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Market Intelligence

Kinsale Capital Group, Inc. NYSE:KNSL

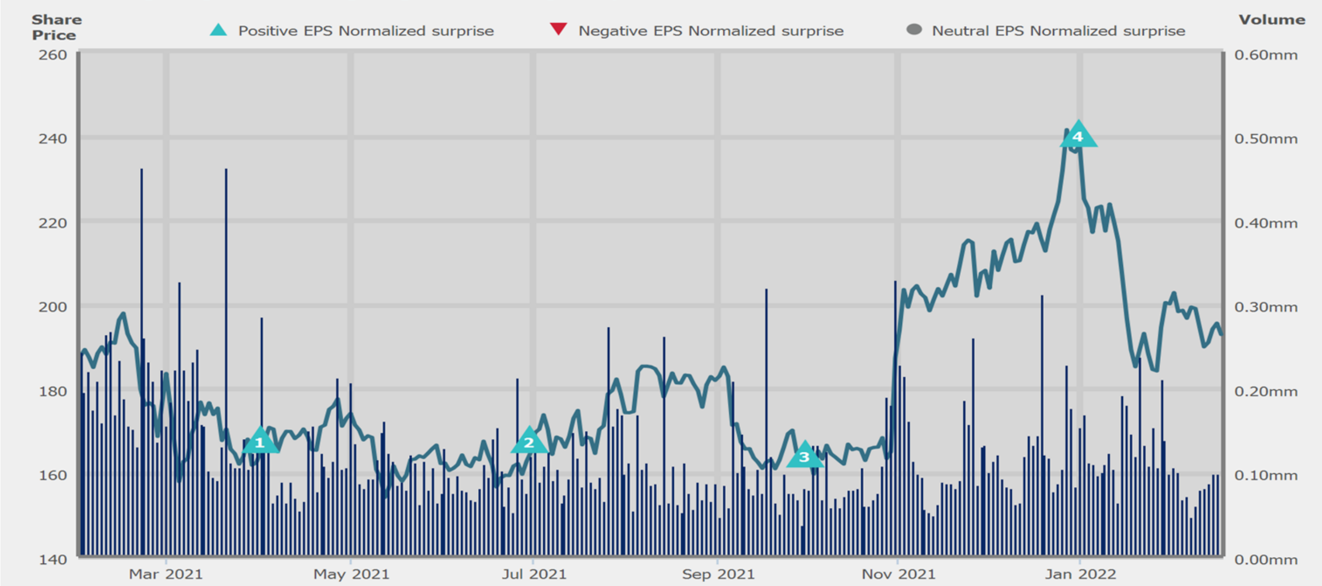
FQ4 2021 Earnings Call Transcripts

Friday, February 18, 2022 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-	-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.38	1.76	▲27.54	1.42	5.36	5.74	▲7.09	6.18
Revenue (mm)	166.98	183.60	▲9.95	175.65	623.14	639.78	▲2.67	775.89

Currency: USD
Consensus as of Feb-18-2022 8:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	0.84	1.11	▲1 32.14 %
FQ2 2021	1.06	1.28	▲2 20.75 %
FQ3 2021	0.99	1.59	▲3 60.61 %
FQ4 2021	1.38	1.76	▲4 27.54 %

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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
Truist Securities, Inc., Research Division

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Rowland Juran Mayor
RBC Capital Markets, Research Division

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Presentation

Operator

Hello. Before we get started, let me remind everyone that through the course of the teleconference, Kinsale management may make comments that reflect 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 2020 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 fourth 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 this 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. Thank you for joining us on the call. With me today are Bryan Petrucelli, Kinsale's CFO; and Brian Haney, Kinsale's COO. After comments from each of us, we'll turn to your questions.

Kinsale's operating earnings for the fourth quarter of 2021 were $1.76 per diluted share, a 54% increase from $1.14 in the fourth quarter of 2020. Gross written premium was up 36% for the quarter. The company posted a 74.5% combined ratio for the quarter and 77.1% combined ratio for the year. And our operating ROE was -- for 2021 was 20.8%.

As we've discussed in prior calls, Kinsale's results are being driven principally by our unique business model of focusing on smaller accounts within the E&S market, controlling the underwriting and the claim handling process instead of outsourcing it and using our advanced technology to operate at a much lower cost structure than our competitors.

An additional tailwind has been the state of the overall E&S market which grew by double digits in 2021 for the fourth year in a row. Strong growth, combined with opportunistic rate increases is having a favorable impact on our margins with our operating ROE of almost 21% in 2021, well above our mid-teens guidance.

