Second Quarter 2020 Earnings Call Transcript August 5, 2020

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PRESENTATION

Operator

Good morning, and welcome to Palomar Holdings, Inc. Second Quarter 2020 Earnings Conference Call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference line will be opened for questions, with instructions to follow at that time. As a reminder, this conference 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 Second Quarter 2020 Earnings Call. With me here today is Mac Armstrong, our Chairman, 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 August 12, 2020.

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, including, but not limited to, risks and uncertainties related to the COVID-19 pandemic. 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, August 5, 2020. 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, everyone.

Before I discuss our second quarter performance, on behalf of Palomar, I'd like to express my hope that all of those on this call are safe and healthy. We continue to find ourselves in uncharted waters as we navigate the COVID-19 pandemic and the ongoing civil unrest in our country.

Regarding the continuing pandemic, our number one priority remains the health and safety of our team. Our employee base remains resilient as the COVID-19 pandemic continues to impact our ability to return to the office safely. To comply with state and local mandates and support our team, we will maintain our predominantly virtual and remote workforce environment through the remainder of this year. I want to thank our entire team who continues to work diligently during these extraordinary circumstances and maintain business as usual standards for our insureds and partners.

Operationally, we remain fairly insulated from the COVID-19 pandemic, and continue to believe the pandemic will not have a material impact on our profitability or growth. Our specialty property focus precludes us from the loss in areas like workers compensation, event cancellation, and trade credit. Additionally, our exposure to business interruption is, in our view, negligible, as our commercial property policies require loss from physical damage to the property from the named peril and feature virus exclusions.

The three months ended June 30, 2020 represented another strong quarter of performance for Palomar. Our second quarter results are highlighted by several notable achievements. First, we formed and launched Palomar Excess and Surplus Insurance Company, or PESIC, our newly-established surplus lines insurance company subsidiary. Second, we continued to thoughtfully manage our risk exposure and risk transfer strategy, as evident in our successful June 1 reinsurance renewals. Third, we further enhanced our distribution channels with the launch of two residential earthquake partnerships and admission into three new states, expanding the geographic footprint of Palomar Specialty, our admitted carrier, to 30 total states. Fourth, based on 2019 industry data recently published by SNL, as of year-end we became the third largest earthquake insurer in California and the fifth largest earthquake insurer in the country. Lastly, to support our growth, we added 18 new teammates across the Organization. As well, we added Daryl Bradley as a new director to our Board. Daryl brings nearly four decades of industry experience, and I personally look forward to working with him. Separately, I would like to thank Ryan Clark, our former Chairman of the Board, for his service and Genstar Capital's commitment to Palomar since inception. Genstar's guidance, insurance expertise, and proven track-record of investment success have been invaluable and greatly appreciated.

Looking at PESIC in more detail, the Arizona-domiciled Company is licensed to transact across all classes of insurance, including our current specialty property line, and is a natural and exciting progression in our continued evolution. The formation of PESIC enables us to further leverage our analytically-driven and disciplined underwriting framework, write business on a national scale, and insure certain risks that our admitted products currently cannot satisfy. As PESIC was just recently launched, we will continue to make the necessary investments in areas like technology, analytics, and revenue-generating underwriting talent throughout the remainder of the year. We have capitalized the Company with over $100 million of surplus, utilizing the proceeds from an offering of our common shares in June. PESIC recently received an A- FSR from AM Best and a group financial size category of FSC IX. With the rating in hand, we expect to begin writing business in the third quarter.

Strategically managing our risk exposure remains a major pillar of our core business. On June 1, we successfully renewed and expanded our excess of loss reinsurance program, which now exhausts at $1.4 billion for earthquake events and $600 million for hurricane events. The program provides adequate headroom to support our growth initiatives, including PESIC. This incremental limit continues to permit the maintenance of reinsurance protection beyond the 1 and 250-year peak zone probable maximum loss, and also to significantly exceed simulated losses from any recorded historical events. We increased our catastrophe event retention from $5 million to $10 million for all perils, maintaining our retention inside one quarter of earnings and less than 5% of surplus.

