S&P Global
Market Intelligence

Kinsale Capital Group, Inc. NasdaqGS:KNSL
FQ1 2020 Earnings Call Transcripts

Friday, May 01, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-			-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.64	0.76	▲18.75	0.66	2.85	3.02
Revenue (mm)	93.35	80.35	▼(13.93 %)	98.04	386.82	445.68

Currency: USD
Consensus as of May-01-2020 10:30 AM GMT

- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	0.56	0.57	1 0.00 %
FQ3 2019	0.59	0.57	2 (3.39 %)
FQ4 2019	0.64	0.63	3 (1.56 %)
FQ1 2020	0.64	0.76	4 18.75 %

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Call Participants

EXECUTIVES

Brian Donald Haney
Executive VP & COO

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Michael Patrick Kehoe
President, CEO & Director

ANALYSTS

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

Matthew John Carletti
JMP Securities LLC, Research Division

Ronald David Bobman
Capital Returns Management, LLC

Samuel Hoffman
Lincoln Square Capital Management

Presentation

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the First Quarter 2020 Kinsale Capital Group Inc. Earnings Conference Call. [Operator Instructions]

Now 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 first quarter 2020 quarterly report on Form 10-Q and the 2019 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 President and CEO, Mr. Michael Kehoe. Please go ahead, sir.

Michael Patrick Kehoe
President, CEO & Director

Thank you very much, operator. And good morning, and welcome to our call. We hope everyone participating on the call is staying well, and we want to especially commend all the Kinsale employees for their hard work and flexibility during this crisis in adapting so quickly to our remote work arrangement and in continuing to deliver best-in-class service to our brokers around the country. Their efforts, in particular, have helped to distinguish Kinsale and to drive the superior performance we reported last night.

Joining me on today's call are Bryan Petrucelli, Kinsale's CFO; and Brian Haney, Kinsale's COO.

Last night, we reported a 19% increase in operating earnings per share compared to the first quarter of 2019, a 47% increase in written premium and a combined ratio of about 84%. Our annualized operating ROE was 17% for the first quarter.

Bryan Petrucelli will provide some additional detail and color on our financial performance here in a moment. Kinsale's strategy of focusing on the E&S market, controlling our underwriting and claim handling operations absolutely and using technology to improve customer service and reduce costs served us well this quarter. When the virus hit and we needed to shift to a work-from-home model, we were able to do so quickly and with no loss in productivity or drop-off in service levels.

As of now, 90% of our employees are working remotely, and our business is firing on all cylinders. There has been a considerable amount of commentary about the coronavirus and its impact on the P&C industry. This is an evolving topic and subject to some element of uncertainty. However, given what we know at this point, we do not believe the coronavirus will have a material impact on Kinsale's profitability or growth. Specifically, Kinsale does not write any of the following lines of business that may have a heightened exposure to virus-related losses: event cancellation, work comp, surety, trade credit, mortgage insurance or reinsurance. Areas where we could be exposed to losses include commercial property, premises liability, management liability and Allied Health Care liability.

I'll start with the Commercial Property. Kinsale's property book focuses on industrial-type exposures in general: processing facilities, recyclers, warehouses, vacant properties, et cetera. We generally avoid occupancies like restaurants, gyms, theaters, et cetera, that may be more exposed to government shutdown orders.

We believe the overwhelming majority of our policyholders are still operating during this crisis. All of our policies require direct physical damage to trigger coverage, all include virus exclusions, and all include an authorities exclusion, which specifically precludes coverage for claims arising from government shutdown orders. To date, we have received 17 commercial property claims. 8 of these involve policies that either do not have business income coverage at all or policies where the BI limit is below the attachment point of Kinsale's excess policy. So in effect, those policies, there's 0 exposure to our coverage. The remaining 9 policies could possibly present exposure to loss, subject to a complete investigation, subject to the terms and conditions of the policy and subject to a BI calculation that exceeds Kinsale's attachment point as these are mostly excess policies.

