Third Quarter 2019 Earnings Call Transcript
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C O R P O R A T E   P A R T I C I P A N T S

Chris Uchida, *Chief Financial Officer*

Mac Armstrong, *Chief Executive Officer and Founder*

C O N F E R E N C E   C A L L   P A R T I C I P A N T S

Mark Hughes, *SunTrust Robinson Humphrey*

David Motemaden, *Evercore ISI*

Meyer Shields, *KBW*

Paul Newsome, *Sandler O'Neill*

Adam Klauber, *William Blair*

P R E S E N T A T I O N

Operator:

Good morning and welcome to the Palomar Holdings, Inc. Third Quarter 2019 Earnings Conference Call. During today's presentation all parties will be in a listen-only mode. Following the presentation, the conference line will be open for questions with instructions to follow at that time. 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, sir.

Chris Uchida:

Thank you, Operator, and good morning, everyone. We appreciate your participation in our third quarter 2019 earnings call. With me here today is Mac Armstrong, our Chief Executive Officer and Founder. 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 November 12, 2019.

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 that will be filed with the Securities and Exchange Commission today, November 5, 2019. 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 everyone. Our third quarter results demonstrate the successful execution of Palomar's strategy and focus on profitable growth. We continue to enhance our product portfolio and expand our geographic footprint in a market where we can deliver differentiated products that serve the needs of our customers and generate attractive underwriting income. This is best evidenced in the third quarter by our year-over-year gross written premium growth of 65.6% and our adjusted net income of $9.6 million and net income of $7.5 million.

Our residential earthquake products, which comprise 53.9% of our gross written premium, generated 66.2% growth compared to the third quarter of last year. As discussed on our second quarter call the Ridgecrest earthquake in Southern California in July, a third quarter event caused a surge of demand for our residential earthquake products, a phenomenon that is common after earthquake events. In the third quarter, California residential earthquake new business policy count was 62.5% higher than the second quarter of 2019. Overall third quarter new residential earthquake policies increased 50.4% sequentially. Third quarter residential earthquake new business policies increased 87.6% over the prior year. This increase in demand is typically most pronounced the first two months after an event, but also historically established a higher new normal level of production as we appoint additional agents.

During the quarter our commercial earthquake business grew 73% year-over-year. Our sustained growth in this business is due to a combination of a stronger rate environment with an average rate increase of 9.2% during the quarter, as well as expanding distribution on the heels of our achievement of an AM Best Financial Size Category 8.

Our wind-exposed business also demonstrated continued strong growth during the quarter led by our commercial all risk division. The all risk division grew its growth written premium 108.6% year-over-year, and also saw existing policies renew with an average rate increase of 8.8%. The composite rate increase on all commercial policies wind and earthquake alike, was 9% during the quarter. Growth in our wind products was also driven by the continued expansion of our distribution network across our wholesale, retail and partner carrier channels, and expansion in new states like North Carolina, where we recently introduced our specialty homeowners product.

As a Company, we remain focused on developing differentiated products to serve acute market needs, and I'm pleased to report that the contribution from our newest product lines continues to grow. Our flood business grew 172% year-over-year, and our recently introduced inland marine and assumed reinsurance products also grew rapidly during the quarter, albeit from a smaller base. Overall non-earthquake products represented 33.4% of our gross written premium during the quarter and grew 62.1% year-over-year. These products are in markets that we believe are multiple times larger than the earthquake market and thus we expect them to represent an increasing percentage of our overall business mix overtime.

Overall, we believe the unique value that we offer to insurers and producers is best demonstrated by our strong premium retention rate. Average monthly premium across all lines of business was 87% during the quarter, compared to 83% during the third quarter of 2018, and was headlined by a commercial, earthquake, and all risk products, which combined for premium retention of 91% in the quarter compared to 75% during the same prior year period.

Generally speaking, the third quarter historically involves the highest frequency of weather events that potentially impact our portfolio due to seasonal hurricane activity in both the Atlantic and Pacific Ocean.