The June 1 placement marks the firmest reinsurance market Palomar has faced since inception, and we are very pleased to have earned the requisite capacity to sustain our growth and margin profile. While the costs are higher with a risk-adjusted rate increase of approximately 11%, they are manageable when compared to the rate increases we are seeing on a primary basis. We believe the rising cost of reinsurance in the property market broadly should create several opportunities within our portfolio.

From a distribution standpoint, carrier partnerships continue to be a differentiated channel for our business, and in the second quarter we entered into two new residential earthquake partnerships, while making progress on several others. As I have mentioned before, these relationships take time to develop, and we are proud to provide valuable solutions to other insurance companies.

With respect to our traditional retail and wholesale footprint, total active producers increased 6.5% sequentially in the second quarter. Additionally, we continued to execute our geographic expansion initiatives by growing the footprint of our admitted carrier to 30 states across the nation.

I would briefly like to touch on our position as the third largest earthquake insurer in the state of California and the fifth largest in the country. While this validates our commitment to the earthquake markets in its entirety, it also demonstrates our ability to increase penetration rates in the earthquake insurance market, which has historically been one of the most underserved property insurance markets in the U.S. We remain dedicated to providing product offerings that are not only differentiated from alternatives in the market, but also motivate the purchase of earthquake insurance by consumers who had previously not identified products that fit their needs. We believe ample room for growth in our earthquake products remain, and that PESIC will further drive growth, in particular in our Commercial Earthquake segment.

Shifting to our second quarter financial results, we are pleased to report strong gross written premium growth of 43.6% year-over-year. We saw meaningful growth across all product lines as we further enhanced our position as a leader in the specialty property market and increased our market share in newer lines of business like Builder's Risk within our Inland Marine department. Major second quarter growth drivers were our Commercial All Risk and Commercial Earthquake lines, which increased gross written premiums by 103.6% and 46.2% respectively, from the prior-year period. Commercial lines growth was a function of new distribution sources, expanded geographic footprint, incremental product traction, and most importantly, sustained pricing increases. Our second quarter commercial policy average rate increase on renewal was 14.2% versus 12.1% in the first quarter, a 17.4% sequential increase. As I mentioned earlier, these rate increases more than absorbed the increase in our reinsurance program.

During the quarter, our book experienced premium retention rates of 88%, consistent with the 90% achieved during the first quarter. Premium retention for our Residential Earthquake, Hawaii Hurricane, and All Risk products were all in excess of 92%. We continue to believe these results are a testament to the unique value that our products offer insureds and distribution partners.

Loss and loss adjustment expense, which Chris will detail shortly, totaled $4 million during the quarter, generating a 10.1% loss ratio. Our strong written premium and earned premium growth and modest loss ratio resulted in adjusted combined ratio of 65.1% and an adjusted ROE of 16.4% during the quarter. This ROE was achieved despite a conservative net written premium to ending stockholders' equity ratio of 0.57 times and the dilution from the $90.2 million capital infusion we received on June 26. Excluding those proceeds, our adjusted ROE would have been 19.1%.

We continue to stay focused on growing our business as we scale our capabilities and broaden our footprint. Our team remains committed to the long-term opportunity for Palomar and believe our results reflect the continued execution of our strategy. Moreover, our team remains focused on delivering for all stakeholders of Palomar.

Before I hand the call over to Chris, I want to take a moment to acknowledge today's current social environment, as it has become increasingly apparent that our country has longstanding systemic issues with racial and economic inequality that must be recognized and addressed. Our thoughts are with those that have been impacted by the racial injustice today and historically.

Palomar is a Company built on values, and those values compel us to help build a more just and fair society across all cities and towns throughout our nation. We stand in solidarity with the African-American community, all of our teammates, insureds, brokers, and partners to fight racism and injustice. We staunchly believe that black lives matter. As such, we recently donated $100,000 to groups focused on fighting civil injustice, racism, and helping build—and helping rebuild the communities most impacted by recent events, including those in the—from the pandemic. We hope that with our help, and the support of companies across the nation, we will work together and move towards a future of equality and justice.

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 am referring to per diluted common share as calculated using the treasury stock method.

