings. The overall net decrease was approximately $1.8 billion before tax effects, including a net decrease of $610 million for unrealized gains in our bond portfolio. At the end of the quarter, total investment portfolio net appreciated value was approximately $4.7 billion. The equity portfolio was in a net gain position of $5.3 billion, while the fixed maturity portfolio was in a net loss position of $564 million.

Cash flow continues to fuel growth of investment income. Cash flow from operating activities for the first 6 months of 2022 generated $755 million compared with $917 million a year ago. As in the past, we emphasize careful management of expenses and balance that with strategic investments in our business. The second quarter 2022 property casualty underwriting expense ratio was 0.6 percentage points lower than last year. Most of the decrease was from lower accruals for profit sharing commissions for agencies and related expenses. Moving on to loss reserves. We aim for a consistent approach by targeting net amounts in the upper half of the actuarially estimated range of net loss and loss expense reserves.

As we do each quarter, we consider new information such as paid losses and case reserves and then updated estimated ultimate losses and loss expenses by accident year and line of business. In the first half of 2022, our net addition to reserves was $414 million, a pace well ahead of 2021 or 2020, and a level we believe is an indication of the quality of our balance sheet. During the second quarter of 2022, we experienced $59 million of property casualty net favorable development on prior accident years that benefited the combined ratio by 3.4 percentage points. On an all-lines basis by accident year, net reserve development for the first 6 months of 2022 was favorable and included $61 million for 2021 and $54 million for 2020. That was partially offset by an unfavorable $15 million in aggregate for accident years prior to 2020.

Next, I'll comment briefly on capital management. We've had a consistent approach that includes share repurchases as part of maintenance intended to offset shares issued through equity compensation plans. At the same time, changing circumstances or opportunities can influence us to repurchase more or less than historical averages. We continue to believe that we have plenty of financial flexibility and that our financial strength at the end of the quarter was excellent. Shareholder dividends continue to be our primary way of returning capital to shareholders and cash dividends declared in the first half of 2022 are up 10%. In addition, during the second quarter, we repurchased just over 1.2 million shares at an average price per share of $124.44.

As usual, I'll conclude with a summary of second quarter contributions to book value per share. They represent the main drivers of our value creation ratio. Property casualty underwriting decreased book value by $0.26. Life insurance operations increased book value by $0.13. Investment income, other than life insurance and net of noninsurance items headed $0.53. Net investment gains and losses for the fixed income portfolio decreased book value per share by $3.03. Net investment gains and losses for the equity portfolio decreased book value by $5.81, and we declared $0.69 per share in dividends to shareholders. The net effect was a book value decrease of $9.13 per share during the second quarter to $66.30 per share.

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

Steven Justus Johnston
Chairman & CEO

Thanks, Mike. While this wasn't the kind of quarter we want to have, one quarter doesn't sway us from our long-term strategies and objectives. Our financial strength remains excellent, and we are optimistic about the future. In the last month, 3 different third-party organizations agreed. Moody's and S&P both affirmed our strong financial strength ratings. We were also again included on the Ward's 50 list. We are 1 of only 4 companies named 31x to the property casualty Ward's 50, recognizing our growth, profitability and shareholder return.

Before we open the call for questions, I'd like to pause to recognize Marty Hollenbeck. Many of you know Marty from his years of investor travel. He's announced his intent to retire at the end of September after 35 years of service to our organization. We thank him for his steady hand overseeing investments, especially during some of the very challenging times of market volatility. As I'm sure you can all imagine, we're sad to see Marty go.

At the same time, however, I have absolute confidence in Steve Soloria and his ability to smoothly step in to lead our investment operation with his nearly 30 years of experience. I know you all will feel the same as you get to know him during future investor visits. As a reminder, with Marty, Mike and me today are Steve Spray, Marc Schambow, then Theresa Hoffer.
MJ, please open the call for questions.

Question and Answer

Operator

[Operator Instructions]

Our first question today comes from Derek Han of KBW.