We have not received any claims to date in the management liability, premises liability or the Allied Health Care liability areas related to coronavirus. Again, we anticipate policy terms and conditions would preclude coverage for most claims. Specifically, the Allied Health care coverage excludes communicable disease on every policy. Our premises liability accounts, both primary and excess, exclude viruses and our D&O book excludes bodily injury on every policy. Of course, upon receipt of any claim, we will conduct a thorough investigation and proceed appropriately given the coverage in place, the allegations and the circumstances.

Regarding the impact on growth, a few thoughts. Kinsale grew 41% last year and 47% in the first quarter principally due to dislocation within the broader P&C industry. After a long period of intense industry competition, many companies, standard and nonstandard, are restructuring their books of business, running off underperforming lines, reducing capacity, raising prices and canceling programs.

As a disciplined underwriting company that didn't lose its way during the soft period of the insurance cycle, Kinsale is not canceling or running off anything. We're working very hard to grow the business and expand our margins. Any slowdown in the P&C industry and specifically the E&S market due to an economic contraction, we expect to be offset by the continuing market dislocation. We expect this dislocation to continue for the remainder of 2020 and perhaps even into 2021. It's possible the coronavirus even adds to this level of dislocation. Time will tell.

I'll now turn the call over to Bryan Petrucelli.

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Thanks, Mike. And as Mike mentioned, we had another strong quarter and are encouraged by the premium growth and the profitability that we've been able to achieve, particularly given the impact of COVID-19 on overall economic conditions. Our goal is to consistently produce mid-80s combined ratios and mid-teens operating returns on equity. On our first quarter, 84% combined ratio and 17% annualized operating ROE are right in line with that guidance. The volatility in the financial markets towards the end of the quarter did have a negative impact on net income and comprehensive income. However, the markets have rebounded in April, and we've recovered approximately 3/4 of the unrealized investment losses that were incurred during the first quarter.

We reported net income of $5.1 million for the first quarter of 2020, a decrease of 72.8% when compared to last year. And again, 2020 included $16 million or so in pretax unrealized losses on our equity investments.

Net operating earnings increased by 24.5%, up to $17.2 million compared to $13.8 million in the first quarter of last year. The company generated underwriting income of $14.4 million and a combined ratio of 83.9% compared to $12 million and 80.3% last year.

Combined ratio for the first quarter of 2020 included 3.4 points from net favorable prior year loss reserve development compared to 10.4 points last year.

As Mike mentioned, we've not received many claims directly related to COVID-19. However, we have experienced a slowdown in reported losses, which appears to be related to courts operating at limited capacity and other legal system inefficiencies related to COVID-19. We added some conservative -- some conservatism into our reserves and recorded approximately $5.4 million in additional IBNR in Q1 to account for any uncertainties related to COVID-19.

Our effective income tax rate was a negative 1.1% for the quarter compared to 17.9% last year, the negative rate being driven by the discrete tax benefits recognized from the exercise of stock options during the quarter and the impact of unrealized losses related to our equity investments on quarterly taxable income.

Gross written premiums were $124 million, representing a 47% increase over last year, for all the reasons that Mike previously mentioned including continued market dislocation and sustained service levels.

On the investment side, net investment income increased by 32% or so over last year, up to $6 million from $4.5 million last year as a result of continued growth in the investment portfolio.

Annual gross investment returns, excluding cash and cash equivalents, did decrease, however, to 2.9% from 3.2% last year, just given the lower interest rate environment here in the first quarter.

Diluted earnings per share was $0.76 per share for the quarter compared to $0.64 per share last year. If you normalized our effective tax rate, that would have been -- the $0.76 would have been lowered by about $0.03 or so.

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

Brian Donald Haney
Executive VP & COO

Thanks, Bryan. As mentioned earlier, premium grew 47% in the first quarter. The highest growth rates were in our commercial property, Allied Healthcare, Excess Casualty, Inland Marine and management liability divisions. But in general, we saw strong growth across the portfolio.