For the second quarter of 2020, our net income was $12 million, or $0.48 per share, compared to net income of $6.7 million, or $0.30 per share for the same quarter in 2019. For the second quarter of 2020, our adjusted net income was $13 million, or $0.52 per share, compared to adjusted net income of $8 million, or $0.36 per share for the same quarter of 2019. The second quarter 2020 and 2019 adjusted net income excludes expenses related to our stock offerings, tax restructuring and stock-based compensation, debt extinguishment costs, and catastrophe bond related costs, including the tax impact of those expenses.

During 2020, our shares outstanding have increased by approximately 1.9 million shares, or 8%, primarily due to stock offerings.

Gross written premiums for the second quarter were $83.8 million, representing an increase of 43.6% compared to the prior-year's second quarter. We continue to see robust new business, rate increases, and strong premium retention with contributions across our products.

Ceded written premiums for the second quarter were $30.2 million, representing an increase of 22.6% compared to the prior-year's second quarter. Our risk transfer strategy remains a critical component to our business, especially as we demonstrate sustained and top-line growth. The increase was primarily due to an increase in reinsurance expense commensurate with our growth.

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 the timing of our reinsurance placements and the terms of the underlying contracts, there may be a lag between earned premium and a reinsurance placement or expense, but over time we expect the impacts to smooth out and their trends to look the same. As of June 1 of this year, we retain $10 million per earthquake or wind event, and we purchase $1.4 billion of total reinsurance coverage for earthquake events.

Net earned premiums for the second quarter were $39.3 million, an increase of 69.4% compared to the prior-year's second quarter. Our results improved primarily due to the earning of increased gross written premiums, offset by the earning of ceded written premiums under reinsurance agreements. For the second quarter of 2020, net earned premiums as a percentage of gross earned premiums were 55.5% compared to 49.2% in the second quarter of 2019.

As previously discussed, we believe the ratio of net earned premiums to gross earned premiums is a better metric for assessing our business versus the ratio of net written premiums to gross written premiums. In the past we have also indicated that, with our current mix of business, we expect that ratio to be around 50% on an annual basis; lower at the beginning of a new excess of loss treaty and higher at the end with our expected growth in earned premium.

As of June 1 of this year, we have altered the structure of our Specialty Homeowners Facility, or SHF. While the overall changes to the structure of the SHF will not have a material impact on our net income or our risk transfer strategy, the changes will impact our net earned premiums to gross earned premiums ratio and our combined ratio. With the changes to our SHF structure, we expect our net earned premiums to gross earned premiums ratio to be about 53% to 54% on an annual basis; still lower at the beginning of a new excess of loss treaty and higher at the end with our expected growth in earned premiums. Additionally, we expect our combined ratio and our adjusted combined ratio, more specifically the expense ratio component, to increase about 2 points to 2.5 points. Again, we do not expect these changes to have a material impact on our net income.

Commission and other income was $937,000 for the three months ended June 30, 2020 compared to $721,000 for the same period in 2019. The increase was primarily due to an increase in the policy-related fees associated with an increased volume of premiums written.

Losses and loss adjustment expenses, or LAE, incurred in the second quarter were $4 million compared to $643,000 in the prior-year's second quarter. Our losses during the quarter were primarily made up of attritional losses in our Commercial All Risk and Specialty Homeowner's lines. In addition, we booked approximately $93,000 of adverse prior-year development. Our loss ratio for the quarter was 10.1% compared to 2.8% for the prior-year's second quarter. Our losses and loss ratio increased in the second quarter of 2020 primarily due to increased attritional losses in our Commercial All Risk and Specialty Homeowners lines from heightened weather activity and PCS events, including Tropical Storm Cristobal. Part of this increase was driven by favorable loss development in our second quarter of 2019 results, and that the majority of our Specialty Homeowners business used a full fronting arrangement through June 1 of 2019.

Our expense ratio for the second quarter of 2020 was 58.3% compared to 66.4% in the same quarter of 2019. The combined ratio for the second quarter was 68.4% compared to a combined ratio of 69.2% for the prior-year's second quarter. Our adjusted combined ratio was 65.1% during the second quarter compared to 63.8% in the prior-year's second quarter. We believe our business will continue to scale over the long term, even with the aforementioned investments associated with the launch of PESIC.