Surplus Lines stamping office tax data that was just released for January of 2022 shows the overall E&S market off to a strong start in the New Year with double-digit premium growth. Likewise, there seem to be a number of competitors struggling with adverse development from prior year loss reserves. And the combination of these 2 data points and the confidence we have in our own business model give us a sense of optimism about 2022, both from a growth and a profitability standpoint.

Like everyone, we're seeing the impact of inflation in the economy. Most of our policies are priced using an inflation sensitive measure like revenue or payroll. As an underlying business adjust its pricing because of inflation, our insurance premiums adjust as well.

In addition, we manage profitability of our underwriting operation carefully and make regular adjustments to our technical pricing to stay ahead of loss trend.

And finally, our rate increases have been running well ahead of inflation for several years now, putting Kinsale in a strong position regarding both profitability and the strength of our loss reserves. Investors should have confidence in Kinsale's reserve position and our overall balance sheet.

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

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

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Thanks, Mike. Just another solid quarter, driven by strong premium growth, favorable loss experience and disciplined expense management. As Mike said, we reported net income of $48.4 (sic) [$48.3] million for the fourth quarter of 2021, representing an increase of 27% when compared to $38.2 million last year and due primarily to higher earned premium, lower cat losses and lower relative expenses.

Net operating earnings increased by approximately 55%, up to $41 million from $26 million in the fourth quarter of last year. The company generated underwriting income of $42 million and a combined ratio of 74.5% for the quarter compared to $22 million and 81.6% last year, with improvements to both the loss and expense ratios. The combined ratio for the fourth quarter of 2021 included 4 points from net favorable prior year loss reserve development and no cat losses compared to 3.1 points of favorable loss reserve development and 5.1 points from cat losses last year.

The 21.4% expense ratio for this quarter continues to benefit from some economies of scale, with earned premiums that have grown faster than our operating expenses and from slightly lower relative net commissions as a result of a shift in the mix of business to lines that are subject to reinsurance and where we receive [seating] commissions. Although it's possible that we'll continue to achieve a modest level of additional economies of scale with some variability from quarter-to-quarter, we believe an expense ratio in the low to mid-20s to be sustainable over time.

Our effective income tax rate for the year was 19.1% compared to 11.9% last year and higher primarily as a result of lower tax benefits from stock compensation activity this year. Operating return on equity was approximately 21% for the year. And again, as Mike mentioned, ahead of our mid-teens guidance.

Gross written premiums were approximately $204 million for the quarter and representing a 36% increase over last year.

On the investment side, net investment income increased by 32% over the fourth quarter last year, up to $8.6 million from $6.5 million last year as a result of continued growth in the investment portfolio. Annualized gross investment returns, excluding cash and cash equivalents was 2.5% for the year compared to 2.9% last year.

Lastly, diluted operating earnings per share was $1.76 per share for the quarter compared to $1.14 per share last year.

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

Brian Donald Haney
Executive VP & COO

Thanks, Brian. As mentioned earlier, premium grew 36% in the fourth quarter, more or less the same as the third quarter. The increase is generally driven by increasing submissions, rate increases as well as economic growth, which drives up exposure basis. Every one of our divisions was up for the quarter, led by our allied health, inland marine and public entity team.

Reopening of the economy and the robust economic growth is still providing us a significant boost and the rapid surge of COVID that began in December country-wide did not appear to have a material effect on growth. Submission growth was in the mid-teens in the fourth quarter.

As for rates, we continue to push them up 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. But all that being said, we see rates being up in the low teens range in the aggregate during the fourth quarter, generally consistent with the past several quarters.

Our expense ratio continues to be a huge advantage for us, with many of our competitors in the 30s and even some in the 40s, we often find ourselves able to be competitive on price while still delivering superior returns to our investors. We've also been busy in expanding our product offering. Over the course of 2021, we created underwriting divisions focused on commercial auto, aviation, entertainment and product recall. We've also added a small property division that focuses on accounts with smaller [insured] values.

Beyond this, we have also incrementally expanded our offerings in existing divisions, and we plan to continue the product expansions in 2022 and beyond. In summary, we feel good about the quarter. We are producing positive results and the market conditions continue to favor us. Our business model works well in any market, soft or hard or anything in between, but the current market conditions are truly excellent and we are working hard to make the most of it.