This quarter, the Atlantic was impacted by among other events, Hurricanes Barry and Dorian as well as Tropical Storm Imelda, while the Pacific was impacted by, among other events, Tropical Storm Faxai.

So while we will incur losses, it's important to point out that we focus on short tail specialty property lines of business that we believe are insulated from unpredictable escalation of loss due to factors such as assignment of benefits and social inflation. In spite of the moderate seasonal losses from our wind portfolio, and the Ridgecrest earthquake, we generated strong returns and increasing operating leverage during the quarter. Third quarter, we delivered an adjusted combined ratio of 63.6% and an adjusted ROE of 18.8%. The 18.8% adjusted ROE is particularly noteworthy, when factoring in our conservative net earned premium to surplus ratio of 0.53 times.

We believe these results reflect the platform we have built and will enhance overtime. Additionally, we continue to invest in technology and carrier partner integration, most notably an Application Programming Interface, API that our partner carriers can use to directly access to our system. This past quarter, we launched such an API, with Liberty Mutual, who can now seamlessly offer Palomar earthquake, flood, and Hawaii wind products through its own point of sale system, alongside its auto, homeowners and personal lines policy. We believe examples such as this are emblematic of our focus on utilizing technology to efficiently distribute our products and improve our operation. As we look ahead, we will maintain our focus on technology and product innovation to address dislocation points in the market and create offerings to capitalize on them.

With that, I would like now turn the call over to Chris for a more detailed review of our financial results.

Chris Uchida:

Thank you, Mac. During my portion, when referring to any per share figure I'm referring to the per fully diluted common share, unless otherwise specifically noted. For the third quarter of 2019, our net income was $7.5 million, or $0.31 per share, compared to net income of $1.6 million, or $0.09 per share for the same quarter in 2018. For the third quarter of 2019, our adjusted net income was $9.6 million or $0.40 per share, compared to net income of $2.7 million or $0.16 per share for the same quarter of 2018.

Third quarter 2019 adjusted net income excludes expenses related to our Company's IPO, the September secondary offering, one-time incentive cash bonuses, tax restructuring, stock-based compensation and the tax impact of those expenses. The third quarter of 2018 adjustments excludes the expenses associated with Company's IPO, tax restructuring and retirement of debt.

Gross written premiums for the third quarter were $66.2 million, representing an increase of 65.6% compared to the prior year third quarter. As Mac indicated, this growth was driven by strong premium retention and new business across our product portfolio as well as by improving price environment, specifically for our commercial lines products, which saw an average rate increase of 9% during the quarter.

Ceded written premiums for the third quarter were $28.1 million, representing an increase of 35.1%, compared to the prior year third quarter. Our risk transfer strategy remains a critical component to our business, especially as we demonstrated sustained top line growth. The increase was primarily driven by an increase in an excess of loss, or XOL reinsurance expense, commensurate with our growth and our quota share reinsurance.

We utilize quota share reinsurance to minimize the impact of attritional losses on our portfolio and to generate valuable fee income from ceding attractive risks to the reinsurance partner. This past quarter, we renewed our commercial all risk quota share agreement and completed the first full quarter under our specialty homeowners facility, both of which typify the successful application of our strategy. The increase we see in written premiums was in part due to increased ceding to these quota share reinsurance partners.

That said, while the total dollar amount of ceded premiums increased, ceded written premiums as a percentage of gross written premiums decreased to 42.4% in three months ended September 30, 2019 from 51.9% in the three months ended September 30, 2018, due primarily to the increase in gross written premiums in our residential earthquake and commercial earthquake product, which are not subject to quota share reinsurance agreement.

As we grow our business, we expect to incur additional excess of loss reinsurance expense as we maintain a conservative level of overall coverage. Due to timing of our reinsurance placement, and terms of underlying contracts there may be a lag between earned premium and reinsurance placements or expense, but over time we expect the impact of these to smooth out and the trends to look the same. Our retention remains $5 million per earthquake or wind event and we purchased over $1 billion of total reinsurance coverage for an earthquake event.

