Palomar®

Fourth Quarter and Full Year 2023 Earnings Call Transcript

February 15, 2024

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PRESENTATION

Operator

Good morning, and welcome to Palomar Holdings, Inc. Fourth Quarter and Full Year 2023 Earnings Conference Call.

As a reminder, this conference call is being recorded.

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

Chris 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 Christianson, our President is here to answer questions during the Q&A portion of the call.

As a reminder, a telephonic replay of this call will be available on the Investor Relations section of our website through 11:59 PM Eastern Time on February 22, 2024.

Before we 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 their 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.

Fourth quarter provided a strong end to what was a stellar 2023. The quarterly results included record gross written premium and adjusted net income, premium adjusted net income growth of 27% and 33%, respectively, and importantly, an adjusted return on equity of 25%.

When looking at the full year, we're equally proud of record gross written premium and adjusted net income, strong top and bottom-line growth and numerous initiatives that led to diversification and reduced earnings volatility. We introduced multiple new lines of business, namely Crop, Environmental Liability and Assumed Reinsurance. This robust and disciplined growth translated into an adjusted return on equity well above the 20% benchmark levels espoused in our Palomar 2X strategic plan.

Before I go into the detail on the fourth quarter, I want to take a moment to recap the accomplishments of our terrific 2023. At the beginning of last year, we outlined four strategic objectives for the year: one, sustained strong growth; two, managed dislocation; three, enhance earnings predictability; and fourthly, scale the organization. I'm pleased to report we execute on all of these objectives and the execution not only led to record gross written premium and earnings but also put us in a position for long-term success.

The highlights of 2023 are numerous, but selected achievements include 29.4% gross written premium growth that is closer to 40% when excluding deemphasized or discontinued lines of business. The successful navigation of the generationally hard property catastrophe reinsurance market in which we renewed our reinsurance program in line with the expectations implied in our full year 2023 earnings guidance, and procured more excess of loss to support our growth in earthquake. The completion of a multiyear effort to reduce our continental wind and severe convective storm exposure that resulted in reduced volatility in our earnings base. This is best exemplified by our minimal catastrophe losses this year.

As an inside, if the 2020 wind season were to happen again, our total losses from the cohort of storms will be less than $10 million on a net basis. The introduction of three new lines of business in Crop Insurance, Environmental Liability and Assumed Reinsurance and incremental traction in newer lines like excess property and casualty. These nascent products will enhance our specialty insurance franchise and create shareholder value.

The addition of best-in-class underwriting reinsurance data actuarial and technology talent to our team, A.M. Best changing the outlook in their rating of Palomar to positive from stable. Last but not least, the successful “beat and raise” of our quarterly adjusted net income targets every quarter of the year. These accomplishments allow us to exit the year energized by our prospects for profitable growth in 2024 and beyond.

With that, I would like to discuss our fourth quarter results and our 2024 strategic priorities for our five product categories. Overarchingly, the quarter saw a robust growth with gross written premium increasing 27% year-over-year, a nice sequential acceleration from 24% gross written premium growth delivered in the third quarter. Excluding de-emphasized lines of business, gross written premiums increased 32%.

Likewise, net earned premiums grew 14% in the fourth quarter, which is an acceleration from the 10% that we delivered in the third quarter of 2023. Chris will discuss the net earned premium trend for 2024.

Looking at our five key business lines in more detail. Our core Earthquake franchise grew 29% in the fourth quarter, up from 23% in the 2023 third quarter. The Residential Earthquake book grew 18% and our Commercial Earthquake grew a healthy 44%. The growth in Q4 for Commercial Earthquake favorably compared to the third quarter's growth of 35% and the second quarter's growth of 29%.

Our Residential Earthquake portfolio remains our largest single line of business and a consistent performer. The market backdrop is still attractive as California homeowners market dislocation persists, existing California Earthquake Authority policyholders are seeing reduced coverage offered at renewal, and an increasing amount of historically standard lines businesses moving to Excess and Surplus nights.

At quarter-end, our E&S premium was 9% of total California Residential Earthquake premium. We believe high-teens growth is sustainable in the year ahead and that a new partnership with the top 25 insurance brand, offering earthquake insurance to their E&S policyholders to provide a further catalyst for sustained profitable growth.

During the quarter, Commercial Earthquake conditions remained attractive as we achieved rate increases of approximately 26% on a risk-adjusted basis and record best levels for average annual loss and 250-year probable maximum loss of premium - our most important portfolio management metrics. We did see the level of rate increases start to moderate from the prior year and expect that to be the case in 2024. This dynamic is more pronounced in large layered and shared accounts than it is in the middle market. We remain positive on the growth and profitability prospects of our earthquake franchise as we enter 2024.