Net investment income for the second quarter was $2.1 million, an increase of 42.5% compared to the prior-year's second quarter. The increase was largely due to a higher average balance of investments during the three months ended June 30, 2020, due primarily to proceeds from our primary stock offerings during the period, as well as cash generated from operations. Funds are generally invested conservatively in high-quality securities, including government agency, asset, and mortgage-backed securities, municipal and corporate bonds with an average credit quality of A1/A+.

Our fixed income investment portfolio book yield during the second quarter was 2.83% compared to 3.00% for the second quarter of 2019. The weighted average duration of our fixed-maturity investment portfolio, including cash equivalents, was four years at quarter end. Cash and invested assets totaled $430.4 million at quarter end compared to $245.3 million at June 30, 2019. For the second quarter, we recognized realized and unrealized gains on investments in the Consolidated Statement of Income of $778,000 compared to $493,000 in the prior-year's second quarter.

Our effective tax rate for the second quarter of 2020 was 21.5% compared to 21.1% for the second quarter of 2019. Excluding any unforeseen events, we anticipate that our tax rate will settle around the 21% mark for the 2020 year.

Our stockholders' equity was $375.2 million at June 30, 2020 compared to $199.6 million at June 30, 2019. For the second quarter of 2020, annualized return on equity was 15.1% compared to 17.8% during the second quarter of 2019. Similarly, our annualized adjusted return on equity during the second quarter was 16.4% compared to 21.2% during the second quarter of 2019. The change in annualized return on equity and annualized and adjusted return on equity reflects a significant increase in the Company's stockholders' equity, primarily due to $213.1 million in capital raised across multiple stock offerings between April 2019 and the end of the second quarter of 2020.

Looking out to the remainder of the year, while investing in our new E&S Company, we believe we are well-positioned to achieve our previously-stated expectations of delivering adjusted net income between $50.5 million to $53 million for 2020, which equates to a growth rate of 33% to 40% year-over-year. It is worth emphasizing that these results assume there are no major losses from a natural catastrophe and/or those arising from business interruption legislation.

As of June 30, 2020, we had 26,222,551 diluted shares outstanding as calculated using the treasury stock method. We do not anticipate a material increase to this number during the year ahead.

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

Operator

At this time, we will 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 question 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, as we poll for questions.

Our first question comes from the line of Matt Carletti with JMP Securites. Please proceed with your question.

Matthew Carletti

Hey, thanks. Good morning.

Mac, you mentioned—you talked a little bit about the Palomar E&S opportunity, and touched on Commercial Quake a little bit. I was hoping you might be able to dig a little deeper and give just a little more color on kind of the opportunities in the market that you're seeing maybe that, without the E&S

Company, you haven't been able to take advantage of, but that with it, you will be able to, just so we get a better feel for the opportunity.

Mac Armstrong

Hey, Matt. Yes, thanks. That's a great question.

The E&S Company is something that we are very excited about, and it's something that we have been contemplating for several years, but fortunately, in 2020, market conditions, as well as our capital base, put us in this position to put—bring it to fruition. Ultimately, at least initially, we think it's going to be very focused on specialty property markets, because there are segments of our core franchise that we really haven't been able to access effectively as an admitted insurer, and I think that's most pronounced in Commercial Earthquake, in Commercial All Risk, and our Builder's Risk departments where we have had more of a small to mid-sized commercial focus, and we have not been able to participate in the layered and shared markets.

Having an E&S platform, which is where the layered and shared market is, and this is going to be—you're talking about total insured values that are in excess of $100 million, and typically, we'll have several carriers participating in a stack of limit, we have not been able to access that, and so now, with the E&S Company, we should be able to do so. It won't change the amount of limit that we put out on a given risk, but where we attach and where we participate, that is one area that we see considerable opportunity. I would also add that that's been an area where there's been considerable dislocation and pricing disruption over the last 18—well, really, last 12 months, and we think it's going to be sustained through the rest of this year into 2021, so that's one segment where we see kind of our core franchise really being extended, and frankly, expanding our TAM.

Additionally, we're admitted in 30 states, so there's certain geographies that we have not been able to access, or just stuff that we couldn't do a good job being competitive with an admitted platform, so we think the E&S Company will allow us to take existing products into new geographies where we just couldn't get our admitted products approved in certain cases, or just they weren't going to be competitive, so I think it opens up all 50 states for us, again, in state segments like flood, in segments like Inland Marine and Builder's Risk, so those are a couple of examples, and I think what you'll see, as we launch in August—so we said August 1 was kind of our target date—as we launch this month, you'll see initially a really—a concerted effort to extend our franchise in specialty property.

