Second Quarter 2024
Earnings Call Transcript

August 6, 2024

CORPORATE PARTICIPANTS

Christopher Uchida, *Chief Financial Officer*

Mac Armstrong, *Chairman and Chief Executive Officer*

Jon Christianson, *President*

CONFERENCE CALL PARTICIPANTS

Paul Newsome, *Piper Sandler*

Mark Hughes, *Truist Securities*

David Motemaden, *Evercore ISI*

Andrew Andersen, *Jefferies*

Meyer Shields, *KBW*

Pablo Singzon, *JPMorgan*

PRESENTATION

Operator

Good morning, and welcome to the Palomar Holdings, Inc. Second Quarter 2024 Earnings Conference Call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference lines will be opened for questions with instructions to follow. As a reminder, this conference call is being recorded.

I would now like to turn the call over to Mr. Christopher Uchida, Chief Financial Officer. Please go ahead.

Christopher Uchida

Thank you, Operator, and good morning, everyone.

We appreciate your participation in our earnings call. With me here today is Mac Armstrong, our Chairman and Chief Executive Officer. Additionally, Jon Christensen, our President, is here to answer questions during the Q&A portion of the call.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

As a reminder, a telephonic replay of this call will be available on the Investor Relations section of our website through 11:59 p.m. Eastern Time on August 13, 2024.

Before I begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These include remarks about Management's future expectations, beliefs, estimates, plans and prospects. Such statements are subject to a variety of risks, uncertainties and other factors that could cause actual results to differ materially from those indicated or implied by such statements. Such risks and other factors are set forth in our quarterly report on Form 10-Q filed with the Securities and Exchange Commission. We do not undertake any duty to update such forward-looking statements.

Additionally, during today's call, we will discuss certain non-GAAP measures, which we believe are useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with U.S. GAAP. A reconciliation of these non-GAAP measures to the most comparable GAAP measure can be found in our earnings release.

At this point, I'll turn the call over to Mac.

Mac Armstrong

Thank you, Chris, and good morning.

I am very pleased with our second quarter results as we achieved record gross written premium and adjusted net income during the quarter and put ourselves in a position to accomplish the inaugural Palomar 2X goal of doubling 2021's adjusted underwriting income in three years.

Our profitable growth remains robust with gross written premium and adjusted net income increasing 40% and 47%, respectively, year-over-year. The quarter's strong financial results and a host of associated accomplishments reflect the sustained execution of not only Palomar 2X or 2024's four strategic imperatives: grow where we want, manage dislocation and diversification, provide consistent earnings and scale of the organization.

Our first imperative is centered on achieving strong premium growth across the portfolio with an emphasis on those segments that generate the strongest risk-adjusted returns. Our top line growth of 40% was driven by solid execution across the book of business, highlighted by our earthquake franchise, which saw an acceleration in its year-over-year growth rate from the first quarter and the continued strong growth in our casualty book. These two product categories helped drive profitable growth with limited volatility.

Our second imperative requires navigating and managing the dislocation in the market while further diversifying our business. During the quarter, we successfully placed our June 1 excess of loss reinsurance program. Not only we complete the 6/1 at attractive rates that were well below our initial expectations, but we also procured incremental excess of loss limit to support our growth and reduced our non-earthquake occurrence retention. Separately, we signed an agreement to acquire First Indemnity of American Insurance Company, or FIA, a regionally focused surety insurer that will allow Palomar to enter an attractive business segment to further diversify our portfolio and create a meaningful growth driver.

Our third imperative is a steadfast commitment to the delivery of consistent earnings. This quarter, we achieved adjusted net income growth of 47%, enabling us to raise our guidance once again this quarter, and more impressively for the fifth consecutive quarter. Additionally, we delivered an adjusted return on equity of 24.7 % with slightly elevated catastrophe losses in the quarter.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

The fourth imperative is scaling the organization and making the requisite investments to accomplish Palomar 2X. This effort starts with an investment in people, and I'm proud to say that we've recruited industry-leading talent to join the Palomar team this quarter.

As we previously announced, Tim Carter joined the Palomar team as our Chief People Officer, and Rudy Herve has come on board as our Chief Operating Officer. Their expertise and leadership will be invaluable as we continue to grow and innovate. We're executing very well. As I mentioned at the outset of the call, we are firmly on track to achieve the Palomar 2X goal of doubling our 2021 underwriting income in three years. Importantly, this strategy is ongoing as we work to continually plant the seeds for future growth and returns.

The accomplishments of 2024 in the past several years undoubtedly helped lead to AM best upgrade and our financial strength rating to an A from an A-. This upgrade underscores our financial stability, strategic success and health as an insurer counterparty and trading partner. Long term, it should create opportunities within our portfolio and beyond.

I would now like to review the performance and market conditions of our five product categories. Firstly, our core earthquake franchise grew gross written premium 25%, representing a strong acceleration from the first quarter's 13% growth rate, which, as a reminder, was 18% on a same-store basis. Overall, we remain confident that earthquake premiums will grow in the high teens to 20% range in 2024, and this quarter's performance in emboldens this stance.

Residential Earthquake business continued to generate consistent new business growth, highlighted by strong E&S production. The E&S book saw 38% growth year-over-year as personal lines business continues to flow into the non-admitted market in California. Additionally, our residential earthquake book saw decent traction from new partnerships with Cincinnati Financial and USAA.