Our Aspera business was up 29% for the quarter. We took significant rate actions in our personal insurance book, which, as you will recall, is focused on manufactured housing in the coastal states. This has led to a more modest growth in item cap but at a more attractive margin. Pre-coronavirus, submission growth was on track to be around 30% for the quarter. The first couple of weeks of the lockdown, the growth rate slowed to a single-digit rate but has recovered significantly to the low to mid-20 range in the last 2 weeks. Weekly numbers can be volatile, but we are encouraged by the bounce back.

During that brief submission slowdown, we made the best of the situation by improving our customer service and quote ratios. As you know, we frequently count our technology as a competitive advantage. Sometimes it's hard to put that in perspective for the investor, but this situation provides an excellent example of how we really are different. In a matter of about a week, we went from having a small percentage of our staff working from home to having more than 90% working from home. We have not missed a beat.

Among our underwriting staff, we had 1 person working from home before COVID and more than 90% after. With 1 month's worth of data to look at, it is clear we are getting out more quotes per underwriter than we did previously. So not only have we been able to smoothly transition to a work-from-home model, we've actually gotten better and more efficient. It's a testimony to the strength of our systems, the effectiveness of our IT team and how hard-working and diligent our employees are.

So while submission growth has moderated in response to the COVID situation, quote growth has stayed high. And combined with the rate increases, we've been able to continue to grow the premium at a healthy pace. The market dislocation we have discussed over the last year hasn't abated due to the virus. Accordingly, we continue to increase rates in response to market conditions. As a reminder, we have a very heterogeneous book of business, which complicates reducing all the rate movement to a single number. With that all being said, we see rates being up in the plus 10% to plus 12% range in the aggregate during the first quarter.

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

Michael Patrick Kehoe
President, CEO & Director
Thanks, Brian. Operator, we're now ready for any questions that come in.

Question and Answer

Michael Patrick Kehoe
President, CEO & Director

[Operator Instructions] And our first question comes from the line of Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

I got a couple of questions. First is just a -- it's a clarification just following on Brian's comments there. That commentary about the brief slowdown and then quickly responded to -- rebounded to the mid-20s, is that a submission count growth you're talking about and not a premium level, so not taking into account pricing or exposure, just the submission count?

Michael Patrick Kehoe
President, CEO & Director

Correct.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Perfect. And then my other question relates to -- another numbers question. Just the small amount of -- the favorable prior period development in the quarter, can you give any color kind of where that came from accident year? Were there larger puts and takes? Or was it just kind of very small movements across-the-board?

Michael Patrick Kehoe
President, CEO & Director

We don't have any specific info. I think it was generally across-the-board, Matt.

Operator

And our next question comes from the line of Mark Hughes with SunTrust.

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

Could you could you talk about the -- just what you're seeing with small accounts? Obviously, a lot of concern about what happens to small business. What is your experience so far? What do you anticipate?

Michael Patrick Kehoe
President, CEO & Director

Yes. I mean we, as a company, definitely focus on small accounts. Our average premium is in the -- in generally in the $10,000 per policy range. Clearly, there's a lot of dislocation in the economy now. You see all the headlines. But I think our business -- we've kind of laid out what exactly what we're seeing, right? We saw a material drop-off in submissions for a few weeks. We've seen a real nice rebound, not back to the 30% but into the 20% range. The premium growth has been less impacted. And I think Brian noted part of that is rate increases, part of that is we've been able to quote a higher percentage of the submissions that come in. But...

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

How about in terms of -- how about cancellations or midterm premium adjustments? Any sign of that happening?

Michael Patrick Kehoe
President, CEO & Director

Yes. I mean we're doing a lot of one-off accommodations. If someone calls and says, "Hey, my business has been shut down for 2 months." "Okay, why don't we extend your expiration date by 2 months for no additional premium?" Right? And just kind of working those things out on a case-by-case basis.