Matthew Carletti

Great. That's really helpful.

The only other question I have is—centers around the reinsurance program, and kind of similar, hoping you can give us a little bit more color there. I know as we compare it against kind of the other mid-year movements, and then a lot of those books are very different than Palomar's, 11% is a pretty good outcome. Could you just tell us a little bit about kind of what you saw, what kind of attracted re-insureds to the program? I know in the past, quake has been a very diversifying risk, and that's been something that they've wanted as opposed to the more wind portfolios, but if there's any—anything that stuck out would be helpful.

Mac Armstrong

Yes, so I think first and foremost, our team, led by Heath Fisher and Jon Knutzen, did an exceptional job in getting the placement completed with a relatively favorable outcome. What I would tell you is you're exactly right that our portfolio is unique. It's unique from an historical loss perspective. It's been very little. There's been no earthquake losses paid. It's unique in that it is, indeed, diversifying. It's unique in that we have a very broad and robust panel. It's not overly concentrated. No one's more than, I think, approximately 7% of limit, so we've got great partners that can accommodate our growth, but what I would say is when you look at the overarching—the 11% increase, it was more—the increases were more pronounced where there was wind exposure—wind and earthquake exposure versus standalone earthquake, so as we add more limit, it's going to be driven by our prevailing exposure, which is earthquake, so I think that will allow us to sustain modest, or not nearly at the level that you're seeing, in wind rate increases, so I think the unique complexion of our book and the strength in our panel allowed us to get it done at, again, I'll use the term relatively favorable outcome.

Matthew Carletti

Thanks, Mac. Really appreciate the color, and best of luck getting the E&S Company live, and rest of the year.

Mac Armstrong

Thanks, Matt.

Operator

Our next question comes from the line of Mark Hughes with Truist Securities. Please proceed with your question.

Mark Hughes

Yes. Thank you. Good morning.

On the excess commercial business, what do you think your pace will be in terms of ramp-up there? If some of the broker commentaries to be believed, they're going to be pretty eager for more capacity. Could you talk about kind of what you're seeing out there now, and then also, what does the individual risk look like; how much exposure per risk? Kind of where are you sitting in those excess layers? Just a little more detail there would be helpful.

Mac Armstrong

Sure, Mark. Good to hear from you.

What I would say is we bought incremental limit to the tune of roughly $200 million to support our growth in and around the E&S Company, as well as the admitted platform, and we think that is sufficient for the immediate future, certainly as we have identified new distribution partners or leveraging existing distribution partners in all of our specialty product markets, but most pronounced in this excess property arena, so I—we—we'll—think we can grow or sustain growth rates like we saw in the second quarter with Commercial Earthquake growing roughly 40%. I'm not going to say that All Risk will grow at 100% ad infinitum, but I think we can continue to see solid growth from that line, and those are going to be the two markets that are most pronounced, or the most pronounced beneficiaries of the E&S franchise, but I think that we're—don't expect us to quintuple the book writing excess property. I think it's going to be consistent growth of what we've done historically.

What also will be consistent is how we participate in the risk from a line-size perspective. Our average line for All Risk is typically between $5 million and $7 million. I think that's what we'll look to continue to do. On the Commercial Wind side, earthquake, we are willing to write a bit of a larger line for select accounts, maybe pushing up to $10 million, and if we use facultative reinsurance, $15 million, and maybe a bit above that, but I don't think what you're going to see is us going and doubling the size of the limit that we put out on an individual basis. Really, what we're trying to do now is access segments of the market where there is dislocation and need for capacity, and do it in the same fashion that we have done it historically from an underwriting standpoint, from an attachment standpoint, and certainly, from a risk transfer modeling standpoint.

Mark Hughes

Thank you for that, and I assume that's something that could be done pretty expeditiously. This isn't a process of a long ramp-up. There's a lot of need for it immediately. Is that fair?