The earthquake market remains stable and attractive from a pricing perspective. Commercial rates averaged an increase of 11.7% this quarter as compared to 11.6% in the first quarter of 2024. The 10% inflation guards that our residential earthquake policies contain are now providing a meaningful cushion above inflationary levels and provide annual increases regardless of market conditions.

Consistent with prior calls, our key portfolio metrics of average annual loss and the 250-year probable maximum loss to premium ratio remain at all-time best levels. This will translate into strong net earned premium growth as the cost of excess of lost reinsurance has moderated from previous highs. We remain positive on the growth and profitability prospects of our earthquake franchise.

Our Inland Marine and Other Property products grew 34% year-over-year, driven by our Builder's Risk, Excess National Property and Hawaiian Hurricane lines of business. Growth in these products that slowed from the first quarter's rate as we continue to focus on our mantra, grow where we want and curtail exposure in hurricane-exposed regions of the country.

Builders Risk, our largest Inland Marine product and our Excess National Property line continued to experience robust premium and submission growth. During the quarter, we hired more regionally focused underwriters for both business lines to expand our addressable markets and sustain the growth in these businesses.

Hawaiian Hurricane premiums grew 52% in the second quarter through a combination of rate increases, as an aside, we received an approval for a 23% increase at the end of the quarter as well as an increased level of fee generating new business written through Laulima Reciprocal Exchange.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Our All Risk business has seen rate increases flatten versus the 18% in the prior quarter. However, the underlying PML and AAL metrics, much like our earthquake business, are healthy, as is the profitability of the book. As previously mentioned, we are not increasing exposure in this line.

It is worth mentioning that we did see elevated cat losses from Texas severe convective storm and tornado activity in our builder's risk book during this quarter. Fortunately, the losses were only modestly above what Chris budgets for mini cats this time of year. The limited impact of these losses on our quarterly results is a testament to our conservative underwriting.

Our Casualty products had another strong quarter with premiums increasing 281% over the prior previous year's second quarter. Excess liability led the growth as the investments made in talent and distribution over the course of 2023 allowed the book to grow five-fold year-over-year.

Other standout performing lines in the quarter include niche segments like contractors, general liability, real estate errors and omissions and environmental liability. Our contractors GL booked grew 122% over the prior year. Real estate E&O grew 110% and our nascent environmental liability book grew 120% on a sequential basis from the first to second quarter.

We are growing our business through broadening our distribution footprint and increasing our submission activity. Our strong growth in Casualty products, which now comprises 16% of our total book, remains anchored in a conservative approach to underwriting targeted in niche segments of the market. We employ prudent risk management tactics such as modest gross and net line size, avoidance of heavily bodily injury and other high severity exposure, and conservative reinsurance to call our loss potential in the class as we write. As an example, the three lines I just highlighted above, real estate E&O, contractors GL and environmental liability, have an average net line of $1.2 million. Additionally, we continue to see decent rate increases in excess of loss cost across the casualty book.

Our professional liability products saw a blended increase above 10%, with real estate errors and emissions rates increasing 18%. The excess liability book was up over 20% and the contractor's general liability books saw an increase of 8%. While there are certain pockets of our Casualty book that are softer from a pricing perspective, private company D&O was down 4.8%, we continue to believe our rates are more than adequate.

For the quarter, the Causality book's loss ratios remained at our conservative loss picks with reserves continuing to build due to the nascency of the book. We are optimistic as the book seasons; reserves will develop favorably.

Our Fronting business grew premiums 20% year-over-year. Fronting growth was primarily driven by a new fronting partner in the personal Marine yacht sector. We also saw solid performance from our cyber cross-border trucking and Texas homeowners' programs. Both our Texas homeowners and cyber fronting programs had successful reinsurance renewals in the quarter, seeing improved economics and reinsurance support.

As previously indicated, we do expect our Fronting segment to under index the growth of our other business segments as we take a very selective approach to curating and managing our Fronting partner portfolio. In the fourth quarter, Fronting premium will decline as one of our key partners, Omaha National, an AM Best-rated insurance company, secured the requisite license to do business in California without a front. Termination of the contract will impact our Fronting segment's growth over the next several quarters as we work to replace the lost business with new partnerships. While we have a healthy pipeline of opportunities, we will be selective as we closely manage the risk in this segment.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Turning to Crop, we wrote $2.2 million in premium in the second quarter, which is a seasonally low period. Year-to-date, we have written over $40 million of premium compared to $0.5 million in the prior year. Overall, it has been a good planting season, and we remain confident in achieving or exceeding the full year forecast of $125 million of gross written premium. As discussed, we see significant opportunity to build a large business in the crop market. To that end, we appointed James Long, EVP of Innovation and Head of Crop Insurance in July.

James joins us from Renaissance Re where he spent 15 years as a senior level specialty reinsurance underwriter with a focus that included global crop insurance. James will work side by side with Jon Christensen in building this business and capitalizing on the large opportunity in the crop market, which as an aside, continues to consolidate. The number of improved insurance providers stands at 12 following Farmers Mutual Hail's recent acquisition announcement of Global Ag from AXA XL.

