Palomar®

First Quarter 2022 Earnings Call Transcript
May 5, 2022

CORPORATE PARTICIPANTS

Chris Uchida, *Chief Financial Officer*

Mac Armstrong, *Chairman, Chief Executive Officer, Founder*

CONFERENCE CALL PARTICIPANTS

Matt Carletti, *JMP*

Pablo Singzon, *JP Morgan*

Mark Hughes, *Truist Securities*

Dave Motemaden, *Evercore ISI*

Meyer Shields, *KBW*

Tracy Benguigui, *Barclays*

PRESENTATION

Operator

Greetings and welcome to the Palomar Holdings Incorporated First Quarter 2022 Earnings Conference Call.

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 first quarter 2022 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 11:59pm Eastern Time on May 12, 2022.

Before we begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning in 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 annual report on Form 10-K filed with the Securities Exchange Commission. We do not undertake any duty to update those 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 or result 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.

Today I'll provide a review of our strong first quarter results and an update on the progress achieved executing our near- and long-term strategic initiatives. Simply put, it was a very good quarter for Palomar as our top line surged more than 60%. We earned 17.6 million of adjusted net income, inclusive of a $1.3 million realized and unrealized loss from our equity holdings and generated an adjusted ROE of 18.1%. Obviously, Chris will review these results in more detail. But I wanted to cut to the chase before I went into my remarks.

When we began the year, we outlined four strategic priorities for 2022; one, generating strong premium growth, two, monetizing the new investments made over the course of 2021, three, sustained delivery of consistent and predictable earnings and four, scaling our organization. I'm quite happy to report that we made strong progress across all four initiatives during the quarter, and I'd like to spend a few minutes updating you on each.

As it pertains to written premium growth, the first quarter is another stout example of our ability to sustain top line growth. In the first quarter gross written premiums increased 65% as compared to the first quarter of 2021, driven by continued strength and residential commercial earthquake as well as in our ENS (phon) business, Palomar Excess and Surplus Insurance Company.

Looking at our lines of business in more detail, I will start with our earthquake franchise. Our total earthquake book grew 24% in the first quarter with commercial earthquake growing 18% in residential earthquake, our largest line of business grew 29%. Several factors drove the growth in the residential earthquake line, including but not limited to a new partnership with Progressive, a continued dislocation in the California homeowners' market and the California Earthquake Authority officially stating they are reducing their reinsurance purchase by the equivalent of 1 billion. These factors along with our existing marketing efforts led to record new business sales for residential earthquake in the first quarter. The partnership with Progressive is one I'm excited about as it is a solution to provide Progressive's homeowners policyholders outside of California with a comprehensive earthquake solution via an assumed reinsurance arrangement. We're thrilled to partner with Progressive and optimistic on the potential for this relationship.

As it pertains to the CEA, we believe that continued uncertainty regarding the claims paying capacity provides considerable room for continued strong growth in this important in profitable line of business. Beyond earthquake, other product lines performing well in the first quarter include Inland Marine which grew premiums 133% year-over-year and is now our fourth largest line, commercial all risk grew 37% year-over-year, with the large majority of the growth coming from rate increases as opposed to exposure. Flood premiums grew 31% year-over-year as the National Flood Insurance programs risk rating 2.0 starts to influence market conditions.

As previously discussed, the NFIP rating action will likely generate a material price increase at renewal, which we believe creates opportunity for Palomar to capture market share as we work through the year. As it pertains to our nascent casualty franchise, our real estate errors and omissions program is a standout as it continues to grow rapidly with year-over-year growth of 151%.

Shifting to our E&S business, Palomar Excess and Surplus Insurance Company had another strong quarter, generating 41 million of gross written premium representing 71% written premium growth year-over-year. Inclusive of our fronting business, the gross written premium was $67 million.

PESIC growth was primarily driven by its main products, namely commercial earthquake, national layer and shared commercial property and builder's risk. Our recently launched E&S products, including professional liability, excess liability and contractors' liability are beginning to ramp and we expect them to be significant contributors to our growth. PESIC continues to be an important growth driver for Palomar we believe that business can become 50% of our premium over time.

