S&P Global
Market Intelligence

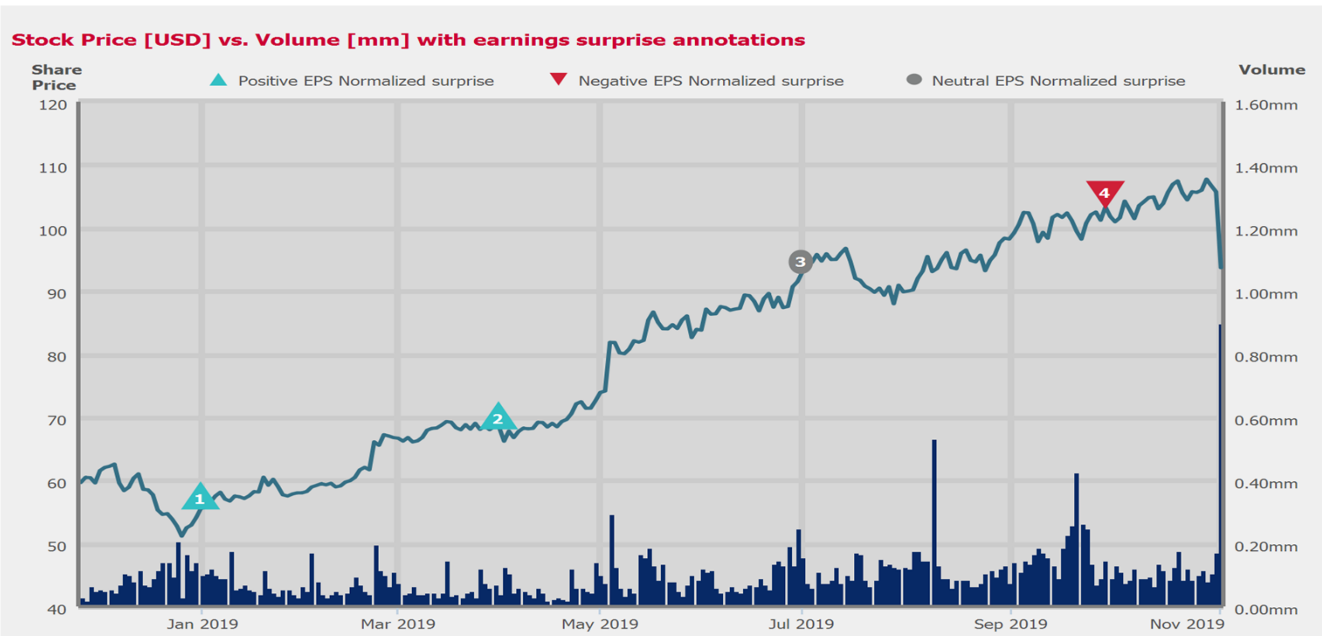
Kinsale Capital Group, Inc.
NasdaqGS:KNSL
FQ3 2019 Earnings Call Transcripts

Friday, November 01, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2019-			-FQ4 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.59	0.57	(3.39 %)	0.63	2.41	2.78
Revenue (mm)	75.52	78.33	3.72	80.46	295.77	355.29

Currency: USD
Consensus as of Nov-01-2019 11:56 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2018	0.43	0.46	6.98 %
FQ1 2019	0.50	0.64	25.49 %
FQ2 2019	0.56	0.57	0.00 %
FQ3 2019	0.59	0.57	(3.39 %)

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Call Participants

EXECUTIVES

Brian Donald Haney
Senior VP & COO

Bryan Paul Petrucelli
Senior VP, Treasurer & CFO

Michael Patrick Kehoe
President, CEO & Director

ANALYSTS

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

Rowland Juran Mayor
RBC Capital Markets, Research Division

Presentation

Operator

Before we get started, let me remind everyone that through the course of the teleconference, Kinsale's management may make comments that reflect their intentions, beliefs and expectations for the future. As always, these forward-looking statements are subject to certain risk factors, which could cause actual results to differ materially.

These risk factors are listed in the company's various SEC filings, including the 2018 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 third 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, operator, and good morning, everyone. Joining me today are Bryan Petrucelli, Kinsale's CFO; and Brian Haney, Kinsale's Chief Operating Officer. We're going to follow a similar format today that we've had on our prior conference calls. I'll begin with some quick introductory comments, and then Bryan Petrucelli, will review our financial results, followed by Brian Haney, who will discuss Kinsale's underwriting results and provide some market commentary. And then we're going to follow-up with any questions.