Turning to Reinsurance. We successfully placed our 6/1 excess of loss reinsurance program at pricing and terms that were better than our expectations. We also procured approximately $400 million of incremental limit to support the growth of our earthquake franchise and issued our fifth Torrey Pines recatastrophe bond. Our reinsurance coverage now extends to $3.06 billion for earthquake events, $735 million for Hawaiian hurricane events and $117.5 million for all other payrolls, including Continental United States Hurricane. These levels all exceed our 1-in-250 year peak zone probable maximum loss.

It is important to note that we did sacrifice some savings as we reduced our hurricane event retention to $15.5 million for non-earthquake catastrophe events, including hurricane and severe convective storm, from $17.5 million in the previous year. We slightly increased our earthquake retention to $20 million. These are levels that continue to be meaningfully within our stated retention guide posted less than one quarter's adjusted net income and less than 5% of Palomar's surplus on an after-tax basis. In the spirit of delivering consistent earnings, we felt sacrificing some savings for improved predictability was prudent.

Overall, our Reinsurance program is becoming increasingly attractive to reinsurance as the program becomes less exposed to Continental US and Hawaii hurricanes. Once all Hawaiian hurricane policies are assumed by Laulima, our reinsurance program will be almost entirely single apparel earthquake. This should afford us better pricing during next year's renewal, all else equal.

In addition to the excess of loss renewal, we renewed 12 other reinsurance treaties, including large quota shares for flood and builders' risk in our cyber fronting program. Overall, the renewals were favorable with half seeing improved economics at the renewal and only one seeing negative economics.

I want to discuss our proposed acquisition of First Indemnity of American Insurance Company, or FIA, which we are acquiring from 1.7X closing book value. FIA is a New Jersey-domiciled insurance carrier that specializes in the underwriting of contract surety bonds for small- to medium-sized contractors, primarily in the Northeast United States. FIA writes approximately $10 million in premium, is licensed in 16 states and is rated A- by AM Best. The company is led by Pat Lynch Sr and has an experienced team with a long track record of profitable underwriting. FIA's delivered loss ratios have outperformed the broader surety market over its history and importantly, over the last five years.

Surety is a very attractive specialty insurance market that we have analyzed for several years. Surety consistently outperforms a broader P&C market in terms of combined ratios and has an underwriting cycle that does not follow the general P&C cycle. In an atypical fashion, we decided it made more sense to enter surety through an acquisition versus building the business from the ground up. We believe FIA is a great business and one that we can help grow significantly using Palomar's capital distribution and technology resources.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

FIA is led by talented market experts and as such, we will maintain their underwriting and claims handling philosophy and strategies. Upon closing, we will invest resources toward the expansion of their distribution and geographic footprint and help them get federal T-listing. These efforts will meaningfully expand our market opportunity.

FIA's strong team will enable Palomar to confidently and expertly build a national surety franchise and a business that could become a material contributor to Palomar's earnings base over the medium term. We expect to close the acquisition before year-end and do not expect consequential revenue or earnings contribution in 2024. We do expect the transaction to be accretive to 2025 earnings.

As I mentioned in my opening remarks, this quarter, we recruited experienced industry veterans to help us further grow and scale Palomar. We recruited Tim Carter from LPL Financial to be our Chief People Officer in June. Tim brings more than 20 years of executive leadership in human resources operations and sales functions. Additionally, Rudy Herve has joined us from Score to be our new Chief Operating Officer. Rudy is an experienced insurance executive who also has more than 20 years of experience across technology, operations, strategic transformations and mergers and acquisitions. What sets these exceptional executives apart is a proven track record and their ability to build market leaders, whether it is by efficiently launching new products, recruiting best-in-class talent or implementing innovative technologies. Their experience and expertise will be invaluable as we enter the next phase of our growth.

To conclude, our business is performing well, and we are raising the guidance range for our full year 2024 adjusted net income to $124 million to $130 million from $122 million to $128 million.

With that, I'll turn the call over to Chris to discuss our results, including guidance assumptions in more detail.

Christopher Uchida

Thank you, Mac.

Please note that during my portion, when referring to any per share figure, I'm referring to per diluted common share as calculated using the treasury stock method. This methodology requires us to include common share equivalents such as outstanding stock options during profitable periods and exclude them in periods when we incur a net loss.

For the second quarter of 2024, our adjusted net income was $32 million or $1.25 per share compared to adjusted net income of $21.8 million or $0.86 per share for the same quarter of 2023, representing adjusted net income growth of 47%.

Our second quarter adjusted underwriting income was $32.9 million compared to $23.1 million last year. Our adjusted combined ratio was 73.1% for the second quarter compared to 72.2% in the second quarter of 2023. Excluding catastrophes, our adjusted combined ratio was 70.3% for the quarter compared to 69.6% last year.

For the second quarter of 2024, our annualized adjusted return on equity was 24.7% compared to 21.3% for the same period last year. The second quarter adjusted return on equity continues to validate our ability to maintain top line growth with a predictable rate of return above our Palomar 2X target of 20%.

Gross written premiums for the second quarter were $385.2 million, an increase of 40% compared to the prior year second quarter. Along with breaking out Crop, we are also regrouping our written premium to align with our five key specialty insurance products, Earthquake, Inland Marine and Other Property, Casualty, Fronting and Crop.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

It is important to remember the seasonality of our Crop premium. Based on our current expectation, the majority of our Crop premium will be written and earned in the third quarter of each year, with only a modest premium in the second and fourth quarters. The Crop premium written and earned in the third quarter will have a seasonal effect on our ratios calculated as a percentage of gross earned premium in the third quarter, specifically, the ratios for net earned premium, acquisition expense and other underwriting expense. Since the majority of our crop business is ceded, the net impact to our financials will not change compared to our previously shared expectations.