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

So my first question is 2 parts related to the commercial umbrella line of business. You readjusted your loss picks last quarter, but just curious what kind of new information that you've gotten to make another adjustment this quarter? And then secondly, since the umbrella line of business is pretty heavily exposed to inflation, how comfortable do you feel about the inflation assumptions embedded within your reserving and accident year loss picks.

Stephen Michael Spray
President & Director

Derek, Steve Spray here. Thanks for the question. Yes, we -- here in the second quarter, we've definitely seen inflationary impacts as well as pandemic effects on the umbrella book. As an example, courts closed during the pandemic, slower to open. We're seeing that show up. I would also say that our umbrella book in general, just -- from quarter-to-quarter is going to have inherent variability. And -- we've seen that here in the second quarter. Maybe for note as well, is that book, our commercial umbrella book is up over $500 million now. And we've got a long track record of underwriting profit, understanding how to price that book. The limits profile on it is relatively lower. The book reflects our primary business, which is -- tends to be smaller to midsized accounts. That's the business that we're primarily writing the umbrella coverages over.

So there's uncertainty for sure. There's inherent variability. You're seeing that in the actual results. And then on top of that, as you can expect from Cincinnati, and our long track record of recognizing uncertainty. We've gone ahead and recognized that through the IBNR for the reserving of the umbrella going forward, too.

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

Okay. That's really helpful. And then my second question is around the personal lines segment. You had really good growth in that segment, especially within the high net worth business. You've talked about in the past about how the high net worth business has a longer-term attractiveness relative to the middle market business. I'm just curious how you think about the overall profitability in the near term just in the context of rising loss trends?

Stephen Michael Spray
President & Director

Yes. Derek, again, Steve Spray. Yes, we are feeling really good about the high net worth business, primarily the team that we've assembled, the expertise, the experience that they have. And you're right. The majority of our growth in personal lines right now is coming from high net worth. On the written premium side, it's almost all coming from high net worth. On new business, we have seen our middle market book rebound, although again, the new business's lion's share is still coming from the high net worth. High net worth is important to us. We think we have a valuable contract. We think the way we handle claims is worth more premium. But that being said, I wouldn't want anybody to think that we are not completely focused on that middle market book as well.

We think that we are in a unique position that we have the sophisticated pricing. We have the products. We have the team. We have the historical experience long term on the middle market book as well. So we feel good about the middle market book. Maybe to get a little deeper for you there. Personal auto obviously is under pressure. A lot of that is coming from inflation. We are taking rate. And we've been taking rate in 2022. We'll continue to take rate in that personal auto book in 2022. And we expect in 2023 that we're going to take a little bit -- a little more than double the rate in the personal auto book that we are this year. The homeowner book is performing better, but it's under a little bit of pressure as well. We're taking rate in '22. We plan to continue to take rate in 2023.

And the other thing I would add there is in homeowner line, we are getting high single-digit exposure change there, too. So that's helping with the inflationary pressure that we're feeling.

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

Got it. I appreciate the color on that. And then last, just a numbers question. Did you see any Russia-Ukraine related loss this quarter?

Steven Justus Johnston
Chairman & CEO

This is Steve Johnston. And yes, we did. For the quarter, we -- and this would come from our Cincinnati Re and Cincinnati Global areas for the quarter, $6 million and for the year-to-date, $11 million. So we think we have that properly managed.

Operator

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

Mark Alan Dwelle
RBC Capital Markets, Research Division

I have a few questions. Starting with the commercial lines, when you had -- you reported a 64.8% accident year loss ratio before cat losses, that was up 7 points. Is all of that second quarter? Or is there a catch-up within that to catch up for first quarter loss trend?

Steven Justus Johnston
Chairman & CEO

Mark, this is Steve Johnston, and that would be our first quarter pick -- I'm sorry, second quarter pick. That would be just the quarter's pick.