Net earned premiums for the third quarter were $27.7 million, an increase of 72.5% compared to the prior year's third quarter, due to the growth and earning of higher gross written premiums offset by the growth in earnings on higher ceded written premiums. Commission and other income was approximately $0.7 million for both the three months ended September 30, 2019 and 2018. Losses and loss adjusted expenses, LAE, incurred in the third quarter over $2.4 million, a decrease of 54.6% compared to the prior year's third quarter. During both periods losses were primarily attributable to our commercial all risk and specialty homeowners lines of business, which both experienced seasonally high exposure to weather related losses during the third quarter.

While we did experience losses during the third quarter, the growth of our overall earned premiums and the reduction in severity of weather-related losses—loss events year-over-year translated into improvement in our loss ratio to 8.8% for the third quarter compared to 33.5% for the prior year third quarter. The third quarter results include $1.8 million of losses and LAE, including incurred but not reported, or IBNR, from the Ridgecrest earthquake and named storms, Barry, Dorian, Faxai and Imelda.

Our expense ratio for the third quarter of 2019 was 64.6% compared to 66.7% at the end of the third quarter 2018. We believe our business will continue to scale over the long term. Our combined ratio for the third quarter was 73.4% and compares to a combined ratio of 100.2% for the prior year’s third quarter. The adjusted combined ratio, which we believe is a better assessment of our efforts during the third quarter was 63.6%, a decrease compared to 94% in the prior year's third quarter.

Net investment income for the third quarter was $1.7 million, an increase in 99.9% due to the prior year's third quarter. The increase was largely due to increased interest income generated by the proceeds from our IPO in April. We maintain a conservative investment strategy as our funds are generally invested in high quality securities, including government agency securities, asset mortgage backed securities, and municipal and corporate bonds with the average credit quality of AA. The weighted average duration of our fixed maturity investment portfolio, including cash equivalent was 3.72 years at quarter end.

Cash and invested assets totaled $263.2 million at quarter end as compared to $157.3 million at December 31, 2018. For the third quarter, we recognize realized and unrealized gains on investments in the consolidated statement of income of $361,000 compared to $1.3 million in the prior year's third quarter. Our effective tax rate for three months ended September 30, 2019 was 21.1% compared to 0.2% for the 2018 comparable quarter. The increase in our effective tax rate is due to our restructuring in the early part of this year. All of our operations are now taxable in the U.S., whereas in prior periods our Bermuda operations were not subject to U.S. tax.

Excluding any unforeseen event, we anticipate that our tax rate will settle around 21% mark for the remainder of the 2019 year. Our stockholders' equity was $208.5 million at September 30, 2019 compared to $96.3 million at December 31, 2018. This increase was primarily due to the addition of IPO net proceeds, which will put downward pressure on our return on equity in the short term, while providing capacity for continued growth over the long term. For the third quarter of 2019, annualized return on equity was 14.6%

compared to 6.9% during the third quarter in 2018. Similarly, our annualized adjusted return on equity during the third quarter was 18.8% compared to 12% during the third quarter of 2018.

I would now like to turn the call back to Mac for concluding comments.

Mac Armstrong:

Thank you, Chris. To conclude, we're pleased with the results of the third quarter, especially the strong top line performance of all of our products in a sustained increasing price environment for commercial specialty property lines. Despite the losses associated with the heightened weather activity in the third quarter, we were able to still generate a compelling adjusted ROE of 18.8%. Lastly, we'd like to thank all the investors, new and existing, that participated in our successful secondary offering in September. We appreciate your support and endorsement and we'll continue to execute our strategic plan on your behalf.

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

Operator:

Thank you. We will now be conducting a question-and answer-session. If you would like to ask a question, you may 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 question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

Our first question comes from the line of Mark Hughes with SunTrust. Please proceed with your question.

Mark Hughes:

Thank you. Did I hear you properly; the losses from the Ridgecrest and main storms was $1.8 million?