Our Inland Marine and our other property products grew 8% year-over-year, as this remains our product segment where we are judiciously managing and in certain cases reducing our exposure. It is the product group that best typifies our “grow where we want” mantra. We continue to invest in lines that hold attractive risk-adjusted returns like Builder's Risk, Excess Property and Flood. Builder's Risk, our largest Inland Marine product, exited the year with over $115 million of in-force premium and added several new underwriters to help expand our geographic reach and distribution footprint in the quarter. We are confident the investments in Builder's Risk infrastructure will sustain the growth of the business through 2024. Our Excess Property line saw approximately 5% rate increases in the quarter and 136% year-over-year growth, as it builds a portfolio of non-cat exposed property business. Like Builder's Risk, the Excess Property line is adding talent and infrastructure to profitably grow in 2024. Flood written premium grew 25% year-over-year in the fourth quarter and 38% for the full year, as we continue to expand the products geographic footprint.

We've now reduced our continental hurricane probable maximum loss to $100 million and the average annual loss to $4 million. This concerted effort meaningfully lowered the volatility in our book but did lead to the decline in our Commercial All Risk premium by 13% year-over-year. Importantly, the remaining commercial all risk book of business is attractive with policies renewing at an average increase of more than 30% in the fourth quarter. As we have completed the triage to the book, we expect Commercial All Risk premium to grow in 2024, albeit it will come exclusively through rate increases.

Hawaii Hurricane premiums grew 13% in the fourth quarter with most of that growth from rate increases and our inflation guard. As we discussed last quarter, we have formed Laulima Exchange, a fully licensed reciprocal insurer for which we serve as the attorney in-fact manager. This new vehicle allows us to transition our business model for the Hawaiian Hurricane product from one that is risk-bearing to one that is fee-generative. We are in the process of rolling our policies into Laulima and expect to have this completed by the fourth quarter of 2024. Our customers have been receptive to the Laulima transition, with 90% of our policies successfully converting. Once this transition is completed, we will all but eliminate balance sheet exposure to wind losses from hurricanes hitting Hawaii.

Turning to our Casualty business, we're pleased to see premiums grew 165% year-over-year. Production was highlighted by strong growth from our Excess Liability and Professional Liability lines as well as our first premium from our recently hired Environmental Liability team. During the quarter, the book saw a blended rate increase of approximately 5% year-over-year, with rates skewing a bit higher in Excess Liability. Importantly, we continue to take a surgical approach to the buildout of our Casualty business, where we focus on niche segments of the market that offer healthy risk-adjusted returns and confinable exposure to social inflation. We employ prudent risk management tactics such as modest gross and net line size, avoidance of heavy bodily injury exposure and conservative reinsurance to minimize loss potential in the classes we write. We feel our approach of bringing on subject matter experts who are comfortable walking before they run will build a well underwritten book of business with limited exposure to large shock loss and significant adverse court rulings.

For the quarter, the Casualty book's loss ratio remained in line with our conservative loss pick. As the predominance of the book is less than two years old, we are focused on building a sizable reserve base that we expect to favorably develop over time. We expect our Casualty business to be a meaningful contributor to premium growth in 2024, primarily driven by our Real Estate E&O, Excess Liability and Professional Lines.

Our Fronting business outperformed our expectations in 2023, growing premiums 63% to $364 million and delivered 24% year-over-year growth in the fourth quarter. We also finalized two new fronting programs in the quarter, and we recognized a modest level of premium from these new deals and are optimistic about their potential for 2024. As we've said on past calls, our goal in Fronting is to provide fee-generative services to a select group of MGAs, carriers, and reinsurers, writing specialty lines of business in industry segments where we have a developed investment thesis and some measure of domain expertise.

We actively manage the compliance oversight reinsurance and collateral of our fronting partners and maintain a risk participation in certain instances with a current maximum participation of 8%. We remain selective of our strong fronting partners and apply that selectivity to our healthy pipeline of prospects.

We continue to be very optimistic about the potential for our newest product group, Crop insurance. As a reminder, Palomar's leadership team has extensive experience in the Crop insurance market, and we are now one of only 13 approved insurance underwriters or AIP in a $20 billion industry. Our strategic partner, Advanced AgProtection, has extensive sector experience and a distinct technology that allows it to target risk at the producer and regional level, more importantly, compete effectively even without immediate scale. We are targeting business throughout the Midwest on a variety of crops with the goal of minimizing exposure to a single event or heavy accumulation of losses in any one region.

Fourth quarter is a seasonally light period for Crop insurers and one of which most AIPs, Palomar included, write negligible premium. During the quarter, we focused on generating premiums that will be booked at the start of the year. Thus far, the market's receptivity is encouraging, and we now expect to deliver more than $100 million of premium in 2024. Chris will provide more detail on the seasonality of the business.

As it pertains to our reinsurance program, we are pleased with the outcome for our reinsurance treaties renewing January 1. While only a few treaties renewed at 1/1, we did have a commercial earthquake quota share, a small earthquake-only excess of loss layer and a casualty quota share renewed at the start of the year. While limited compared to what renews June 1, these renewals offered a decently broad perspective of the market. The earthquake quota share renewed at improved economics with an increased ceding commission that implies a risk-adjusted decrease of approximately 5%.