Mark Alan Dwelle
RBC Capital Markets, Research Division

So the relatively lower loss pick that you had for the first quarter, you've picked a -- I'm just trying to make sure I understand, based on the run rate you're seeing right now, you would like your loss pick to be roughly 65 points as compared to the relatively lower pick that you had in the first quarter?

Steven Justus Johnston
Chairman & CEO

We just -- for each quarter, we try to do our best estimate of our reserves of our losses and premiums for each of the quarter. So the two stand on their own and of course, the year-to-date would be the sum of the two.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. Understood. And I presume the same applies related to the personal lines, the 8-point bump there that in accident year loss pick. That's all just on -- there's no prior quarter development embedded within that number.

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

That's correct.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. When you think about your loss cost trends right now, and I appreciate they vary by line of business. If you were thinking about the loss -- your average loss cost trend across the entire commercial lines book, for example, what would you say that, that is right now based upon what you're seeing in your data?

Steven Justus Johnston

Chairman & CEO

Well, you're right, Mark, that it is done at a very detailed level. And when we look at our prospects, we do it prospectively. We try to estimate what we think we need to trend losses for into the prospective rating period for the policies that will be effective. We do think, and as Steve kind of alluded to, that we are in a position that we can keep up with and/or exceed those loss cost trends as we go forward.

Mark Alan Dwelle
RBC Capital Markets, Research Division

I mean can you share sort of a run rate number? I mean some companies have said 5, some of it 6, 6.5. I mean is there a number you can share in terms of what you're seeing as far as trend?

Steven Justus Johnston
Chairman & CEO

We don't have a specific number like that in terms of a number, but when we do talk about getting mid-single-digit rate. And as Steve alluded to, for both personal and commercial, some inflationary effects on our exposure growth, we feel that we can keep pace with and exceed that trend.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. Turning over to the personal lines. I mean, again, you commented that you're getting kind of low single-digit rates across the personal line book. Can you break that between what portion -- what you're seeing in the auto book as compared to the homeowners book?

Steven Justus Johnston
Chairman & CEO

Yes. This is Steve again. For the auto, it would be currently in the low single digit and for the homeowners in the mid-single digit. And again, as Steve mentioned, for the homeowners, there is exposure growth and the rate for inflation in addition to the rate that we quote -- rate increase that we quote.

Mark Alan Dwelle
RBC Capital Markets, Research Division

As far as raising the rates on the auto book more aggressively, are you largely locked in on those rates now for this year based on your state filings or will you have to kind of begin that process from the start in order to try to get more. I ask because I mean your average rate increase in your auto book seems to be distinctly below where I would see at least some of your competitors at?

Steven Justus Johnston
Chairman & CEO

It's a rolling process. So we're already engaged in some of the 2023 rate increases and then also a point we make is through the pandemic, we did not reduce our rates any through there at all. We did have a kind of a stay-at-home discount that was in place on the expense side for several weeks, but did not take rate decreases.

Mark Alan Dwelle
RBC Capital Markets, Research Division

So there's not much you can really do to improve the rate picture for 2022. It's -- you're pretty much just beginning the process of trying to tackle on '23. Is that what I'm hearing?

Steven Justus Johnston
Chairman & CEO

Well, it's ongoing. It's rolling. So they've already been filed. But to your point, and we both kind of understand the earnings diagram for 2022 in terms of how rate will be earned during 2022. The ones that are in process, don't move the needle much.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Right. Okay. One other question related to the investment portfolio. I guess I was a little surprised that the average pretax yield was effectively unchanged in the quarter. I would have thought if for no other reason than just getting better interest rates on your shorter-term money that, that would have pushed a little bit higher. But -- can you talk about maybe some of the dynamics there? When we might see that move a little bit higher?