Chris Uchida:

That was correct Mark. You did hear us, was $1.8 million including IBNR from those events for the quarter.

Mark Hughes:

Then, you talked about the commercial retention being 91% this quarter versus 75% a year ago. Did I hear that properly, and that's a pretty meaningful change. Any detail you can give on that?

Mac Armstrong:

Sure, Mark, this is Mac. You did hear correctly, it's 91%. Again that is premium retention. So that reflects the improving rate environment that we're in right now. As I said on the call, the composite rate increase across all commercial lines was 9%. So the combination of better policy retention, which is driven by the overall competitive environment in the market, in combination with the improving rate environment has allowed us to materially increase our retention.

Mark Hughes:

The underwriting and other expenses were very good in the quarter. Were there any one-timers, anything else there?

Chris Uchida:

One-time like I guess, you're talking benefits in the quarter that drove that, yes, no, there was no one-time benefit. Obviously, any adjustments we have listed in the items that we take out of that to kind of get a more a base line. Quarterly expense ratio, our quarterly expense dollar amount, so I think you've already removed those. All one-time expense they should be removed and that's a good baseline for the quarter. I'd say probably a better Q3 and Q4 of this year, there can be a better reflection of our current run rate based on the size and operations that we have right now.

Mac Armstrong:

Just to echo what Chris is saying, I think we try to say that, by the time we got to the third and certainly into the fourth quarter we should be at pretty decent steady state barring any major investments in new lines of business and things of that sort. So, we're hoping to really start to generate decent operating leverage.

Mark Hughes:

Then the ceded written premium relative to gross written, 42% in the last couple of quarters, is that a reasonable way to look at it? Does that ratio hold steady or how much of that's influenced by seasonality, perhaps on the written premium?

Chris Uchida:

Yes, so I definitely say that there is a little bit of seasonality in the written premium, not necessarily, I'll call it by season, but definitely by events that have been impacting outlook this quarter and historically. So we look at Q3 the Ridgecrest event obviously happened earlier in the quarter. That helped with the overall growth for the quarter. So when you think about the gross to net premium ratio, there is a little bit of seasonality and I'll call it noise in that ratio.

That can be from two things. It can be from significant portion of growth in a quarter or could also be from assumed deals. If you think back to the first quarter of this year, where we had an assumed deal come on the books, was about $6 million of additional written premium at that point in time. That can make the written premium look a little bit lumpier compared to the ceding out the excess of loss or on the quota share size.

So a couple things that we'd like to note and make sure that you guys are aware of. When we think about it, we think that the net to gross earned ceded premium and earned premium is a better way to look at our business because that has been smoothed out for any lumpiness for seasonality or for assumed deals that may come into our portfolio. That number right now you'll see it in the queue is hovering just below 50%. We think that is probably a better indication of what the long term run rate will be, or at least a current run rate base on our mix of business.

Mac Armstrong:

I do think, just to echo what Chris is saying there, I do think what's looking—what's driving it in the third quarter and the most pronounced fashion is just the composition of the mix of business. Earthquake actually overindexed the growth rate for the quarter, and earthquakes does not have a quota share component to it. It's all excess of loss, and so therefore, there's a lower ceded premium amount. So as earthquake continues—or earthquake continues to grow at this rate, that could lower that ceded premium conversion if you would. So it's really—it is a function of mix, and in this quarter we benefited from a very strong growth in the earthquake business.

Mark Hughes:

Thank you.

Operator:

Our next question comes from the line of David Motemaden with Evercore. Please proceed with your question.

David Motemaden:

Hi, thanks. Good morning. Just have a question—just wanted to talk a bit about the continued penetration in some of the new distribution channels in the commercial business. I was wondering if you could just break down maybe how much of the growth that we saw within commercial quake and commercial all risk is being driven by some of these new relationships versus existing relationships and how you expect that to proceed as we head into 2020?