As a reminder, Kinsale combines disciplined underwriting and claim handling with technology-enabled low costs to deliver attractive returns and growth. We focus on smaller and sometimes hard to place accounts within the excess and surplus lines market.

And unlike competitors, we maintain absolute control over the underwriting and the claim management process, and we do not outsource those functions to external parties. We use proprietary technology and automation to operate at a significant expense advantage over many larger competitors. And this combination of disciplined underwriting and low costs is a winner every time.

The third quarter saw a continuation of Kinsale's profitability and growth from the first half of the year. The combined ratio for the quarter was 86.9%. Through 9 months, the annualized operating return on equity was 15.9%. These numbers are consistent with our forward guidance of a mid-teens return on equity and a mid-80s combined ratio. Premium growth for the quarter, 40.9%, was up from 36% in the second quarter and 32% in the first.

The growth we experienced in the third quarter was driven by Kinsale's business strategy combined with a trading environment that is not only favorable but improving. As we've discussed on prior calls, this improving trading environment is driven by dislocation within the broad P&C market, and that includes both standard lines and E&S companies. Wherein companies are reducing capacity, withdrawing from certain lines of business, canceling some delegated programs and generally becoming more discriminating about risk in their underwriting process.

And now I'm going to turn the call over to Bryan Petrucelli for the financial report.

Bryan Paul Petrucelli
Senior VP, Treasurer & CFO

Thanks, Mike. Kinsale had another strong quarter. And we are encouraged by the premium growth and improved market conditions. We reported net income of $13 million for the third quarter of 2019, an increase of 9% when compared to $11.9 million for the third quarter of 2018 and due primarily to growth in business.

Net operating earnings increased by 20% to $12.6 million compared to $10.6 million in the third quarter of last year. The company generating underwriting income of $9.5 million and a combined ratio of 86.9% compared to $8.4 million and 84.6% last year. Cat activity contributed 1.2 points to the third quarter 2019's combined ratio and was less than 1 point last year.

The combined ratio for the third quarter of 2019 included 0.7 points from net favorable prior year loss reserve development compared to 4 points from net favorable prior year loss reserve development last year and was lower largely as a result of lengthening of actuarial loss development factors in an effort to add a modest amount of conservatism to our IBNR reserves for certain prior accident years.

Our effective income tax rate was 16.6% for the first 9 months of 2019 compared to 17.1% last year and lower due to the tax benefits from the exercise of a larger amount of stock options this year. Annualized operating return on equity was 15.9% for the first 9 months of this year and in line with our mid-teens guidance.

Gross written premiums of $97.9 million represented a 41% increase over last year. And as Mike mentioned, growth continues to be generated from an increased submission flow from our brokers and firmer pricing driven by market dislocation. Brian Haney will get into this in a little more detail here shortly.

On the investment side, net investment income increased by 29% or so over the third quarter of 2018 to $5.3 million from $4 million last year as a result of continued growth in the investment portfolio. Annualized gross investment returns increased to 3.1% from 2.9% for the first half of the year. Diluted operating EPS was $0.58 per share for the third quarter of 2019 compared to $0.55 per share last year and $1.77 for the first 9 months of 2019 compared to $1.32 last year.

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

Brian Donald Haney
Senior VP & COO

Thanks, Bryan. As mentioned earlier, premium grew 41% in the third quarter. Our commercial property business grew significantly, driven by a surge in submissions, significant rate increases and a focus on improving internal processes to get to more of the submissions as quickly as humanly possible.

We're also seeing strong growth in our management liability, product liability and environmental divisions, so the growth is widespread across many different divisions and classes of business. Our Aspera's units were up 40% for the quarter, in line with the rest of the company.

Submission growth was 35% for the third quarter. We continue to see substantial across the board increases in submission volume in most divisions. We feel we're doing well to keep up our service levels, but some areas are seeing inflows of submissions of such magnitude and servicing them all becomes a challenge at times.

We are becoming more and more assertive in seeking rate increases. As a reminder, we have a very heterogeneous book of business, which complicates reducing all the rate movement to a single number. But that all being said, we see rates up being in the plus 8% to plus 10% range in the aggregate. We are seeing higher rate increases for property business and lower increases for professional lines. At this point, the rate increases are starting to contribute materially to the premium growth.