Mac Armstrong

Yes, I think that is fair. I think there's—this is very different than admitted, where you get an admitted company up and running, and then you're waiting for 45 to 90 days for a department of insurance to approve your rates and forms. We already have existing forms. We already have existing underwriting guidelines, so we should be able to start to bring business on. August 1 was our official launch date. We have written a policy or two as I speak to you today, so it should ramp, but we're going to be disciplined. We're not going to ramp it up just for the sake of top-line. It's got to be consistent with our underwriting framework. It's got to hit our target metrics from a PML and an ALL perspective, but it does—it's much more expedient than doing it on an admitted basis.

Mark Hughes

In the loss ratio in the quarter, you mentioned elevated weather. How much do you think of the loss ratio was driven by that?

Chris Uchida

Yes. I think, obviously, Mark, weather played a factor in it, and there's a little bit of seasonality with some of our—we do have some Texas exposure and some southeast exposure outside of Florida right now, so when you look at that, obviously, we were exposed to weather, but the other piece of it is when you look at our book, the complexion has been changing over time. If you look at the—call it the first half of 2020, our lines exposed to attritional losses are now about 40% of the written premium in the first half of the year compared to the full year of 2019. That was about 30%, so that is growing about 30% on a year-over-year basis, so that is also kind of pushing up the loss ratio problem where it was at the end of last year. It was about 5.6% at the end of last year, and so now that has grown to about 7.9% when you look at the full first half of the year, so it's kind of like we said before. It has ticked up from where it was at the end of last year, but that's—a lot of that is being driven just by the complexion of the overall portfolio.

Mac Armstrong

I think it's worth emphasizing a couple of things, and just reiterating what Chris said, the other side of the coin is 60% of the book showed does not have attritional loss, so that gives us a lot of visibility on the underlying loss ratio of the book of business, and then, additionally, there was heightened weather activity, and I think a lot of people in the market pre-announced cats. This is what—this is the—these mini cats is what we're built to do, so we don't really bifurcate them unless they are really pronounced kind of land-falling storms. A tropical storm is—that's par for our course, which is as we wish it wouldn't be.

Mark Hughes

Final question, did you give a—any dollar figure for how much the ramp-up of the E&S unit has been? What are your costs, say, in 2Q?

Mac Armstrong

Mark, we have not given dollar figures there. I think what Chris alluded to in his remarks, and I did as well, is that the guidance that we provided reflected the investments that we are making and we'll make in the third quarter and fourth quarter on the E&S Company, and that can include talent, systems, incremental bespoke reinsurance for certain new products or products. It's hard to handicap, because there might be someone that we find that's a terrific layered and shared underwriter or someone that could help lead certain facets of what we're doing from new product development. We're budgeting for them, but they may come on earlier. They may come on a little later, so we're not trying to peg a dollar, but what we are going to give you is kind of targets on what we think we'll—how we'll end the year.

Mark Hughes

Thank you very much.

Operator

Our next question comes from the line of Jeff Schmitt with William Blair. Please proceed with your question.

Jeff Schmitt

Hi. Good morning.

The question on the attritional loss ratio; I understand how that's being impacted, obviously, in that shift in business mix into non event based products, but could you provide a more detail on the quarter shares there? I think you retained a little bit; maybe 10% of Specialty Homeowners, maybe more like 20% of Commercial All Risk. Has that moved a lot? I mean where do those stand today?

Mac Armstrong

Yes, Jeff. Chris can chime in.

We did increase our participation on the Specialty Homeowners Facility. I think now we are around 22.5%. The All Risk, we are taking more of the cat, but still seeding off the good majority of the attritional fire premium and exposure.

Chris Uchida

Yes, I'd say similar to our excess of loss retention, we've—it increased our participation in the quota shares a little bit, so I talked about that in the prepared remarks, that it's going to impact a little bit of the expenses, and also the net earned, so we talked about that in there, but those are the key pieces. Overall, we don't expect a—call it a material impact from those changes, but there is going to be, let's call it, a little more participation on our side commensurate with a growth from net income, but also growth from the capital that we just raised, so those are all being put into place, and I think leveraging our balance sheet a little bit more now with the additional capital.

Jeff Schmitt

Okay, and then is that the case with the Builder's Risk and Residential Flood as well? I mean I know you kind of started out small there and thought maybe you could increase that over time. Are you starting to increase that participation on those yet?