Net earned premiums for the second quarter were $122.3 million, an increase of 47% compared to the prior year second quarter. For the second quarter of 2024, our ratio of net earned premiums as a percentage of gross earned premiums were 37.4% compared to 34.3% in the second quarter of 2023, and compared sequentially to 35.6% in the first quarter of 2024. The year-over-year increase in this ratio is reflective of our higher growth rate of our non-fronting lines of business, including earthquake that cedes less premium.

In addition, these results include the first month of our new excess of loss reinsurance placement has started June 1. While the dollars associated with this placement are higher to facilitate continuing earthquake growth, the risk-adjusted rate online is lower than the previous year. With our excess of loss reinsurance in place and the majority of our Crop premium, for which we currently cede about 95% written and earned during the third quarter, we still expect the third quarter to be the low point of our net earned premium ratio. From there, we expect the net earned premium ratio to increase the remainder of the reinsurance treaty at a similar pattern to last year. While there is some expected seasonality in our net earned premium ratio, we continue to expect strong net earned premium growth.

Losses and loss adjusted expenses for the second quarter were $30.4 million, comprised of a $27 million of non-catastrophe attritional losses and $3.4 million of catastrophe losses from severe convective storm activity. The loss ratio for the quarter was 24.9% compared to a loss ratio of 21.5% a year ago. For the second quarter, our attritional loss ratio was 22.1%, and our catastrophe loss ratio was 2.8%.

During the quarter, we also experienced favorable prior year development from our Property lines of business as we continue to maintain conservative casualty reserves. We expect our attritional loss ratio to be approximately 21% to 25% for the year, and our catastrophe loss ratio to be about 2% to 3% for the year. These expectations include our estimate of third quarter catastrophe losses from Hurricanes Beryl and Debbie of $5 million to $7 million.

Our acquisition expense as a percentage of gross earned premiums for the second quarter was 11% compared to 10.8% in last year's second quarter and sequentially to 10.5% in the first quarter of 2024. This percentage increased for the same reasons as our net earned premium ratio, strong growth from our non-funding lines of business, resulting in higher commission expense and less ceding commission to offset our acquisition expense. Similarly, we expect third quarter Crop written and earned premium result in the higher ceding commission, pushing this acquisition expense ratio a little lower in the third quarter. We expect this ratio to move up from the low point in the third quarter.

The ratio of our other underwriting expenses, including adjustments to gross earned premiums in the second quarter was 7.3% compared to 6.9% in the second quarter last year and compared sequentially to 6.8% in the first quarter of 2024. Slightly higher this quarter from the performance-based accruals from our strong results, but in line with our expectations as we continue to invest in our organization as we continue to grow. We continue to expect long-term scale in this ratio, while we may see periods of sequential flatness as we continue to invest in scaling the organization. Crop premium will have a similar seasonal impact on this ratio for the third quarter as it does with the acquisition expense ratio.

Our net investment income for the second quarter was $8 million, an increase of 43.6% compared to the prior year second quarter. The year-over-year increase was primarily due to higher yields on invested

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

assets and a higher average balance of investments held during the three months ended June 30, 2024, due to cash generated from operations.

Our yield in the second quarter was 4.3% compared to 3.6% in the second quarter last year. The average yield on investments made in the second quarter was 5.9%. We continue to conservatively allocate our positions to asset classes that generate attractive risk-adjusted returns.

At the end of the quarter, our net earned premium to equity ratio was 1.02 to 1, and our stockholders' equity has reached $532.6 million, a testament to our profitable growth. As Mac mentioned, we are raising our full year 2024 adjusted net income guidance range again. The increased guidance range includes $6.8 million of catastrophe losses incurred for the first half of the year and $5 million to $7 million of additional catastrophe losses related to Hurricanes Beryl and Debbie incurred in the third quarter, but does not include any incremental income from the FIA acquisition if it closes this year.

Based on our strong performance during the first half of the year, we are raising our full year adjusted net income guidance range to $124 million to $130 million, implying 36% adjusted net income growth at the midpoint of the range. Also implying that we will double our 2021 adjusted underwriting income in three years. With our sustained strong performance, we are confident in our ability to continue achieving our Palomar 2X goal of doubling adjusted underwriting income in three to five years while maintaining an ROE above 20%.

With that, I'd like to ask the Operator to the line for any questions. Operator?

Operator

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your questions from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for question.

The first question comes from the line of Paul Newsome with Piper Sandler. Please go ahead.

Paul Newsome

Good morning. Congratulations on the quarter. I was hoping you could give us a little bit more of your thoughts on the topic of the quarter, which is casualty reserves, and I think mainly concerns that the underlying inflation rate is rising in general for cash you raised. Just to the extent you're seeing it or not seeing it in your book of business, you're growing quite a bit there and how you feel you can be really comfortable in an environment that seems kind of uncertain? Any additional thoughts would be great, I think.