The XOL layer renewed at a similar, if not slightly better risk-adjusted decrease. The casualty quota share renewed with improved economics and our ceding commission increased from the expiring level. While the outlook for reinsurance has certainly improved from a year prior, we are conservatively budgeting for modest price increases in our June 1 renewals. We are confident the apex of a historically hard market is behind us, which bodes well for net earned premium growth and margin expansion.

To conclude, 2023 has been a banner year of profitable growth and consistent earnings for Palomar. We continue to invest in both of our core lines as well as new lines of business to ensure we are positioned to achieve our Palomar 2X goals, notably doubling our underwriting income over a three to five year period, while delivering adjusted return on equity above 20%.

As we set our sights on 2024, our steadfast commitment to profitable growth remains unwavering. Our strategic imperatives in many ways, emulate those of 2023, affording us conviction in their executability. Our high-level strategic imperatives for 2024 are summarized in the following four rubrics: one, grow where we want; two, manage dislocation and diversification; three, provide consistent earnings; and four, scale of the organization.

As considerable progress has commenced across these directives, we are pleased to offer full year 2024 adjusted net income guidance of $110 million to $115 million. Importantly, this range includes losses incurred in the first quarter from California flooding of approximately $3.5 million, as well as full year loss estimates for severe convective storm and mini cat events. Our guidance does assume a low single-digit risk-adjusted increase on our XOL renewal at 6/1. The midpoint of our guidance implies an adjusted ROE of 21%, a level above our Palomar 2X target.

With that, I will turn the call over to Chris to discuss our results in more detail.

Chris 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 we incur a net loss.

For the fourth quarter of 2023, our adjusted net income was $28 million or $1.11 per share, compared to adjusted net income of $21.1 million or $0.82 per share for the same quarter of 2022. Our fourth quarter adjusted underwriting income was $29.3 million compared to $23.5 million last year. Our adjusted combined ratio was 68.8% for the fourth quarter compared to 71.4% in the fourth quarter of 2022.

For the fourth quarter of 2023, our annualized adjusted return on equity was 25.1% compared to 22.4% for the same period last year. The fourth 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 fourth quarter were $303.2 million, an increase of 26.8% compared to the prior year's fourth quarter. Excluding deemphasized products, our written premium growth rate was 31.7% for the quarter. It is important to remember the seasonality of our Crop premium. As anticipated, we did not have any Crop written premium in the fourth quarter.

Based on our current book, the majority of our crop premium will be written in the third quarter of each year followed by the first quarter, which should see about a quarter of the year's premium. The second and fourth quarters will see only modest premiums. As our Crop premiums grow through the year, we plan on splitting out our Crop premium into its own category and will provide an update on our first quarter's earnings call.

Net earned premiums for the fourth quarter were $93.7 million, an increase of 14% compared to the prior year's fourth quarter. For the fourth quarter of 2023, our ratio of net earned premiums as a percentage of gross earned premiums was 33.9% compared to 38.9% in the fourth quarter of 2022, and compared sequentially to 31.6% in the third quarter of 2023. The year-over-year decrease is reflective of our growth in fronting and lines of business that use quota share reinsurance and the second full quarter with our renewed excess of loss reinsurance program.

With the mix of business maturing and our excess of loss reinsurance program are in place, our net earned premium ratio was at its low point in the third quarter of 2023 and increased in the fourth quarter. We continue to expect a slight improvement in this ratio for the first part of the year and relatively consistent patterns for 2024.

Losses and loss adjustment expenses for the fourth quarter were $17.9 million, comprised almost entirely of non-catastrophe attritional losses. The loss ratio for the quarter was 19.1%, which compares to a loss ratio of 22.4% a year ago in the fourth quarter, which was comprised of a catastrophe loss ratio of 2.3% and an attritional loss ratio of 20.1%.

For the full year, our loss ratio was 21%, in line with our previously expected range and which compares to 24.9% in 2022. Based on our mix of business and growth, we expect our loss ratio to move up incrementally from the 2023 levels.

Our acquisition expense as a percentage of gross earned premium for the fourth quarter was 10.5% compared to 12.7% in the fourth quarter last year, and compared sequentially to 9.9% in the third quarter of 2023. Additional ceding commission and fronting fees continue to drive the year-over-year improvement. The acquisition expense ratio may be flat to modestly up in future quarters as our business mix matures. This quarter, our acquisition expense was a little higher but was completely offset by a higher commission and other income for the quarter both related to our crop business.

The ratio of other underwriting expenses, including adjustments to gross earned premiums for the fourth quarter was 6.9% compared to 6.9% in the fourth quarter last year, and compared sequentially to 6.7% in the third quarter of 2023 in line with our expectation as we continue to invent our organization as we continue to grow. We continue to expect long-term scale in this ratio, while we face periods of sequential flatness as we continue to invest in scaling the organization.