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

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

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Mark Hughes of Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Bryan, the expenses in the quarter were up a little bit sequentially. The ratio was up. You had mentioned mix, but I'm not sure whether you were applying that or saying that, that was impacting the quarter. Was there anything unusual? Any expense accruals or compensation accruals, anything like that?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

Yes. I would just say there was a modest increase in variable comp during the quarter. Other than that, nothing meaningful.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then the -- when you look at the 2020 accident year, I'm curious if there's anything you can say about the loss development. You had good reserve gains in the quarter, a little bit less though than what you might have seen in the first half. How was 2020 developing? Anything about the submission or the claims activity that's unusual? Or any change from, I think, what was pretty benign at the time?

Michael Patrick Kehoe
President, CEO & Director

Mark, this is Mike. One thing we've talked about on prior calls has been the fact that reported losses in '20 and '21 have come in below our expectations. We think a lot of that has to do with the COVID pandemic, the closure of the court systems and the like. Obviously, we've spoken in the past about the fact that we've largely offset the lower-reported losses with higher IBNR.

So I think we're well reserved if there's a kind of a mean reversion or a bounce back in those loss trends. But if there's not a bounce back at some point, and they're just going to be permanently lower, then, hey, that's good news that will drift out over the years ahead very gradually.

I would just reiterate the fact that reserving conservatively is really a fundamental part of our business strategy. And I think it's just a good reminder, especially in period of time where there's a lot of distress across the P&C market.

I'll just reiterate investors should have a lot of confidence in our reserves and our balance sheet.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then thinking about the broader cycle, I'll ask maybe the inning question or I'll throw that out there. It's interesting that you talked about sustained rate increases, still strong submission growth. Others have talked about maybe a little bit of tapering. I'm just sort of curious to hear how you see it at this point?

Michael Patrick Kehoe
President, CEO & Director

This is Mike again. When we were at the conference a number of months ago, we had a variety of conversations with reinsurers. And it seems they were all noting the fact that they anticipated continued weakness on the part of some companies in terms of adverse development of their casualty books. And of course, they also noted the fact that with the heightened cat activity, nobody's really made any money on property for the last 5 years.

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And I would say, uniformly, they attributed these 2 data points to their own optimism around the fact that the favorable trading environment would continue for some time. And that makes sense to us. I think there's also some data out there around rate trends, maybe rates in some lines of business aren't rising as rapidly as they were in the past.

Some of those rate increases have come in a little bit. But I would just say, if you go back to Brian Haney's comments a few seconds ago, we're seeing good growth in our own business and the January stamping office tax data indicates that 2022 is opening pretty strongly for the E&S market overall. And you combine that, I think with, again, the confidence we have in our unique business strategy. And obviously, we feel pretty positive about things.

Operator

[Operator Instructions] Next question comes from Pablo Singzon of JPMorgan.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

So on the fourth quarter loss ratio, once again pretty good. I'd curious be to hear if there's anything one-off about this quarter, whether from the mix of the business versus other quarters. The new business you put on or perhaps [short-tailed] losses like property being unusually low. Just sort of any color you can provide there would be helpful and how to think about how that AY loss ratio might trend going forward?

Michael Patrick Kehoe
President, CEO & Director

Yes. I don't think there was anything unique in the fourth quarter. Keep in mind, Pablo, there's always going to be a little bit of variability that's just inherent in the business. We work hard to manage that volatility with the conservative reserving, with the reinsurance program we have and the like. But there's always going to be a little bit of variability, but nothing unique beyond just normal trading conditions.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

Understood. And then just sort of a question on growth. But I guess from the perspective of distribution, I was just curious to hear more color on distribution expansion as component to your growth. Meaning are you seeing higher volumes in the same number of [indiscernible] today? Or are you working [indiscernible] more distributors today than at the start of pandemic, for example? And if so, is there any way to size that?

Brian Donald Haney
Executive VP & COO

I'd say we're -- I mean, we're seeing more inflow of submissions from the existing brokers. We're continuing to appoint occasionally additional brokers. We're adding new products, so that's driving some of the new growth. And then we are still working on sort of efficiency and process to sort of get to more growth to get to them faster. So that's driving some of that as well. But nothing that we haven't been doing for the last...

Michael Patrick Kehoe
President, CEO & Director

Pablo, this is Mike. I'll just add to Brian's comments. A lot of times, we talk about our technological advantage with regard to efficiency and operating our company at a low expense ratio and how much of an advantage that is in a commodity industry like P&C. There's an equally important benefit when it comes to the service levels that we can provide to our brokers.

The more efficient our business process, the better the service to our brokers and there's a very direct correlation between the quality of your service and the propensity for you to find a given quote. I mean, we don't talk about it at a time, but it's a really important part of our strategy, and it's another powerful benefit from having a more advanced approach to technology.