Mac Armstrong

Yeah, Paul, this is Mac. Good to hear from you. Thanks for the question. I think it starts just with reinforcing what we're doing in casualty and we're writing niche segments within the market. Real estate E&O, contractor's GL, environmental liability, narrow professional lines like E&O and some miscellaneous professional lines broadly. But, we're not weighed down by legacy books of business. Really is a matter of us making sure that we feel very confident in our underwriting, our loss picks and our line size in risk management.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Just to give you a little bit of color on the risk selection side, we're really avoiding severity exposed classes, whether it's public D&O or large commercial auto fleets. We have really modest limits. Our max gross line is $5 million. But as I've pointed out in the call, when you look at some of those niche segments, our net line is $1.2 million. On the high end, it's going to be $2 million on a net basis. What we like about that is, A, it insulates us from a shock loss. B, it's not in the realm of litigation finance and social inflation. Then there's other underwriting controls, like for contractors GL, if we do have auto, we're trying to confine it to fleets that are less than 50 units of vehicles and minimizing the number of jobs that people are driving to on a daily basis.

I think the other thing though is you look at how we're managing the book relative vis-a-vis loss costs, we think we're getting rate right now. The excess liability, we had rate increases that were 20% plus. On the real estate agency E&O, it was in the high teens. I think when you look at that line, that's also a line that's really not too exposed to social inflation, right? It's really tied to transaction values in home sales. If there's a loss of value in the home, you're covered by that because you underwrite it on the value of the home and the sales that the agency does. What you're really looking at there is inflation exposure that's come down meaningfully because it's tied to property values.

We are very, very focused on making sure that we have rates in excess of lost cost. We're very, very focused on managing line size, and we have terrific people that are doing a well-experienced industry veterans that are building great books of business. Hopefully, that gives you some color, but we feel very confident, and we also feel very comfortable, we haven't touched our reserves yet. We're building up a good bit of reserves that hopefully will favourably develop.

Paul Newsome

That's great. Second question, maybe another broad one. Could you please talk about the—can you just talk about the competitive environment from your perspective with your business mix? I think there's broader concerns that properties are moderating, casualty sort of not very much, but your mix is pretty unique. Do you think it's the same, getting better, getting worse from a continued environment?

Mac Armstrong

Yeah. Listen, I'm going to give it somewhat broadly because we do have a diverse book of business, and I'll talk about it within our five product categories. In the circumstance of Earthquake, we feel like it remains a very attractive competitive environment for us. Our rates remain strong, up 10% to 12% — 11.6%, I think, exactly. The CEA on the residential side continues to pull back its coverage. It actually now has a rate increase that will be going into place, effective, I think, the start of the year.

Commercial Earthquake there still is limited capacity, and we bought incremental reinsurance to support our growth. I think you saw the growth in the first quarter. That broad brush, how I would describe that. Inland Marine and Other Property, this is where we see, we are growing where we want to. Yeah, there is a little bit of increased competition in the all-risk book. You can see that with our rates flattening in the second quarter. Capacity has come back into that market because the rates have been so strong, our metrics are really strong there, but we're not looking to grow exposure.

We're seeing in builders' risk a little bit more competition. But for us, we're more focused on building out a national footprint there. We've added underwriters to help us expand in the Midwest, to help us expand in the Northeast and the Western US. Probably, that's probably the second where I'd say we see the most competition in that Inland Marine and Other Property.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Casualty, you touched upon it. We're writing niche lines. We feel like that we're getting rate. We're coming into markets and expanding our distribution footprint, adding underwriting talent. We feel like there's good growth there and not too much in the way of competitive impact that's going to slow down our growth plans.

Crop is the fourth one. We've seen consolidation in that market. We're the new kid on the block there, so we think we can continue to take share and are well on our way to doing so. Then Fronting is a bit of a mixed bag. As I said, we lost one large account, a good partner, highly rated AM Best-rated company that now has the licenses that merits getting rid of a front. I'd say there's competition in that market as well. If I had to sum it up, Inland Marine and Other Property and Fronting's probably where we're seeing the most competition.

Paul Newsome

Great. Thank you. That's very helpful. Appreciate it as always.

Mac Armstrong

Thanks, Paul. Yeah, appreciate it.

Operator

Thank you. Next question comes from the line of Mark Hughes with Truist Securities. Please go ahead.

Mark Hughes

Thank you. Good morning. The ratio of earned premium to gross, Chris, I think you say will bottom out in the third quarter; it'd be a low point. Can you kind of say roughly where that number will bottom out?

Christopher Uchida

Yeah. Thanks, Mark, for the question. You and I talked about net earned premium a lot. But yeah, we do expect the net earned premium ratio to be at its low point in the third quarter. There are two factors affecting that. The one that's consistently impacted is excess of loss. The first full quarter of our new excess of loss will be in the third quarter of this year, similar to last year. That will put pressure on the ratio. We do buy that premium or buy the excess of loss to support our overall growth in the portfolio. Even though the rate was down approximately 5% on a rate online basis, the dollars we spend are still going to be up. That increased dollars will put pressure on the ratio.

The second factor that's going to affect it this year and in years to come, is also the Crop premium. The majority of the Crop premium that will be written and earned in the third quarter of this year, like years to come. We still see about 95% of that premium. That will also put additional pressure on that ratio and look at it in the third quarter. When I look at it specifically, I would expect something similar to what you saw last year. I would expect low 30s type net earned premium ratio in the third quarter and then moving up from there.