Our net investment income for the fourth quarter was $7 million, an increase of 58.9% compared to the prior year's fourth quarter. The year-over-year increase was primarily driven by a higher average balance of investments held during the three months ended December 31, 2023, and a mix shift of invested assets from lower-yielding investment assets into higher-yield investment assets with a similar credit quality. Our yield in the fourth quarter was 4.1% compared to 3.3% in the fourth quarter last year. The average yield on investments made in the fourth quarter was 5.9%. We continue to conservatively allocate our positions to asset classes that generate attractive risk-adjusted returns.

During the quarter, there were no share repurchases and we have $43.5 million of our authorized share repurchase program remaining as of December 31, 2023, that we will continue to use opportunistically. At the end of the quarter, our net written premium to equity ratio was 0.87 to 1.

For the year, our strong topline performance continued to translate to the bottom line. Our adjusted net income grew 31% to $93.5 million. Our adjusted EPS grew 33.5% to $3.69. Our adjusted combined ratio was 71.2% made up of a loss ratio and an expense ratio of 21% and 50.2%, respectively, both improvements from 2022, ultimately resulting in an ROE of 21.9%. Our adjusted underwriting income grew 29.1% to $99.5 million, positioning us to achieve our Palomar 2X objective from 2021 in less than four years.

As Mac mentioned, we are initiating our full year 2024 adjusted net income guidance of $110 million to $115 million, implying 20% adjusted net income growth at the midpoint of the guidance. This range includes our current estimate of the catastrophic California flood losses incurred in the first quarter of approximately $3.5 million. It is important to remember that our loss estimates and guidance include our expectations of mini cats such as severe convective storm activity.
For the year, we expect our loss ratio to be approximately 21% to 25%, including the first quarter flood losses incurred to date and our estimate of mini cats, which represents approximately two to three points of our expected loss ratio.

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

Operator

Thank you.

Our first question is from Paul Newsome with Piper Sandler. Please proceed.

Paul Newsome

Good morning. Congratulations on the quarter. Just to start with a little bit of a modeling question. Can you give us a little bit more thoughts on the relationship between gross and net over the course of the next year? Obviously, crop is a big reinsurance-related product, and there's mix shift in there, and so a lot of pieces, I think to think about. But maybe you could just talk to us about that and sort of the increasing and decreasing pieces of the reinsurances.

Chris Uchida

Yes. Thanks, Paul. Good question. When we think about it, right, we've said this all along that the gross-to-net ratio was probably at its lowest point after Q3 of this year and after the full reinsurance placement was put in place. You did see that improve slightly in the fourth quarter. What I would expect with that is I expect that trend to continue in Q1. I'd expect that to move up a little bit in Q1, and I'd expect potentially a little bit of movement up in Q2. When we buy reinsurance again at the end of the second quarter, I would expect kind of that stair-step relationship that you saw in 2023 to happen again in 2024.

Overall, 2024 is going to have a higher overall load on the reinsurance cost. I would expect the full year net earned premium ratio to be a little bit lower than what you saw in 2023, but I would expect it to—when you get to the second half of 2024, I would expect it to look very similar to what you saw in 2023. Those same relationships starting to play out from what you saw.

The other part of your question was related to crop, right? There is definitely some seasonality in our crop business because for 2023, we were a full front for crop. Really, all the seasonality that you saw was in the written premium. I would expect that to be very similar in 2024. We are only participating 5%. It will start contributing to the bottom line. But that bottom line contribution will not be as material as the seasonality that you see in the written premium.

The written premium, as I mentioned in the prepared remarks, I would expect to see about 60% of that written premium in Q3, probably 25% of that written premium in Q1 and then a little bit spread out between Q2 and Q4 of 2024. But, that seasonality you see in that written premium isn't going to be a driving factor and make our bottom line move significantly in a material way. I think that noise that you guys are expecting isn't going to be material to our overall results, but you will see it in the written premium and then it will just net out in the net earned.

Mac Armstrong

Paul, the one thing I'd add on crop though, long-term, we do expect to take a more meaningful risk participation, but that wouldn't incept until January 1, 2025. We'll have ample opportunity to guides our analysts on how that does change the relationship of earned premium and the like. But again, 2024, like Chris described is one where we're still more of a fee generator with a modest 5% risk participation.

Paul Newsome

That makes sense. I hate to beat the crop a little bit more, but I will anyway. Crop is interesting in that at least amongst the companies I cover, there are different opinions upon when the profits should emerge. Like a Chubb tends to show all their profits in the third quarter in line with revenue, where an American

Financial Group tends to show its profits, essentially a favorable reserve development in the fourth quarter. Any thoughts about sort of how you might end up treating it? I don't know if there's a right answer to it either way.