I did want to address the topic of social inflation, which several other insurers have commented on recently. With a book as relatively small as ours and with as diverse a book of business as we have, it is not always easy for us to discern certain changes in trends using only our own data. We tend to rely on publicly available third-party information when developing our views on loss trends. So while we haven't seen anything in our own data that would suggest a significant uptick in social inflation, we have been revisiting the available third-party data and have been revising some of the trend assumptions used in our pricing models where appropriate.

It is worth keeping in mind that we write very little commercial auto. We write mostly $1 million limits or lower and focus on smaller accounts. All 3 of those facts, we feel, would make us less exposed to any social inflation the industry is seeing.

Lastly, and as a reminder, while the market has definitively moved in our favor recently in terms of pricing and market opportunity and while we are growing at a very strong rate at the moment, investors should not expect that this extraordinary growth rate will continue forever. We don't know how long it will last. But the market moves in cycles, and at some point in the future, we expect to see a return to more normal growth rates.

Bryan Paul Petrucelli
Senior VP, Treasurer & CFO

Yes. This is Bryan Petrucelli. Just to clarify one thing. Diluted operating EPS was $0.50 per share for the quarter.

Michael Patrick Kehoe
President, CEO & Director

$0.57.

Bryan Paul Petrucelli
Senior VP, Treasurer & CFO

$0.57 per share for the quarter. It was $0.58 just on a diluted earnings per share basis.

Michael Patrick Kehoe
President, CEO & Director
And operator, we're now ready for any questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mark Hughes with SunTrust.

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

Just to clarify, you say the lengthened reserve development is not something you're seeing in your own data, but rather the third-party data is motivating you to make the change?

Michael Patrick Kehoe
President, CEO & Director

No. Bryan was talking about some of the commentary we've seen on other companies' conference calls or earnings releases, where they're talking about social inflation impacting their financial results. And -- so we just want to -- we anticipated the question, and we're just trying to get ahead of that.

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

So is that -- when we look at the 70 basis points of favorable development versus, what, 4 points last year, just to clarify, is that based on your book of business? Or is that -- are you saying that, that's just taking a more conservative approach based on what you're seeing across the industry?

Michael Patrick Kehoe
President, CEO & Director

Right. So if you're talking about our quarterly results, yes, I would say, in terms of the amount of favorable development that was impacted by our reserve position, I think we talked about on our last conference call 3 months ago that we had lengthened our reporting patterns, which has the effect of slowing down the release of IBNR, injecting a little bit more conservatism into our reserve position. And then a lot of it was just loss activity in the quarter. No trends of any concern, but just the normal loss variability that you get in a 90-day period of time.

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

And then on investment income, was there anything that was nonrecurring, anything unusual would bump that up, that wouldn't be recurring next quarter?

Bryan Paul Petrucelli
Senior VP, Treasurer & CFO

No, Mark.

Michael Patrick Kehoe
President, CEO & Director

It's mostly just -- it's the assets growing with the book of business.

Operator

Your next question comes from the line of Rowland Mayor with RBC Capital Markets.

Rowland Juran Mayor
RBC Capital Markets, Research Division

Sticking on the investments. The portfolio duration got a bit longer in the quarter, and it looked like the new money from the capital is on the fixed income as opposed to equity. So I was wondering if there's a change in thinking there. Or how we should think about that going forward?

Michael Patrick Kehoe
President, CEO & Director

No. There's no change. I think we're -- on the equity side, we're just lagging into the market over time. But I think our allocation is pretty steady here recently.

Rowland Juran Mayor
RBC Capital Markets, Research Division

Okay. Got it. And then you mentioned a new headquarter construction in the press release. I was wondering if there's a time line on that and if we should incorporate any additional operating expense to the project.

Michael Patrick Kehoe
President, CEO & Director

The time line -- the building is under construction today. We expect to occupy half the building in September of 2020. And then we expect to lease out the balance of that building to other tenants. So that's the general time line.

Operator

[Operator Instructions] At this time, there are currently no further questions in the queue.

Michael Patrick Kehoe
President, CEO & Director

Okay. Well, I just want to thank everybody for participating, and we look forward to speaking with you again here in another 3 months. Have a good day.

Operator
Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may now disconnect.