Mac Armstrong

I think we mentioned this in our year-end remarks, but we took the quota share participation on the Residential Flood up to 30%, and so that was consistent with year four of operation, and now starting to see a pretty consistent performance. The Builder's Risk, it is still early, so we have not changed much in the way of our participation there.

Jeff Schmitt

Okay, and then just a question on the capital raise. I mean it looks like the majority of that just went into cash. Is there plans to deploy that in investments pretty quickly?

Mac Armstrong

Yes, Jeff, it is being deployed fairly expediently. There was a little bit of a—our investment manager was fair, frankly, in that they told us it would have been, from a cost management perspective, ineffective if we'd have put it into an investment account on day one, so we just put it in cash because we were closing that financing June 26, June 27. The return we would have got would not have matched what the investment management fee would have been, so we decided to put it in cash.

Jeff Schmitt

Got it. Okay. Thank you.

Operator

Once again, if you would like to ask a question, please press star, one on your telephone keypad.

Once again, if you would like to ask a question, please press star, one on your telephone keypad.

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

Meyer Shields

Great. Thanks. I just had a series of small questions.

Mac, you talked about extending the team by about 18 people. Is that underwriters or tech people, or what?

Mac Armstrong

Yes, Meyer, all the above. It was a lot in tech, a lot in accounting—or actually, underwriting. There were a few in accounting, especially as we are now no longer an emerging growth Company and need to start to push forward on stocks compliance. We also added our Chief Strategy Officer, so continue to build out that function, too, so I would say the biggest hires would have been in underwriting and technology, and then it would have been rounded out with other corporate seats.

Meyer Shields

Okay. Thanks.

The two new partnerships, does that increase or decrease the percentage—or should that increase or decrease the amount of California Earthquake in the book relative to other lines?

Mac Armstrong

Those partnerships, the two new ones should—well, one of them is a kind of national earthquake partnership, but just the size of the market is—in California is quite larger than the rest of the exposures—exposed states, so I think that would push California Residential Earthquake higher as a percentage of Residential Earthquake, and then the second partnership is really around California Residential Earthquake.

Meyer Shields

Okay, perfect.

Chris, based on your guidance for the tax rate, should it be below 21% in the back half of the year?

Chris Uchida

Say that again, Meyer. Sorry, I was—that was hard to hear.

Meyer Shields

No, I'm sorry. I've been hearing that all day.

Does the tax rate guidance for the full year imply something below 21% in the back half?

Chris Uchida

It's always possible. I think we look at different things around that, whether there's stock option exercises, things of that nature, that could potentially push it down, but we think that our average effective tax rate is going to be around 21%, so that's kind of what we're comfortable providing guidance around, but there are, obviously, things out there that can move it around, but I would say it's always a potential, but my guess it would still be around the 21% mark.

Meyer Shields

Okay, got it, and then, final question, I guess back to Mac.

Should we think about PESIC participating in the Florida marketplace, or is that still a region you want to avoid?

Mac Armstrong

Yes, Meyer, that's a great question.

I think there—we will likely take a small participation in the Florida commercial market, and, as a result, we would likely reinsure. It's somewhat independent of our core reinsurance program, which frankly, governs how much business we will do there. We will not do any residential business there. It's more than likely where it would be is writing national property accounts that have locations in Florida, but not standalone Florida business.

Meyer Shields

Perfect. Okay. Thanks so much, and stay well.

Mac Armstrong

You, too. Thank you.

Operator

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

David Motemaden

Hey. Good morning.

Just a question just on the residential earthquake business, so I heard the points just on the good retention. Wondering specifically just how new applications were trending in 2Q versus 1Q, and if—there seems to be a trend at least of a move away from cities and more into the suburbs as a result of the pandemic, and I'm wondering if you're seeing that creating any opportunities for you guys to gain share in the resi market, or maybe even expand the market?

Mac Armstrong

Hey, Dave.

Yes, that's an interesting assessment and observation. To answer your first question, new business volumes were pretty consistent between Q1 and Q2, save for some new partnerships that are coming online and starting to ramp, so we were pleased by that. Additionally, we continue to see dislocation in the counseling and homeowners market, which is creating this kind of vacuum for capacity on the homeowner side, which, in turn, creates policies that come out for bid on the earthquake—come up for bid on the earthquake side, so that dynamic is persisting.