Chris Uchida

Yes. When we look at it, the hard thing about it in the way Chubb does it or American Financial does it. it is not necessarily going to be a right or wrong. I think when we look at it, we plan on having most of the written premium in the third quarter because of the fact that's when we expect the acreage reports to come in. When we tie the risk and the premium together, we expect probably to be a little bit more like Chubb if we were a full underwriter of this. That's when we think about it.

As Mac mentioned, we will start taking more and so in time, I would expect us to probably look a little bit more like Chubb that where you would see a little bit of that catch up in Q3 from some of the earning of that premium, the writing of that premium and then also the losses to come in. But our goal isn't to have significant swings in our reserve. We want to keep it a little bit smoother. That you'd probably going to be more a little bit more like American Financial. We're not expecting to have a giant catch up in a period for something like that. But we expect our premium to come in more in Q3 because that's when we're going to tie it to the acreage report and having better confidence in what that written premium is.

Paul Newsome

Makes sense to me. I'll let some other folks ask questions but always thankful for the help.

Chris Uchida

Thanks, Paul. Appreciate it.

Operator

Our next question is from Peter Knudsen with Evercore ISI. Please proceed.

Peter Knudsen

Good afternoon. Thanks for taking my questions. My first question, there's been some noise in the industry recently on construction-oriented liability lines. I believe Palomar started writing contractors GL in early 2021, which I know is after some of the more concerning years. But I'm just wondering if you could talk a little bit about that and how you guys are getting comfort growing in that line?

Mac Armstrong

Yes. Sure Peter, thanks for the question. We have started writing contractors general liability really in the early part of 2022. We hired a great leader in Tai Robin towards the tail in that year. It's a nascent effort led by someone that's a 20-year veteran that joined us from American Financial Group, with long-standing distribution relationships, a keen sense of the exposure. As such, we feel very good about what we're writing.

Now mind you, we are conservative in our approach to this. We are riding modest line sizes typically on average $5 million gross that our net participation is between 35% and 40%. We are avoiding heavy auto liability there. As a result, the book has performed very well. That also being said, we are still booking everything at our loss picks. We are building up a nice loss reserve base that we have not touched and don't intend to touch but we do expect it to develop favorably based on the quality of the underwriting and the underwriter leading the team.

Peter Knudsen

Okay, great. Thank you. My second question, it sounds like you guys saw a rate in casualty remain at around 5% this quarter, flat sequentially. I guess I would have expected that to moderate slightly. I'm just wondering if you could talk a little bit more about what you're seeing with regards to casualty rate and maybe what your outlook is for that in ‘24?

Mac Armstrong

Yes. It's a good question. I would say on the casualty side, the 5% was the blend across the multiple lines that we have. It does vary by line of business. Our Real Estate E&O book of business, which is right now heavily concentrated in California because of slower transaction activity, the rates were a little bit down. Excess Liability rates were 5% plus. If you go back to your Contractor's GL, depending on the size of the account, it was 3% to 7% up. Our view is that you are going to see casualty rates flattish to modestly up over the course of this year, at least in the niche segments where we write.

Peter Knudsen

Great. Thank you so much.

Mac Armstrong

Thank you.

Operator

Our next question is from Mark Hughes with Truist Securities. Please proceed.

Mark Hughes

Yes. Thank you. Good morning. Good afternoon. Mac, you had mentioned that the layered and shared pricing might moderate. Is that the rate of gain might decelerate? Or, do you see that flattening out or perhaps going negative?

Mac Armstrong

Yes. Mark, good question. I should clarify, it's the rate of increase. In the fourth quarter, we still saw a Commercial Earthquake across all of our both layered and shared and mid-market blend out of a 26% rate increase. What you are seeing now is risk-adjusted increases coming under a little bit of pressure year-over-year from the amount of increase. We do think that's going to come down. That being said, you will still see risk-adjusted increase that's a function of price as well as enhanced terms and conditions, whether it be deductible or attachment. I don't want to paint a picture of a circumstance where rates are going to start to decline, it's just going to be the level of increase is decelerating.

Mark Hughes

Then, could you just talk about the quake business. You had mentioned some factors driving that earthquake authority, cutting limit and you also mentioned new distribution. How far along are you in those drivers? I think this are the high teens growth is sustainable kind of where are we at in that cycle?

Mac Armstrong

Yes. Good question. I would say that the two that you bring up, new distribution partnerships that's carrier partnerships, let's touch on that first. That has been a tried-and-true distribution strategy of ours, and we are pleased that we have two new carrier partnerships that are going live this quarter, one, focusing on high-value E&S in California, another more of a nationwide partnership. Both of those are early innings, if not the top of the first. We think that there is good potential there, especially the one that's focusing on high-value E&S business in California, it's with an entrenched operator in the space.