Mac Armstrong:

Hey Dave, it's Mac. I don't think we can breakdown how much was from existing distribution partners, how much was from new distribution partners, because a lot of times, our commercial business we generate through wholesale distribution. So we would need to understand who the underlying potential retail originator is. But so we can't tell you if something came from for instance, AmWINS, if it came from a retailer that we were not cleared by the Security Committee, versus one that we previously were. But what I can say is they grew 73% in the quarter. It was a combination of us writing new distribution sources through all different channels, whether it is retail or other carrier partners.

So the commercial earthquake and commercial all risk is just growing through a combination of broadening distribution and opening up new distribution sources, having a bigger appetite on the heels of a larger balance sheet, and not having access to new channels that we previously couldn't access because of our financial size category.

David Motemaden:

Got it. Thanks. Would you—just to follow up on that, would you say we're still pretty early days in terms of those—access to those new channels? Like do we have any more additional ones that could be brought online within the next few quarters?

Mac Armstrong:

Yes, I would say that we are still very, very focused on broadening our distribution for all our commercial products, but commercial earthquake and all risk specifically. There's a lot of runway for growth there. So I think it's early stages. Yes.

David Motemaden:

Okay, great, and then just a question on the reinsurance purchasing and sort of buying additional limit for earthquake just given the growth that we've seen. Just wanted to get a sense for where are we and just how you're thinking about pricing for reinsurance at the—at 1/1 renewals?

Mac Armstrong:

Yes, it's a good question. So what I would say is, we say it every quarter. One of our guiding principles is staying, keeping our reinsurance limit, well above that 250 year PML, and maintain an adequate cushion above that. Because of the growth that we saw in the third quarter in particular in residential earthquake we will be buying more limit in short order to again maintain that buffer.

Our expectation is that we'll be in the market in the fourth quarter and then at 1/1, we have $305 million of limit, that's up for renewal. That is all loss free business. Our expectation is the market's going to look similar to 6/1. We think loss free business will be flat to maybe modestly up like it was 6/1. We think our portfolio remains very distinct in the sense that we are a great diversifier, we are an excess of loss provider that's dominated by earthquake and the secondary peril is Hawaiian hurricanes.

So we are very appealing not only to the primary interest but even those in the retro market that are potentially pulling back their capacity. They like the fact that we are a way for them to access earthquake.

David Motemaden:

Great, thanks for the answers.

Operator:

Our next question comes from the line of Meyer Shields with KBW. Please proceed with your question.

Meyer Shields:

Great, thanks so much. Two really quick modeling questions. First; was any prior period reserve development in the quarter?

Chris Uchida:

Yes, so we had favorable development in the quarter of about $200,000 from the prior year.

Meyer Shields:

Okay, fantastic. Going forward, should we be modeling non-cash compensation around the levels we've seen in the second and third quarter? Is that a recurring expense that will then ease after (phon) that?

Chris Uchida:

You're talking about the stock comp, about $400,000 for the quarter, yes, I think that is—that's the right current level. I think over time, obviously as we add resources to support the technology and the growth of the Company we will probably have additional options granted to those folks. So the comp will probably tick up in relationship to the overall addition of those folks. But I wouldn't expect a material movement overtime. I think that's a good—

This is the first full quarter for all the stock compensations. I think that is a good marker for the near term.

Meyer Shields:

Okay, yes. I just wanted to make sure that's included. Then final question, when we look at other underwriting expenses, I appreciate your comments on the run rate going forward. Do you have any expectations or estimate about what the annual inflation rate is associated with that group of expenses?

Chris Uchida:

We haven't provided that guidance, what we expect from that. I will say that, as we look at the business, we do think that there's going to be additional scale that occurs overtime. With that, we're still going to continue in important parts of our business to make sure that the growth and the efficiency of the business continues, and so that's going to be technology, there's going to be some underwriting in relation to the commercial line and then also just some public company expenses that are required as we continue to grow.

But I wouldn’t expect that line to grow at a rate similar to the top line growth. So I do expect the margin and the scale to continue over the long term. But we haven’t provided any specific guidance on say go up 5% or 10% in the next quarter or year.