Pablo Augusto Serrano Singzon
JPMorgan Chase & Co, Research Division

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Got it. That makes sense, Mike. And then last one for me. I just wanted to pick up on your comment about dislocation in the E&S market. I guess it's more of a qualitative question. How would you describe or qualify dislocation today versus maybe 3, 4 years ago, where some of the larger competitors in the market like [indiscernible] really clean portfolios. Today, it seems like they're trying to grow, probably not the same they did before. But then again, you made comments about, I guess, more E&S companies undergoing reserve issues, right? So I guess, if you take a step back, overall, is there more dislocation today than there was like 3 or 4 years ago? Or the same or less? Just your thoughts on that.

Michael Patrick Kehoe
President, CEO & Director

I'll start, and then I'll turn it over to Brian for his comments. I would just say, I think it might be more or less steady. Some very large E&S writers that have run off multiple billions of dollars of premium over the last several years, I can think of one big one that has kind of reverted to growth.

But I can think of other very large E&S writers that are still triaging their books of business. And then there's a ton of anecdotes about companies, smaller, more boutique-sized E&S companies shutting down underperforming lines of business and canceling programs and the like.

But offsetting the dislocation is the fact that there's been an explosion in the number of delegated underwriting authorities. Somebody told me the other day we're up to 21 [fronting] companies that more or less facilitate those kind of delegated arrangements. So the delegated underwriting market is red hot as well, right, that would offset a lot of dislocation. So to me, it's kind of a mixed market and it has been for a number of years. But on whole, I think it's still pretty favorable.

Brian Donald Haney
Executive VP & COO

Yes, this is Brian Haney. I would agree with Mike right now, it's stable. But just the time period, we happen to take the 3 to 4 years. It's definitely -- like that would extend back to 2018. It's definitely a much more favorable market now than it was in 2018. But I'd say we're not seeing dramatic shifts either way at the moment in January 2022.

Operator

[Operator Instructions] And we have a question from Rowland Mayor of RBC Capital Markets.

Rowland Juran Mayor
RBC Capital Markets, Research Division

When you look at the long-term growth rate, I think you guys have talked about a mid-teens rate longer term. When you look at '22, it seems like there's a lot of stuff going favorably. Is there a way to sort of ballpark how much higher you think that growth rate could be in '22 versus sort of your long-term goals?

Michael Patrick Kehoe
President, CEO & Director

Rowland, this is Mike. We don't offer guidance on growth because it's hard to get -- to nail that down with precision, right? What I would say is, I think, certainly over the long haul, right, when the market kind of mean reverts at some point in the future, low double-digit growth is something we think we can maintain for the long haul given our expense advantage, the uniqueness of our business model and the like.

If you look back over the last 4 or 5 years, we've been growing at 30% or 40% rate. And so the 2 data points I mentioned at the beginning of the call, one, it looks like the E&S market is off to a double-digit growth rate at the beginning of 2022. That's certainly quite positive for our growth. And then again, the dislocation in the market. Not that there's not a ton of competition, there is.

But as Brian said, "Hey, this market is much more attractive to us as a risk-bearing entity than what we experienced a few years back. So the combination of our strategy being quite unique and competitive combined with an attractive overall market opportunity. I think you can read our body English. We're pretty optimistic.

Rowland Juran Mayor
RBC Capital Markets, Research Division

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I figured that was -- what the response is going to be, but it's worth trying. The balance sheet. I was wondering you've raised capital a few times in the past to support growth. Is the business now able to support itself on a growth front from organic capital generation? Or would there be a need at some point to raise further capital?

Bryan Paul Petrucelli
Executive VP, CFO & Treasurer

I think we've talked about in the past. We have somewhere around a 6% debt-to-cap ratio right now. And I think over time, we want to get up to somewhere in 20% range. So yes, there may be some need to raise additional capital, but we would look to the debt markets for that here, I'd say, in the near-to-medium term.

Operator

Thank you. And I'm seeing no further questions in the queue. I will turn the call back over to Mr. Michael Kehoe for closing remarks.

Michael Patrick Kehoe
President, CEO & Director

Okay. Well, thank you, everybody, for joining us. And I just want to extend thanks and congratulations to all the Kinsale employees. We just finished the best year in our company's history, and it's obviously the result of an enormous amount of hard work and dedication on their part.

So thank you for all the listeners, and we look forward to speaking with you again here in 2 months. Have a good day.

Operator
This concludes today's conference call. Thank you all for participating. You may now disconnect. Have a pleasant day, and happy weekend.

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