As it relates to the CEA, I would say the changes in coverage that they are now offering to their policyholders of renewal didn't really start kicking into gear. The renewals weren't received by those policyholders until late Q4. Whether that be a TIV that's over $1 million now having to move up its deductible from 5% to 10% to over 15% to 20%, or it'd be the reduction of the coverage to your personal property protection moving down to $25,000 from $200,000, that dynamic is just starting to also emerge for us and we think that is going to allow us to continue to take share from policies that our CEA policies are being shopped or are being extensively non-renewed. We think that both of those are good dynamics to sustain that high teens growth in residential quake for the immediate future.

Mark Hughes

Then, Chris, could you give an overall thought about written premium for this year in light of the Crop Insurance, some of these other drivers that you kind of consolidate that into one number or range?

Chris Uchida

Yes. For 2023, obviously, the Crop premium is in our fronting portfolio. I think, overall, for the year, we're very pleased with how it all played out. I think the one thing that we pointed out in the prepared remarks is that we do expect that crop will be broken out in the future. It will still from a fee generation standpoint or an underwriting risk standpoint still look more like a front. But we are making significant investments there. We are very pleased with the opportunities that are there.

We would expect to break that out in the future, probably starting with Q1 2024. We expect to start splitting out Crop into its own line of business. We will participate about 5% on that. As I said earlier in response to one of the other questions from Paul, that yes, there will be some seasonality there. But the overall impact on the earnings for the year will still be small and shouldn't be as material and cause any significant swings from quarter-to-quarter at least for 2024.

Mac Armstrong

But Mark, I think to your question around broadly, we feel great about top line growth for the Company. We have not given guidance on premium growth historically, but I will say that we feel that we can certainly have strong growth that's in excess of 20-plus percent for sure, and think that Crop is going to be a nice contributor. As I mentioned, previously, we thought we saw ourselves to doing high double digits of millions of premiums. Now we're saying that we can do over $100 million. I think that's a good indicator.

But we don't want to be overly prescriptive on premium growth. We do want to be very prescriptive on bottom line net income growth because I think that's what all of our investors and certainly us as investors and shareholders in the business are more focused on. It's the ROE in the bottom-line growth.

Mark Hughes

I appreciate that. Thank you.

Operator

Our next question is from Andrew Andersen with Jefferies. Please proceed.

Andrew Andersen

Hey, good morning. Maybe going back to the NPE to GPE ratio, Chris, you had mentioned you think in '24, it would be a little bit lower. I was hoping you could just unpack this a bit more for me because I suppose

'24, you're bearing the full cost of the '23 XOL program. Perhaps a benefit that we would see at mid-year '24, renewals wouldn't really come up until 2025. Then we would see the ratio increase again? Is that the right way to think about it?

Chris Uchida

No. What I would describe is that, let's say, 2023 had seven months of that full cost. For the first five months of 2023, it was at a lower rate. If you remember, we had about a 30% increase at our 6/1 renewal. That full weight we saw for seven months in '23, you will continue to see that for five months in 2024. As Mac mentioned in our guidance, we have, in our assumption, we are assuming a low to single-digit type increase in our reinsurance. You'll have five months at the current rate, and then, let's call it, less than 5% type increase at 6/1 of 2024. A little bit up, right? When you look at and think about that, 2024 will have a higher overall reinsurance load in 2023 had that had the first five months at a lower reinsurance price.

With all of that when you look at the cycles, we buy our reinsurance or excess of loss reinsurance for growth. At 6/1 of this year, we will have a slight or we expect to have a slight increase, plus we will buy for the growth that we expect throughout 2024 and into 2025. Those factors together kind of create that stair-step function when you look at the net earned premium. The net earned premium in Q4 was 33.9%. It was up from Q3 of 31.6%. I expect Q1 of 2024, that 33.9%, I expect it to move up a little bit. I expect there to be that same little bit of benefit into Q2, but then you'll get one month of that new reinsurance.

Then in Q3, with the full reinsurance with a little bit of price increase, also buying for growth, I expect that ratio to then come back down a little bit. It was kind of that same stair step, a much more muted stair step that you probably saw in 2023, but still that little bit of stair for that function. Let's say, it's 34% plus in Q1, I would expect you to go back down to something that you saw similar to Q3 of 2023. Q3 was 31.6%. If it's somewhere around there, that's probably the right way to think about it because it's going to start smoothing out as things start to mature and the mix starts to mature a little bit in our overall portfolio.

Mac Armstrong

One thing I would add, Chris describes it very well. It does somewhat hinge on XOL. We like to think that we're being conservative and assuming that there is going to be a slight rate increase in XOL that renews at 6/1. What we saw at the start of the year is encouraging, but it's on a very small sample set. When you add up the quota share in the excess of loss that we renewed at 1/1, it constitutes about 10%, maybe a little bit more of the total limit that we buy. It was down. But, I don't want to let 10% inform the totality. If it mirrors what we saw at 1/1, then it's the inverse of what Chris described.