Our second 2022 strategic priority is monetizing the investments made over the last year or so in new products and businesses. Along these lines, I'm very pleased with the initial success of Palomar Front. Launched in September, Palomar Front achieved almost $30 million in gross written premiums in the first quarter. One of its initial success stories is a fronting program for an innovative cyber-MGA in a world class panel of reinsurers that has gained strong traction in the market and is taking advantage of the remarkably hard market pricing environment in the cyber market.

On the whole, our fronting programs are performing well from an underwriting collateral perspective, and we continue to believe that adding a fee-based revenue stream to our business will further fortify earnings base. Given our strong start to the year, we remain confident in our goal building the fronting business to $80 million to $100 million of managed premiums this year.

We're also pleased with the progress that our newly hired underwriters are making as they build their franchises in segments like general casualty, professional liability, and non-catastrophe exposed excess property. While still in their early stages of formation, these businesses will be important growth drivers for Palomar in the year ahead. That said, our focus over the first half of 2022 is to thoughtfully build these businesses while adding the necessary talent, infrastructure and support to enable our underwriters to scale their franchises.

During the quarter, considerable efforts were made in the procurement of quota share reinsurance, distribution network buildout and the development of systems, forms and filings. While the premium generated in the first quarter was modest, we're encouraged with the quality of business bound.

The third strategic priority is focusing on earnings predictability and reducing volatility in our results. While growth is certainly a priority, we're also laser focused on growing profitably and properly managing the risk in our portfolio. Along these lines, we took three important steps during the first quarter to achieve this goal. First, we renewed our aggregate reinsurance program and, in the process, move the floor on our adjusted ROA from 10% to 14%. We believe this program creates real value for our shareholders by essentially collaring the downside of our financial results.

Second, we successfully placed new quota shares for our new professional lines and casualty products. These quota shares allow us to walk before we run, as we conservatively build the books of business for these important new lines. They not only reduce our net limit exposed to an account, and the impact of the shock loss on a nascent book, but also permit us to generate fee income. The architecture of the quota shares enables us to proceed cautiously, and if we write to a 90 combined ratio, generate half of the products income from seeding commissions and half from underwriting, a further demonstration of our focus on fee income and earnings predictability.

As an example, take a professional liability program where we assume 25% of the risk and seed off 75%. We will earn a 10-point margin on 25% of risk that we underwrite assuming a 90% combined ratio. We will then earn a 5 point override in excess of our costs on the 75% of ceded premium, so the majority of our profits come from ceding commission.

Third, we continue to reduce our continental wind exposure. Our non-Texas homeowner's business is now officially in runoff, and we are not growing the exposure of our national layered and shared commercial property business.

Our fourth strategic priority is scaling the organization. What makes our platform so attractive to new hires is that we can offer them industry leading technology and infrastructure, combined with a wealth of talent and expertise that affords our new underwriters the opportunity to build a platform capable of delivering our products and services in the fastest, most efficient way possible. This competitive advantage is a strong selling point to experienced talent in our industry. Our entrance into casualty is being led by market experts with strong track records of success who saw Palomar as an attractive platform to build their businesses.

We continue to bolster the analytical, actuarial, technology and operating expertise to support our growth. Key hires this quarter included Eric Hennen, VP of Analytics who formerly helped lead the property analytics team of a global reinsurance broker and Ben Markowski another actuarial fellow to augment our budding casualty franchise.

As you can see, we've made significant strides executing our strategic initiatives in the first quarter as we strive to position Palomar for sustainable growth, predictable earnings and reduced volatility. At this point, I'd like to spend a few minutes updating you on what we are seeing in the market. From a pricing standpoint, we are seeing sustained rate increases across all lines, and pockets of business where rate increases are accelerating. In commercial earthquake, the average rate increase picked up from the fourth quarter of 2021 as rate increases moved up from approximately 5% to 7% of the quarter. We expect further hardening for the next few quarters in this line of business. As previously mentioned, we are not looking to grow the exposures in our wind exposed national layer and shared commercial property business as we believe we can generate sufficient growth from rate. For this line of business, we experienced risk adjusted rate increases of 22% year-over-year, with over 14% risk adjusted rate strengthening in Q1 alone. This market is becoming increasingly dislocated as the reinsurance market hardens, and we are generally seeing continued rate increases combined with improved terms and conditions.