I'd say the down and the up will probably be a little bit steeper this year, but that's really driven by Crop. While when you look at the net earned premium dollars, I expect to see continued sequential growth in the net earned premium dollars. When you look at Q1, Q2 and then into Q3, I still expect to net earned premium dollars to increase, but that ratio will see a little bit more variability in the third quarter and a lot of that driven from the Crop premium that we're expecting.

Mark Hughes

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Thanks for that detail. Then the impact of the lost Fronting business, what is the dollar amount roughly?

Christopher Uchida

Yeah. The total portfolio for that book of business is right around $165 million to $168 million. That obviously is a significant chunk of business that we will be losing. We will start losing that or we will start, I'll call it, rolling that over in the second or the third quarter of this year. We'll probably experience about half of it this year. The first quarter is the heaviest quarter for that. Then just trying to—sorry, to get to the number right now that we will see. It's about $39 million of premium last year in the third quarter.

I would say, think about that as half that we will not get this year. The fourth quarter of '23 was about $37 million of written premium. The first quarter of '24 was about $48 million in written premium. Q2 of this year, this quarter was about $44 million of written premium. In total, that's about $168 million of Fronting premium that we will be rolling off of starting in the middle of the third quarter.

Mac Armstrong

I think what I would add, Mark, is just importantly, I think a couple of things. One, this is a company that now has the requisite licenses needed. It's always had an AM Best rating. I think it speaks to the quality of the counterparty. Two is, if you look at Fronting, it's a nice fee income stream, but it's a lower margin product for us. We think we can certainly play through that next year and then some because we have a nice pipeline, and we added new clients in the quarter. Furthermore, there's so many other growth vectors we have. The beauty of our business is we can lose someone like this, and we have a great portfolio, and we still feel very good about the long-term growth prospects of the business.

Mark Hughes

Thank you for that. Then in California, in the personal lines market, the dislocation, I think, has been helping from the quake standpoint, I think you talked about more movement into E&S was beneficial on the residential side. Is that continuing to pace? How do you see the trajectory in that, is it still as dislocated or is that slowing down a little bit?

Mac Armstrong

Mark, good question. Yes, it's continuing to pace. I mentioned 38% E&S growth in residential quake in the second quarter. We're seeing still steady new business in E&S as we sit here today. The admitted homeowners market remains as this located discombobulated, and we don't expect that to remedy itself in the near term. We think that's a nice tailwind for us. The other thing I'd add is a lot of the partnerships we brought on, like Cincinnati Financial, that is with their E&S offering, their high-value E&S offering. Its a natural conduit from E&S homeowners' policies to come over to quake.

Mark Hughes

Appreciate it. Thank you.

Mac Armstrong

Thanks, Mark.

Operator

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Thank you. Next question comes from the line of David Motemaden with Evercore ISI. Please go ahead.

David Motemaden

Thanks. Good morning. I had a question just on the some of the loss ratio discussion. It sounds like 21% to 25% attritional with two to three points of cat losses for this year. If I think about that all-in loss ratio of about a 23% to 28% for this year, I guess, how are you guys thinking about that as we head into next year, given all the changes in the mix of business? Any thoughts there would be helpful. Thank you.

Christopher Uchida

Yeah. Thanks, Dave. No, I think the loss ratio is moving up as we have projected and expected, right? I think the one nice thing that we're seeing is that the lines of business that do have attritional losses, Casualty, Inland Marine, are growing at a very strong rate. Those are profitable lines of business, but those lines of business also come with attritional losses, which we expect. That growth is outpacing our expectations a little bit. We think it's prudent to push the loss ratio up a little bit. We've said that I wouldn't be surprised if it moves up a point-ish every quarter as these books mature and as that earned premium, and growth comes on the books. I think that's what we're seeing.

That two to three points of cat loss that you talked about, that does reflect the losses that we've seen through the first half of the year, but also our estimates for losses from Beryl and Debbie that is still impacting the US right now. We hope those estimates are conservative, but we do think that our loss ratio is moving as we would expect. The other thing is that when you look at our loss ratio for the quarter, there was some favorable prior period development. We're happy to see that as always. That did come from our property line of business, specifically some of our larger builders' risk where we were holding some conservative reserves.

We were able to close out some claims during the quarter. We felt comfortable taking those reserves down. Importantly, as Mac pointed out a little bit earlier, we are not touching our casualty reserves, right? The casualty book is a little newer for us. We are reserving that in our minds conservatively, and we're holding those reserves. We have not taken those reserves down at this stage. We feel like we have a conservative position for our total reserve base, and we hope that proves out.

But importantly, our book of business is maturing, our mix is growing in lines of business outside of earthquake, while earthquake still has strong growth. These other lines are going at a greater rate. That greater rate is causing our attritional loss ratio to move up because while these businesses are still profitable, unfortunately, they're not a sub-20 loss ratio line of business. But they're still very profitable, and we're happy to see the attritional loss ratio move up with the growth in those lines of business.

David Motemaden

Got it. That's helpful. I guess just on the cat losses. If I look at year-to-date and include the Beryl and Debbie losses, it's, I guess, around $13 million to $14 million. Is that what you would expect in terms of a cat load for a typical year, just given the mix shift in your business?