Chris Uchida

Yes. To your point that we'll say we're expecting a little bit of increase, that if it goes the other way, that margin, let's call it, expansion, it starts happening in same thing in Q3, end of Q2 and fully in Q3.

Andrew Andersen

Very helpful. Thank you for the expanded answers there. Maybe going back to cat losses here and recognizing the improvement over the years and the derisking of the book, year-to-date, $3.5 million of cat losses included in the guidance, but you're also kind of talking about a $4 million AAL, which I suppose, isn't exactly the same as like a cat loss ratio, but can you kind of help us square the two in the context of guidance and cat losses here?

Mac Armstrong

Andrew, couple of things. It's a good question. The $3.5 million losses related to floods in California. The atmospheric river, El Nino, what you saw kind of on the front-page news in San Diego and other parts of the state. The $4 million we are referring to is tied to our Continental Hurricane. That is our Continental

Hurricane average annual loss. The flood losses is a separate peril, and it's something that we budget for. When Chris refers to his two to three points in our loss ratio for mini-cat that includes floods. This is just an elevated amount that's cross the threshold that we are disclosing.

Chris Uchida

Yes. Maybe I'll add on to that a little bit for just the overall loss ratio. When you look at it from a guidance standpoint, we said, our loss ratio for the year should be about 21% to 25%, and that includes the $3.5 million of flooding loss that's going to be in the first quarter. So, that first quarter loss ratio will be a little bit higher.

From a quarter standpoint, that's three to four points of loss ratio for the year. It's probably less than 1 point of overall loss ratio. But when we think about our loss ratio in that 21% to 25% loss ratio, target or expectation, we believe and we feel that we do have a cat load in there. That cat load is made up of mini cats, which is going to be severe convective storms, it's going to be normal flooding, it's going to be tropical storms. We believe net of that 21% to 25%, there are two to three points in there that is related to catastrophes. That's what we would say, other companies bucket as catastrophes, we could bucket it as catastrophes, but it's something that's just part of our planned loss ratio. What it does not include is a large major hurricane or earthquake impacting our portfolio.

But we believe similar to prior years, the cat load is in there. We call it mini cats because they're usually smaller for us because of the way we use reinsurance, because of the way we underwrite and do all different sorts of things. But, we believe that we have a two to three point cat load in our guidance for next year.

Andrew Andersen

Very helpful. Thank you.

Operator

Our next question is from Meyer Shields with KBW. Please proceed.

Meyer Shields

Great. Thanks, and good morning. Mac, I don't want to misinterpret it, but it sounded like you were a little cautious on fronting appetite for 2024. I understand that there's the Crop issue because it will be broken out. But, am I misreading what you're thinking about the growth potential there?

Mac Armstrong

Hey, Meyer. Thanks for the question. I think with fronting, we do take this very much more of a rifle shot approach. We want to go deep with existing partners that have high credit quality that we feel terrific about the collateral with that we can orchestrate the reinsurance and we can, frankly, acutely manage from an underwriting and claims handling and compliance standpoint. What that means is we kind of elephant hunt to some degree. We think we can grow fronting this year, but it's not one that's going to grow 63% like it did in '23. It's going to index the growth rate of the overall operation. I think that's what I would say. It's not to say that we don't have a pipeline. It's not to say that we are not in discussions with a range of partners but our bar is high.

I think the other thing, it helps when it's one of five product categories. We can be selective. It's a nice fee generator, but we also have Crop that we think will do over $100 million this year. We also have Quake that we feel great about, high teens, 20% growth. We have a casualty franchise that's really coming into its own. It's a great line of business. It's not the totality of what we do, which allows us to be selective.

Meyer Shields

Okay, that's very helpful. Thanks so much. With regard to the Crop, obviously, as an approved carrier, you have the ability to buy reinsurance from the government reinsurance plan. Does that responsibility rests with Palomar or with the companies that you'll be sharing the premiums with?

Jon Christianson

Hey, Meyer this is Jon Christianson and I can take that one. That is—you're referring to the SRA reinsurance treaty with the FCIC that is a benefit to Palomar. We buy reinsurance through that government program, but then also we have supporting private market reinsurance that completes the totality of that 95% risk transfer that we have in place for our reinsurance. That is the benefit of Palomar with regard to the risk transfer.

Mac Armstrong

I think Meyer, as we've said, 1/1/25, the complexion of our participation will be different, and therefore, the reinsurance structure will be different as well. But we've got time to put that in place and educate you guys on that.

Meyer Shields

Okay, perfect. I just wanted to understand where the dominance lie. Final question, this is just with regard to the guidance. You talked about conservatively anticipating higher property cat rates online, I guess, for reinsurance costs. At June, does the guidance anticipate a meaningful change in the attachment point? I apologize if I missed that before.

Mac Armstrong

No. Good question there. No, it's assuming the same attachment.

Meyer Shields

Okay, thank you so much.