As it pertains to inflation, in addition to the use of third-party licensed data, we can leverage our builder's risk program that audits construction project on a monthly basis to inform our perspective on the cost of materials and labor. We're incorporating these factors into our underwriting and marrying them with rate increases and higher inflation guards. For personal lines like residential earthquake, we increased the inflation guards from a historical level of 5% to 8% this year. While our casualty lines remain in their infancy, and therefore don't offer much in the way of renewal price increase commentary, we are getting rate increases of approximately 5% to 7% on expiring terms, with certain segments professional lines and general liability seeing greater increase.

Turning to our 6/1 reinsurance renewal, we are currently in the market placing our program, and believe the combination of rate increases and reduction in our continental hurricane exposure portends a successful renewal. While it is undoubtedly a hard reinsurance market, our unique program includes ILS market support remains appealing to reinsurers and ILS investors. We are more than 60% placed at this point and expect to finalize the placement shortly. We will provide an update to the market when the placement is complete.

Turning to capital allocation, we'll continue to see operating leverage in our business model financial metrics as we scale. Additionally, we are generating cash from operations which provide sufficient capital to fund our growth initiatives, while providing ample room to execute on our $100 million share repurchase program. As a result, we were active with our repurchase program as we saw and continue to see our shares at levels we believe are undervalued especially in light of the numerous growth vectors in our business, and the adjusted ROE floor of 14%.

To conclude, we're very pleased with our results and the momentum in our business as we look out to the remainder of the year. We are reiterating our guidance for the full year '22 where we expect to generate between $80 million and $85 million of adjusted net income representing 54% year-over-year growth, and an adjusted ROE of 19% at the midpoint of this range. This range factors in the additional investments that we need to make in talent systems infrastructure, the current projected cost of reinsurance and the unrealized losses on equity securities in the quarter.

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

Chris Uchida

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

For the first quarter of 2022, our net income was $14.5 million, or $0.56 cents per share, compared to net income of $16.6 million or $0.63 per share for the same quarter in 2021. Our adjusted net income was $17.6 million, or $0.68 per share compared to adjusted net income of $19.3 million or $0.73 per share for the same quarter of 2021.

As we compared to the prior year results it is important to remember the impact Winter Storm Uri had on our results for the first and second quarters of 2021. While Uri resulted in favorable net losses in the first quarter of 2021, we did incur additional reinsurance expense or seed written premiums in the first and second quarters of 2021.

Gross written premiums for the first quarter were $170.9 million an increase of 65% compared to the prior year's first quarter. This continued strong growth was driven by a combination of increases in premiums across our core products as well as gained momentum in our recently entered line such as fronting.

Ceded written premiums for the first quarter were $89.6 million, representing an increase of 106.5% compared to the prior year's first quarter. This increase is primarily from quota share reinsurance from our new fronting business, as well as increased catastrophe XOL reinsurance related to the exposure growth. Ceded written premiums as a percentage of gross written premiums increased to 52.4% for the three months ended March 31, 2022, from 41.9% for the three months ended March 31, 2021. Our new fronting business was the primary driver of the increase in this percentage, slightly offset by the decrease in XOL percentage compared to last year that included the impact of Uri.

We believe the ratio of net earned premiums and gross earned premiums is a better metric for assessing our business versus the ratio of net written premiums and gross written premiums. Net earned premiums for the first quarter were $76 million, an increase of 61.6% compared to the prior year's first quarter. This increase is due to the growth and earning of higher gross written premiums offset by the growth and earning of higher ceded written premiums under reinsurance agreements. For the first quarter of 2022, net earned premiums as a percentage of gross earned premiums were 54.7% compared to 51.5%, in the first quarter of 2021, and compared sequentially to 55.2% in the fourth quarter of 2021. As previously indicated, the launch and expected growth of our fronting business could push this ratio below 50% on an annual basis, though it will add consistent fee income that will enhance our ROE and bottom line.