Mac Armstrong:

Meyer, this is Mac, and this might be a bit of overkill, but I think it’s worth reiterating just that the composition of the book-of-business and the fact that it’s roughly 65% to 70% residential and personal lines business, really does allow us to scale. So if you think about it just on the heels of the third quarter with what we saw on residential earthquake, we not only saw the growth in 65% in that line of business, we also saw the number of agents that we appointed increase by 12%.

For us to do that, we don’t need to add volumes. We can appoint them on a one-time basis and then they’re transacting within the system. So we can scale very naturally. So I do think it’s worth pointing that out that. As Chris says we will invest but it’s going to be selective, and it’s certainly nowhere near a circumstance where you have an investment that is step function to keep up with the growth in the top line.

Meyer Shields:

Yes, completely understood. Thank you so much. It’s very helpful.

Operator:

Our next question comes from the line of Paul Newsome with Sandler O’Neill. Please proceed with your question.

Paul Newsome:

Good morning. Thanks for the call. Any update on product roll out and how that may change the mix prospectively?

Mac Armstrong:

Paul, yes, what I would say is we’re continuing to introduce new lines of business. We were pleased in third quarter with the traction that we got in our recently launched, in the marine division as well as our reinsurance divisions. The inland marine is right now, it’s really focusing on builder’s risk and we’ll start to move into other lines like contractors' equipment and installations. But it’s still early stages in a sense that what we’re trying to get is—get our rates approved, get approved producers appointed across basically a national geographical footprint. Right now we're writing business in five states, have a target of 26.

So long way to go. I think what you will see though is while the third quarter, we said that we want to get to a 50-50 mix between other perils and earthquakes, the third quarter, ultimately, that didn't—we didn't reduce earthquake as a percentage of the overall book. That's actually a good thing because of the growth. But we are trying to continue to build around the earthquake and with the particular emphasis on niche commercial lines. So I think you'll see commercial business increase as a percentage. I think you'll see commercial products outside of earthquake, increase as a percentage as well.

Paul Newsome:

How should we think about the moves to the loss ratio, the expense ratio with that mix change?

Mac Armstrong:

Yes, well it's a good question, and Chris has talked about in the past that, you would likely see the loss ratio tick up some. But at the end of the day right now, 72% of our business has zero—if things go as we hope, and we expect to have 0% loss ratio at the end of the quarter. That's earthquake, both commercial and residential and Hawaiian hurricane.

So as we grow, even if it grows at 100% year-over-year like in the circumstance of builders risk or flood or even all risk, it's not going to move it too materially, it's going to be pretty subtle in how it goes up.

Chris Uchida:

Just to add to that a little more, I guess, context around the loss ratio and the acquisition expense. Those lines that we're expanding in to, obviously, do have an attritional loss component to it. So that's usually the lines that we're going to look at using some sort of quota share to help minimize the volatility those losses will have on the book. So that's going to help keep the loss ratio lower. We do expect obviously that it will tick up just naturally as it becomes a larger component of the book.

The other nice thing about the quota shares though is it also helps with the acquisition expense. Those lines naturally have a lower acquisition expense than some of our other lines of business. But additionally, the acquisition expense will be offset by ceding commission anytime we have a quota share in place. So that will also help to, minimize or lower the acquisition expenses as those lines of business expand.

Paul Newsome:

Thank you very much.

Mac Armstrong:

Thanks, Paul.

Operator:

As a reminder it is star, one to ask a question. Our next question comes from the line of Adam Klauber with William Blair. Please proceed with your question.

Adam Klauber:

Thanks. Good morning, guys. Are you still seeing the demand surge carrying to this quarter in California earthquake that you saw last quarter?

Chris Uchida:

Hey, Adam. What I would say is what we have been looking at is, demand is persisting. It does dissipate, as we talked about, it does come down immediately following the event. But in the metrics that we try to track that we think, gives us an indication of this new normal of new business is the number of agents that we appoint, not just the number of policies that that we write in a quarter.