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

And how material has that activity been?

Michael Patrick Kehoe
President, CEO & Director

It hasn't been overwhelming, but there's clearly a number of transactions every day. I mean keep in mind, we write tens of thousands of policies. We have hundreds of thousands of submissions. So in the grand scheme of things, it hasn't been dramatic enough that it's impacted our top line. But we're trying to do the right thing. This is an incredible crisis that's come up very suddenly, and we want to treat our policyholders fairly. And that's essentially what we're doing.

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

Brian, you had mentioned you put a $5.4 million in additional IBNR in 1Q. Could you expand on that? Is that to say that you're -- was this tied to the drop in claims given the claims you would have normally booked lower losses, but you added to the IBNR for conservatism sake?

Michael Patrick Kehoe
President, CEO & Director

Mark, it's Mike again. Yes, we noticed a modest downtick in claim frequency. But the real driver is just kind of the general uncertainty created by this crisis. You can read all the commentary out there about its a possible impact on the P&C industry. We feel that we're very well positioned, but there's still a lot of uncertainty out there. And so we're just trying to drive a little bit of additional conservatism in our IBNR.

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

So you're suggesting that in -- other things being equal with the claims volume, with the pricing, the loss pick might have been lower, $5.4 million lower, but you added some additional conservatism?

Michael Patrick Kehoe
President, CEO & Director

Yes.

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

Okay. How about -- the expense ratio was quite good. You appear to be getting operating leverage. I think you said in the past that you think 25 is kind of a good number, 25, 26. This is, I think, 24, is -- should we expect a lower number to be sustainable?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Mark, I think that 25% pick is probably a good number. We -- obviously, premium is growing. We're adding staff in the underwriting areas and some in the IT areas. We're monitoring what's going on sort of with the premium, and we'll add staff accordingly. But I think -- just like we always have, I think we're very conscious on managing expenses to a reasonable level. It's going to ebb and flow a little bit. But I'd say the 24.5%, 25% is probably a good place to look.

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

And how about -- any commentary on pricing trends as you've seen in April? I think Mike, you said you expect the dislocation to continue through 2020, no change in that upward trajectory in April?

Brian Donald Haney
Executive VP & COO

Yes. This is Brian. No, no change. It's -- we're still pushing rate, and there's really no change in the trajectory.

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

And then I'll ask, any noteworthy change in Lloyd's? I just was intrigued to see they seem to trim some of their exposure in California in the first quarter. And they have been, I guess, at least the latest data wasn't clear that they were reducing the E&S business. Anything from Lloyd's or maybe just more broadly about the dislocation?

Michael Patrick Kehoe
President, CEO & Director

Yes. Mark, this is Mike again. I don't think we want to comment on competitors. We'll let them speak for themselves. But in general, I think to Brian's point, right, the dislocation in the market is continuing. There's a -- we went through a long period of very intense price competition. I don't think it's unusual that it takes the industry a little bit of time to kind of get things on track, right? So that's why we made that comment. And obviously, we're speculating. We don't know definitively how the year is going to unfold. But our general guess at this point is that the trading environment in terms of rate trends and reduction in capacity and all these restructurings that are ongoing, we think that's going to continue for the balance of the year.

Operator

And our next question comes from the line of Ron Bobman with Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I'm wondering -- without sort of addressing the competitive questions that were just asked, I'm wondering if you could sort of come at it from a different way. Are you seeing any change to your buying-to-quote ratio of late?

Michael Patrick Kehoe
President, CEO & Director

No.

Ronald David Bobman
Capital Returns Management, LLC

Okay. And then separately, there's a reasonable probability that there's going to be some -- a lot more pain for certain lines of business by virtue of the pandemic and the weakening economy. And I mean it's conceivable that some segments could actually sort of approach sort of crisis mode where there's just not enough capacity in a certain line. Are there opportunities that are sort of on your radar where you may enter a new line if it were to approach that, that are sort of on a short list if it -- if rates move and terms and conditions move to such a dramatic effect?