Martin Francis Hollenbeck
Chief Investment Officer, Executive VP, Assistant Secretary & Assistant Treasurer

Yes, Mark, this is Marty. I think you'll start to see it soon. that's what you look there is actually a realized yield. Our book value ended the quarter 4 basis points higher than Q1, although still 5 basis points less than a year ago in the second quarter. So we kind of had a little bit of a muted effect in the first quarter of the run-up in rates, it was sort of backloaded. So we didn't quite get the benefit with a little bit longer duration than typical. I didn't quite see it. But we saw definitely a significant rise in Q2, I think book yield purchased for the taxable was just under 5. Tax exempt was about 4. So it should start being more pronounced going forward here in the next couple of quarters.

Mark Alan Dwelle
RBC Capital Markets, Research Division

I see. Okay. So you are getting somewhere between 50 and 100 basis points of incremental, say, new [indiscernible] rate relative to kind of where the realized book rate is right now. Is that about right?

Unknown Executive

Yes, about -- probably about 3/4, 70 to 75 basis points.

Operator

Our next question comes from Paul Newsome of Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

I wanted to hone in a little bit on the large losses again. Is there any way to kind of think about that increase from a sort of inflationary perspective versus not anything that would be noninflationary frequency level maybe just sort of something that's odd for the quarter as we look at sort of that impact and think about it on a prospective basis. Both for the personalized business as well as for the commercial lines business, where I think they look kind of both large losses in general [indiscernible].

Stephen Michael Spray
President & Director

Yes. Paul, Steve Spray, again. I would say, again, that umbrella book, there's inherent variability in it. And statistically, the number of losses that are there is just -- it's a really -- it's a really low number from quarter-to-quarter. So even if it jumps it's a smaller number. I would say, other than inflationary factor, which is certainly -- or inflationary factors certainly paying -- playing a role in that was what I mentioned earlier was just the courts reopening coming out of the pandemic. We've noticed that, that has -- that's impacted the quarter. And I don't know if Steve wants to add anything to that or not?

Steven Justus Johnston
Chairman & CEO

That's hard to improve upon. I guess if I would think of any other comment would be umbrella it attaches at a higher layer. And so there is a leveraged impact of inflation. So what I mean by that is if historically, a claim is just below the retention, now if inflation is heating up, it would inflate into the layer. And so you have a leveraged effect on the upper layers like an umbrella policy, which would add to the claim count.

Stephen Michael Spray
President & Director

Paul, again, Steve Spray. I might just add a couple of things there for you is it's not uncommon that auto losses, both personal and commercial are what get up into that umbrella layer, those umbrella layers, and we saw that in the second quarter. So it's larger auto claims that have gotten up in there. We look at every single one of these claims, as I mentioned in the first quarter. And as far as geography or class of business, industry segment, we're not -- there's randomness there, and we're not seeing any patterns. So I thought I might add that for you, too.

Paul Newsome
Piper Sandler & Co., Research Division

That's great. Just to clarify, and I apologize I can be very slow. Are these -- the umbrella, is this is both commercial lines and personal lines or just commercial lines? And I guess your comments on the auto is that also both commercial lines and personal lines. Are auto creeping up into umbrella on both sides of the business or just the commercial side?

Stephen Michael Spray
President & Director

Well, yes, so we write commercial umbrella over commercial business, obviously, and personal umbrellas over personal. In personal lines, it is always -- it's almost always predominantly auto claims that get into your umbrella policies there. On the commercial side, it varies between, say, general liability claims that can balance up into the umbrella or commercial auto. I would say that we've seen just a slight uptick in the commercial auto getting into the umbrella.

Paul Newsome
Piper Sandler & Co., Research Division

So the umbrella cases are on the commercial line. And so just -- and the auto was elevated to -- personal auto was elevated too, but that the commercial umbrella is not necessarily related to just the auto on the commercial line side?

Stephen Michael Spray
President & Director

That's correct.

Operator

Seeing no more questions in the queue. This concludes our question-and-answer session. I would like to turn the conference back over to Steve Johnston for any closing remarks.

Steven Justus Johnston
Chairman & CEO

Thank you, MJ, and thank you all for joining us today. We look forward to speaking with you again on our third quarter call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.