Mac Armstrong

Yeah, Dave, I think it's directional. Candidly, I believe that the second quarter had elevated SCS activity, and we had a tornado loss that hit our builders' risk book that's probably disproportionately and unusually high. I wouldn't expect that every year, but it's not a bad trajectory.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

The other thing is it was the first quarter, most of those cat losses were from the flood activity in California. If we rotate out of an El Niño into La Niña, there may be potentially lower rain activity in Southern California, I probably just jinxed myself, but nonetheless, it's a combination of cat load. It's from SCS flood and continental hurricane, that's not a bad directional target over the course of the year.

David Motemaden

Great, thank you. Then interesting to learn a little bit more about the surety deal for FIA. I guess, are there any other lines you haven't spoken about where you're thinking of entering and where you're weighing either building it yourselves, which is what we've seen you guys do in the past versus acquiring something like you just did here?

Mac Armstrong

Yeah. Good question, Dave. What I would say is, first and foremost, we still believe that we are an organic growth story. All of the growth that we've done to date has been organic and the predominance will remain. FIA was unique. It's a market that we really like, but there is an expertise that we thought we were better suited to buy than build. I think you should continue to consider us an organic growth story. But in the case of FIA, because we have market experts who have generated exceptional returns and better than industry returns for decades, we found a great partner. What I think you'll probably see, though, as I mentioned, it's $10 million of premium. Our goal is to build in multiples of that. It will turn into an organic growth story once we bring it on board. But consider us organic growth than an opportunistic acquirer, especially when you could buy a great franchise like FIA.

David Motemaden

Got it. Understood. Thank you.

Mac Armstrong

Thanks, Dave.

Operator

Thank you. Next question. Comes from the line of Andrew Anderson with Jefferies. Please go ahead.

Andrew Andersen

Hey, good morning. Any way to size the benefit or expand growth opportunity from the recent AM Best upgrade? What would be the timeline to seeing any benefit there?

Mac Armstrong

Hey, Andrew, yeah, good question. We were thrilled to get that upgrade. It's hard for us to size it. I think there are segments of our book that will be more positively impacted than others, in particular, professional lines and some of the niche casualty segments that we write in. I don't think it's going to be a permanent to Property. But I think it does enhance us as a counterparty. It certainly enhances us as a trading partner. It will open distribution sources. It will potentially open new lines of business. I also think it will probably help us recruit talent. But I don't want to give you some type of dollar impact, but we're going to use it to do the best of our ability to market.

Andrew Andersen

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Understood. Then maybe on the Earthquake side, the inflation guard has been pretty sticky. Should we think of that maybe reversing in '25? Then if you could also just touch on the commercial earthquake market where pricing has, at least quarter-over-quarter, remained relatively consistent.

Mac Armstrong

Yeah. I'll let Jon Christianson speak to that. I'll say just on the inflation guard, and he should chime in, it's a locked-in underwriting guideline that we have filed. Underwriting rule rather that we have filed. We have no intention to rescind it and change it. It will be firm for 2025.

Jon Christianson

Yeah. I'd add, that's one thing that we watch those retention ratios very closely and how the inflation guard may impact a buyer's decision to renew a policy. As of right now, we're seeing no change in buyer behavior. Like Mac said, we're pleased to continue that conservative inflation approach that we've had employed here over the last couple of years.

On the commercial earthquake, to your question, that rating environment continues to be very strong, the strongest in our careers. While there has been some decreases that Mac mentioned or flattening, I should say, of the all-risk segment, we continue to see some appreciation in rate over the course of the second quarter in the commercial earthquake segment. More opportunities in the market and pleased to see the rates hold up.

Mac Armstrong

I think, Andrew, what I would add is two things on respect to the residential earthquake. There those retention rates and sustaining those with the CEA pushing forth a rate increase that again will be effective at the start of the year. That gives us a bit of competitive cover, so to speak. Then on, just all of the earthquake, the fact that we were able to lock in our reinsurance at a 5% rate decline while maintaining that type of price integrity, whether it's the inflation guard or commercial rate increases, that does bode well for net earned premium conversion/margin expansion in that line of business.

Andrew Andersen

Thank you.

Operator

Thank you. Next question comes from the line of Meyer Shields with KBW, please go ahead.

Meyer Shields

Great. Thanks so much. A couple of questions, probably all over the place. First, is there any overlap in FIA's agency network and the contractor related liability lines that you're writing now?

Mac Armstrong

Not a lot currently. There's potentially ways to cross-sell in time. I actually think there's probably a decent cross-sell to with some builder's risk. But as we sit here today, there's not much in the way of geographic or distribution overlap. FIA is Northeast heavy, our contractors GL tends to be Western US heavy.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Meyer Shields

Okay. Perfect. I'm assuming that just because of the size and presumably reinsurance plans, we shouldn't expect this to impact acquisition expense ratios for 2025.

Mac Armstrong

For FIA?

Meyer Shields

Yeah, including the FIA.

Christopher Uchida

Yeah. No, I think obviously, it's a smaller book of business than some of our other lines of business. It will have an impact, but I wouldn't expect anything material to change just on the overall weight of that book in 2025 from a ratio standpoint, sorry.

Meyer Shields

Right. No, no, understood. On the Fronting side, I guess—the remaining books in other words, outside of, I guess, Omaha casualty, if I have the name right, is that business more permanent in nature? Or are clients there also looking for licensing or distribution to branch it on their own over time?

Mac Armstrong

Yeah, Meyer, I would say it's more permanent in nature. The Omaha National, we knew that at some point, they would no longer need a front. The other ones tend to be more either MGA's or reinsurers that don't have a primary company access.