Chris Uchida

I would expand on that just a little bit when you think about our overall book and quota shares and things like that. Our guidance and estimates are basically static from a risk participation status. Obviously, we've mentioned crop that 5% is in there. But when we think about our overall portfolio, in loss ratio, acquisition expenses, all these things and that we kind of guide to in net earned premium, those all assume, let's call it, static participation or underwriting to 2023 or end of 2023.

Meyer Shields

Okay, phenomenal. That's very helpful. Thank you.

Operator

Our final question is from Pablo Singzon with JPMorgan. Please proceed.

Pablo Singzon

Hi, thanks. First question, when thinking about the growth in underwriting income that's implied in your guidance for '24, would it be fair to assume that the improvement there will be driven by net earned premium growth? It seems like you're implying some deterioration in the combined ratio, which is consistent with what you've said in the past, given you're changing the mix? Therefore, would it be fair to assume that the uptick that will be basically driven by net earned premium growth?

Chris Uchida

Yes, no, that's a great question Pablo. We do expect our net earned premium to continue to grow. We've talked about it that reinsurance increase that we saw at 6/1 this year was about 30% or $13 million a quarter. Now, let's say that we've got that fully in our results for Q3 and Q4, you saw that growth show up in the Q3, Q4 results. I would expect those dollars to continue to grow into Q1 and Q2. We're not expecting the same type of rate increase. I would expect the growth in the top line to better translate to the growth in net earned premium throughout the year because of that factor.

Overall, we feel very good about it. We try to project that and share with everyone what we expected to happen during 2023. And we think we did a good job of that, but we are expecting to see net earned premium continue to grow throughout 2024 even with a potential slight increase at 6/1 of this year.

Pablo Singzon

Okay. Then, Chris, I guess as a follow-up. The loss expectation you gave for '24, I think 21% to 25%. If you do the math, that sort of implies a wider range than the $110 million to $115 million you're giving for 2024. I was wondering how you sort of get from that wider loss ratio range to a tighter range on income? Just if you could provide more context on how to bridge those 2 things?

Chris Uchida

Yes. No, it's a wider range. Part of that is strategic just to make sure that we give those ranges out there for people because one thing, while I view that range as a good range for the year, I think some people like to apply that to every single quarter. On a quarterly basis, our loss ratio I would expect to be probably in between those numbers. But for the year, I would expect something closer to the middle of that range, let's say. But because some people interpret that differently, I would like to give a little bit of a wider range there. But that is to your point, even on an after-tax basis, that is probably wider than the $5 million adjusted net income range.

But overall, that's why we do it that way because different people interpreted different ways. If for some reason it was a little higher or a little lower, it doesn't mean it's not going to be close to that for a quarter, it's not going to be close to that to the midpoint when you get there for the full year. That's kind of the philosophy there. But, you're absolutely right. That is from a dollar standpoint, probably a little wider range than what we give with the guidance.

Pablo Singzon

Got it. That makes sense. Last one for me, just a smaller question. Investment income has clearly been at the event for Palomar like for all the other insurers, and just given your run rate in the fourth quarter, right, I think you pointed 7, you can just multiply that you can reach the high 20s in 24 easily. Could you just give a sense of your current book yield and the new money yields you're investing at? Thank you.

Chris Uchida

Yes. For the fourth quarter, our investment yield was about 4.1%. It's been improving throughout the year, which is very similar to other folks. I think the new money yield in the fourth quarter was about 5.9%. Still above that number. We still think there is upside in investment income.

I think, the one thing I'd point out, and so there is a little bit of improvement from our view in our 2024 results. But when we go back to anything like Palomar 2X or adjusted underwriting income and the improvements we're seeing there, that's before investment income. We are an underwriting company first. We want to be valued on the results of our underwriting. We think investment income is something that you kind of put on top of that. We are performing well. We are doing everything we need to do to help keep that performance at a very high level while still being very conservative.

But overall, the growth we're seeing in the bottom line is being delivered by our underwriting results, not a buyer investment income. Yes, I do feel there is upside investment income, but I am happy with the overall organization and the improvements that we've made and the growth in the underwriting income that we're seeing for the organization.

Pablo Singzon

Thank you for your answers.

Mac Armstrong

Thanks Pablo.

Operator

We have reached the end of our question-and-answer session. I would like to turn the conference back over to Mac for closing comments.

Mac Armstrong

Great. Thank you, Operator, and thank you to all who joined us this morning. We appreciate your participation, your questions and your sustained support of Palomar. To conclude, I'd like to just reiterate how pleased I am with not only our fourth quarter but also our full year results. But moreover, how proud I am of the team at Palomar who allowed us to achieve these results. I'm confident that 2024 will generate equally strong performance and results and our guidance indicates as much. I'm equally confident that Palomar's sound and consistent execution will be recognized by the market and hence, will deliver real value to our shareholders.

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

Operator

Thank you. This will conclude today's conference. You may disconnect your lines at this time and thank you for your participation.