So as I just said, we did increase our agent footprint by 12% on a sequential basis from Q2 to Q3 on the heels of the Ridgecrest earthquake. We think that's a great indicator because what that means is, those agents can now offer earthquake alongside all of their homeowners renewals, when they come up. So it opens up the market. It kind of hopefully level sets the new business production for a period of time. Then when you combine that with a product that got north of 90% premium retention, it offers a nice bit of visibility. So we're optimistic that we can see this persist for the immediate future.

Adam Klauber:

Great, and just following up on that. I'm not sure if you can answer this, but the one thing that you sort of have three different types of distribution. You got retail agencies, you got MGA wholesalers, and then you've got partnerships with insurance companies. Can you rank them, even it's just on a rough basis, which ones actually are producing the fastest level of growth?

Mac Armstrong:

Right now, I would say the fastest level of growth right now is probably going to be the MGA and wholesale, because if you look at just—what, how is certainly in aggregate because if you look at the third quarter specifically, there was very strong growth in commercial all risk and commercial earthquake, that's wholesale and/or MGA driven. Residential quake is kind of a combination of all the above. So I would say MGA and wholesale is probably the fastest grower. But in terms of potential—it's going to be a combination probably wholesale and retail, that drives the future growth.

Adam Klauber:

Okay. Okay. That's helpful.

Mac Armstrong:

The carrier partners are harder, they're a great channel for us. They're just harder to predict. They're lumpier. We saw good traction from Liberty Mutual and AllState, but they're still early in the third quarter. Those were both newly launched initiatives, great promise, but it's from a sitting start.

Adam Klauber:

Great, and then as we look at the commercial all risk, and probably commercial earthquake, are you benefiting and it may be early, but are you benefiting to some extent from unbundling of the major carriers in other words, in the past maybe an AIG or Zurich would throw in a flood of throw in the earthquake along with their property coverage, but today versus a year ago, they're probably less likely to just give away those coverages. Are you seeing an impact from that?

Mac Armstrong:

Yes, and that's a great observation. We are. But I would say we're probably not seeing it in as pronounced fashion as others. You have to remember, we're an A minus, 8 Company. Those circumstances that you just outlined where large national carrier was bundling in the flood or throwing in the quake with an all risk schedule. That's probably a national schedule, that's a $500 million of TIV, or a couple hundred million dollars of TIV. We track it more in the sub-$50 million.

Now we have a smattering of risk where we're going to be a $10 million part of $100 million or $10 million part of $200 million, but more often than not, we're going to be kind of a mid-market account. But that is a dynamic that is persisting in the market that's allowing us to see our rates go up by 9% in the quarter and see them accelerate from up 5% in the second quarter, to up 9% in the third and frankly something that is dynamic that we don't think is going to change in the immediate future.

Adam Klauber:

Okay. Thank you, that's very helpful.

Operator:

Our next question is a follow-up question from the line of Mark Hughes with SunTrust. Please proceed with your question.

Mark Hughes:

Thanks. Could you mention the average pricing on residential quake?

Mac Armstrong:

Hey, Mark, it's Mac. Are you referring to what's the average premium point? Average premium for an account or what the average rate increase is? Or what the—

Mark Hughes:

I'm sorry, it's the average rate increase is my question.

Mac Armstrong:

So we have this inflation guard, which basically locks in an increase of approximately 5% on an annual basis. So that's a good rule of thumb. That's going to renew up 5% year-over-year. Now it doesn't mean — but that's also tied to the exposure increasing somewhat as well, but it's an annual 5% premium renewal increase.

Mark Hughes:
Thank you.

Operator:

There are no further questions in the queue. I'd like to hand the call back to Mac Armstrong for closing remarks.

Mac Armstrong:

Thank you very much Operator. So that does conclude Palomar's third quarter earnings call. We thank you for your time, your questions and moreover your support. We remain focused on the execution of our strategic plan and we look forward to speaking with you after the fourth quarter. All the best. Thanks very much.

Operator:

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.