Meyer Shields

Okay. Perfect. Then last question, if I can, Omaha National, did you retain any of that underwriting risk?

Mac Armstrong

We did. Yes, it had been between 5% and 7%. But that will not go forward.

Meyer Shields

Okay, perfect. Thanks so much.

Mac Armstrong

Thank you.

Operator

Thank you. A reminder to all the participants that you may press star and one to ask a question. Next question comes from the line of Pablo Singzon with JPMorgan. Please go ahead.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Pablo Singzon

Hi. Good afternoon. I was a bit surprised by the sequential increase in the net earned premium ratio. Just given that we only have one month of a, I guess, a rebased XOL cost here. Putting that aside, as you think about where you're growing, are there lines of business where you get the most leverage against reinsurance budget that's flattened out? As you think about resi earthquake, that's an obvious one, that runs on an XOL program, but within Marine or Property, which I think has grown the fastest for you year-to-date, are there lines there that benefits like earthquake from an XOL budget that flattened out?

Mac Armstrong

Yes, all the property business, and even Laulima, where we're now an attorney-in-fact manager, there's more margin for us to retain potentially there. All of the property business from builders' risk to earthquake to Hawaiian Hurricane and All-Risk. They benefit from decreasing reinsurance pricing.

Pablo Singzon

Okay. It sounds like those lines are not heavily quota share then, right? Is that correct?

Mac Armstrong

Correct. Builders risk has a quota share, but it's for non-cat. The excess national property, same. That tends to be more back heavy, but yes. But Hawaii, earthquake and All-Risk, that's where there's not much quota share we're using there.

Christopher Uchida

Pablo, maybe I'll speak a little bit just to the sequential growth in the net earned premium ratio, which was a little unexpected when we go back to the Q1 results. But I think after the placement of the excess of loss, we did receive some benefit there. It was better than our expectations. We had, call it, single-digit savings there versus we were expecting a rate increase. That definitely impacted our expectations on the net earned premium ratio. Then just overall growth in lines of business that use, let's call it, less reinsurance or quota share reinsurers than fronting, right?

Fronting was probably the slower grower over the first half of the year. The growth in lines like Inland Marine and Casualty, even though they still use quota share, they don't use as much as Fronting. The growth in those lines of business was a little bit ahead of our expectations as well, helped increase that net earned premium ratio sequentially from Q1 to Q2. That's something else that needs to be factored in when you think about it. While when we talked last time, we were probably expecting that ratio to be a little bit flatter for Q2, but still, we do expect that dip in the third quarter.

Pablo Singzon

Yes. Okay. That makes sense. Then switching gears here, just on the E&S resi product in California. The high-value homeowners' customers you're getting, are these customers net new business for you? Or are you seeing some shift from a bit of volatility to the E&S side?

Mac Armstrong

It's both. That's a good question, Pablo, and I'd say it's both. I've highlighted again, Cincinnati Financial, those are going to be new business. There are others that are coming into the market to buy and only the

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

E&S is open to them. Then we have made a deliberate renewal, or migration rather, of certain policies in peak zones in Southern California or Northern California for that matter, that we want to have on E&S paper, whether we need to charge more for it to justify the reinsurance costs or just improve the spread of risk.

Jon Christianson

Yeah. Pablo, I'd also add that as we see changes in the personal lines market in California with associated with those carriers who are participating in insurers will the California earthquake Authority. As the California Earthquake Authority reduces its exposure, particularly to those that may be kind of a higher value profile of customer, we see that business coming to us. While they may be historically earthquake buyers, we see that business coming to us on the E&S side of the house as well.

Pablo Singzon

Got it. That makes sense. Then just last for me on FIA. Mac, you said the aspiration is a growth premium base of $10 million multiples of what it is now. The question for you is, what does FIA gets by being part of the Palomar platform that you think will enable that growth, right? Is it distribution? Is it operations? How are you thinking about all those things?

Mac Armstrong

Yes. I think our objective is to export their excellence in surety underwriting and claims management to a broader geographic and distribution footprint. We can bring capital, potentially keep a little more on the balance sheet. They write nice modest limits that wouldn't disproportionately impact our risk management targets. We can give them capital to write more and keep more. We definitely can open up distribution for them. We certainly, if we can, bring more resources to bear to help them expand their geographic footprint. What you won't see is a material change in the underwriting appetite and classes of business nor their claims handling approach. They are excellent at that, and that's what we want to export.

Pablo Singzon

Understood. Thank you so much.

Mac Armstrong

Thanks, Pablo.

Operator

Thank you. Ladies and gentlemen, we have reached the end of question-and-answer session. I would now like to turn the floor over to Mac Armstrong for closing comments.

Mac Armstrong

Thanks, Operator, and thank you, everyone, for participating today.

In conclusion, we had another strong quarter and where we executed our Palomar 2X strategy. I want to, as always, thank our talented team for their hard work and dedication. Our success is a reflection of their efforts.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Looking to the second half of the year, we were optimistic of our ability to execute our plan and deliver profitable growth. Lastly, I look forward to welcoming you on the FIA team to Palomar upon the closing of the acquisition. I'm very excited about what we are going to accomplish together.

Thank you all. Enjoy the rest of your day, and we'll talk to you next quarter.

Operator

Thank you, this concludes today's teleconference, you may disconnect your lines at this time. Thank you for your participation.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com