Yes, I think an ex-urban migration creates opportunity, certainly as people buy their homes, and I think the other thing, frankly, as we enter into month six or seven of the pandemic in a remote work environment, I think people are mindful more and more of protecting their assets, and corporations trying to make sure that there's continuity in the operations of their businesses, so I think that's something that could be something that sustains our new business and the growth in that residential earthquake market.

David Motemaden

Got it. Thanks. That's good color. Thanks for that, and then I just have another question about a report from a cat-risk modeling agency, Trembler that had indicated slightly higher earthquake probability, especially on the San Andreas Fault relative to, I guess, previously thought. Obviously, that's just one opinion, but I'm just wondering what your take is on that, how you're thinking about it, and how you’re pricing your risk or pricing the product. Are you changing it at all as a response to this Trembler report?

Mac Armstrong

We know the folks at Trembler very well, and think they're sharp data scientists; very bright geologists as well, and we've collaborated with them on several items. What I would say is it's not something that's caused us to change our underlying base rates, but it does factor in in terms of exposure management, concentration, spread of risk, and I think, also, when we marry that—those theses with what we're trying to do from traditional underwriting and target returns, and in the teeth of a hard market, it probably presents an opportunity for us to get more rate in the B zone, but it's not something that we've taken the Trembler report and added a Trembler base relativity to our rate forms and filings and our underlying data analytics.

David Motemaden

Got it. Thanks, and do you expect your see, or have you seen already, just any change to the way reinsurers are pricing the risk for you guys to cede off to as a result of that?

Mac Armstrong

We have not seen it, and I think they're going to look at concentrations and how we stack up in our—in that area. They always do. I don't think it'll change their perspective. I think they —what they like about our portfolio is that we provide terrific spread of risk, not just within California, but nationally on an earthquake basis, so I don't think it's going to hurt us because we are not overly concentrated either way. In fact, it could potentially help us.

David Motemaden

Got it. That's helpful. That makes sense, Mac, and then if I could just sneak one last one in, just about—just sort of thinking through the market opportunity here for the E&S Company, I guess what—how can I think about, I guess, the ultimate size that you think that can get to? Is it really just—can I just take the capital that you guys are putting in the E&S Company and putting a—some sort of premium to surplus multiple on that, like 0.7 times, 0.8 times, and that could be like a—sort of a good initial target, or, I guess how—is there a certain number you can get us to to think about what the opportunity is there?

Mac Armstrong

Yes. I mean I think over-archingly, the lines of business that we're going to write, if they maintain a similar complexion, which, at least initially, they will in the specialty property—with a specialty property bent, you would—we should be able to write at a net premiums earned to surplus ratio of just inside of one to one, maybe 0.9 to one, and that's a target that we would have. I don't see any reason why we can't get the E&S Company, in due time, to a similar size as the admitted company, but we're not going to do that overnight by any stretch of the imagination, nor would you want us to, but I think when you factor in the market environment right now, the geographical breadth, the expansion of TAM of existing lines of business, the expansion of the TAM with the new geographies, and new products that are made for E&S that we just haven't—that we wanted to get into, but we haven't yet, like layered and shared, All Risk Earthquake or Builder's Risk, again, there's a lot of potential for it, so I think if you want to just look at the group, it can expand—it expands our prospects considerably.

David Motemaden

Great. Thank you.

Operator

Ladies and gentlemen, we have reached the end of our question-and-answer session. I now would like to turn the call back over to Mr. Armstrong for any closing remarks.

Mac Armstrong

Great. Thank you, Operator, and thank you all for your time this morning.

This concludes Palomar’s second quarter earnings call. We appreciate the time and questions, and always, your support.

Our team and our business has shown, frankly, remarkable resilience during a complex and challenging year for our country and our world. We’re going to continue to adhere to our founding values and principles as we execute our strategy and honor our stakeholders. We’re excited and eager to pursue the near-term and long-term initiatives that we’ve covered today; most notably, Palomar Excess and Surplus

Insurance Company, and we're going to also continue to prioritize safety for our team, equality and justice, as well, so thanks very much, and we'll speak to you after the third quarter. Have a great day. Goodbye.

Operator

This concludes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.