Michael Patrick Kehoe
President, CEO & Director

I would say we're always looking to -- we're always looking for new opportunities. We're always working on incremental expansion of our product line. Keep in mind, we write on a nonadmitted or excess and surplus lines paper only. And I think some of the areas you're talking about, if it's -- I'll just use surety as an example, right? You have to have licensed paper for that. So the answer is yes. We're always looking to expand. But we're also, near term, just looking at the E&S market.

Operator

[Operator Instructions]

I'm showing no further questions at this time. So with that, I'll turn the call back over to CEO, Michael Kehoe, for closing remarks.

Michael Patrick Kehoe
President, CEO & Director

Yes. We'll take him. Do we have one more call, operator? Or one more question?

Operator

Yes. I see we just had Sam Hoffman from Lincoln Square queue up.

Samuel Hoffman
Lincoln Square Capital Management

I'm just following up on Mark's question where you said that the cancellations and midterm premium adjustments were relatively minor at this point. To what extent do you believe that these are lagging indicators and that they should increase dramatically in the second quarter? Because, I guess, maybe your insurance company might be the last party that you would call at the beginning of the crisis. And so how do you think about that going forward in terms of your expectations to receive additional cancellations and midterm adjustments?

Michael Patrick Kehoe
President, CEO & Director

I would just say, as an E&S company that focuses on small commercial buyers, we have a very high volume of cancellations every day of the week in a normal operating environment, right? It's not unusual that small businesses don't pay their premium promptly or somebody buys coverage because they -- they're a contractor and they get a job where the general contractor requires it. The job's over in 3 months. They cancel the policy. But we're 6 weeks into it, Brian? 8 weeks? And...

Brian Donald Haney
Executive VP & COO

We're not seeing an upward trend in the requests. If anything, it's slightly downward. And it is -- I wouldn't characterize it as material at all.

Michael Patrick Kehoe
President, CEO & Director

Yes. So I mean it's possible that it picks up. But we feel pretty good about -- that, that's not going to be a big problem for us.

Samuel Hoffman
Lincoln Square Capital Management

And is this different from your experience in previous recessions like the financial crisis or consistent?

Michael Patrick Kehoe
President, CEO & Director

I think it's consistent. I mean if you look back at the E&S market broadly during the 2008 recession, the E&S market did shrink a couple of percentage points. But it's an industry where our customers are typically buying insurance because it's compulsory. Either their landlord or the general contractor requires it or if you work for the highway department, they require the coverage. If your product is being sold to a retail store, the retailer requires the coverage. So you don't have wild swings in revenue volatility like you might have in other industries like, say, auto manufacturing.

We're kind of insulated, I think, from some of that dynamic.

Samuel Hoffman
Lincoln Square Capital Management

Okay. I missed the very beginning of the call, but did you comment on your exposure to restaurants and bars and the retail and other types of industries that are shut down and how that affects what we're talking about?

Michael Patrick Kehoe
President, CEO & Director

We did as respect to the property book. We write commercial property. That was 8% of our premium volume last year. And our property book is skewed heavily in favor of a more industrial-type exposure. So warehouses and processing facilities, recyclers. We have very, very limited exposure to, I think, the type of occupancies you're talking about in our property book. Restaurants, theaters, gyms, things like that. We think anecdotally that overwhelmingly, our insurers continue to operate during this crisis. It's not to say universally, but most of them we think are. And that, combined with our coverage limitations, we think put us in a very good spot in terms of exposure to COVID-related claims.

Operator

Thank you. I will now turn the call back over to CEO, Mr. Michael Kehoe, for closing remarks.

Michael Patrick Kehoe
President, CEO & Director

Thank you, operator. And thanks, everybody, for joining us on the call today. And stay well, and we look forward to speaking with you again in a few months. Have a good day.

Operator
Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.