Losses and loss adjustment expenses incurred for the first quarter were $15 million due to attritional losses of $14.5 million and unfavorable prior year catastrophe loss of element of $0.5 million. The loss ratio for the quarter was 19.7%, comprised of an attritional loss ratio of 19.1% and a catastrophe loss ratio of 0.6%.

Our expense ratio for the first quarter of 2022 was 56.8%, compared to 69.8% in the first quarter of 2021. On an adjusted basis, our expense ratio is 52.4% for the quarter, compared to 62.7% in the first quarter of 2021 and compared to 55.7% sequentially in the fourth quarter of 2021.

Similar to our net earned premium ratio, we feel it is a better representation of our business to look at our expense ratios as a percentage of gross earned premium. Our acquisition expense as a percentage of gross earned premiums for the first quarter of 2022 were 20.2% compared to 21.2% in the first quarter of 2021 and compared to 22.2% sequentially in the fourth quarter of 2020. The decrease was driven by additional ceding commission from our new fronting business that has netted in acquisition expense and overall changes in our mix of business. The ratio of other underwriting expenses, including adjustments to gross earned premiums for the first quarter of 2022 was 9% an improvement compared to 11.9% in the first quarter of 2021 and compared to 9.2% sequentially in the fourth quarter of 2021. As we continue to invest in talent, systems and our infrastructure, we expect our business to scale over the long term. But I wouldn't be surprised if this ratio was flatter in the coming quarters with those investments.

Our combined ratio for the first quarter was 76.5% compared to 60.4% in the first quarter of 2021. Our adjusted combined ratio was 72.1% for the first quarter compared to 53.3% in the first quarter of 2021, which included the unsustainable negative loss ratio in the first quarter of 2021 from Uri.

Net investment income for the first quarter was $2.6 million, an increase of 16.2% compared to the prior year's first quarter. The year-over-year increase was primarily due to a higher average balance of investments held during the three months ended March 31, 2022, due to cash generated from operations and by slightly higher yields on our invested assets.

Our fixed income investment portfolio book yield during the first quarter was 2.34% compared to 2.24% for the first quarter of 2021. The weighted average duration of our fixed maturity investment portfolio, including cash equivalents was 4.17 years at quarter end.

Cash and invested assets totaled $533.2 million as compared to $436.7 million on March 31, 2021. For the first quarter, we recognize losses on investments in the consolidated statement of income of $1.3 million compared to losses at $739,000 in the prior year's first quarter. We will continue to take a conservative investment approach which may impact our recognized gains and losses from quarter to quarter.

Our effective tax rate for the first quarter was 23.8%, compared to 17.3% for the first quarter of 2021. For the first quarter of 2022, the tax rate differed from the statutory rate due to non deductible executive compensation expense.

Stockholders' equity was $380.4 million at March 31, 2022, inclusive of the share buyback and unrealized changes to our investment portfolio, compared to $394.4 million at December 31, 2021. For the first quarter of 2022 annualized return on equity was 15% compared to 18% for the same period last year. Our annualized adjusted return on equity was 18.1%, compared to 20.8% for the same period last year.

As of March 31, 2022, we had 25,817,059 diluted shares outstanding as calculated using the treasury stock method. We do not anticipate a material increase to this number during the year ahead. For 2022, we reiterate our previously provided adjusted net income guidance range of $80 million to $85 million, representing 54% year-over-year growth, and adjusted ROE of 19% at the midpoint of the range. Consistent with previous guidance, these estimates do not include any losses from major catastrophic events. As a reminder, we expect the continental U.S. wind projected net average annual loss or net AAL of approximately $6 million as of September 30, 2022, the peak of wind. This net AAL is an industry metric used to assess continental hurricanes and severe convective storm exposure.

During the quarter we repurchased 219,061 shares or $13 million worth of shares under our previously announced two-year $100 million share repurchase program. We have approximately $87 million remaining under the authorized program. While we are not pivoting from our established growth strategy, we view our current shares as undervalued, and we will take an opportunistic approach to share repurchases under this program. While our goal of investing for profitable growth remains our core focus, we believe the share repurchase program is an appropriate use of our capital in order to increase long term shareholder value. This bifurcated capital allocation strategy reinforces our confidence in the strategic direction of the Company for long term growth.

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

Operator

Thank you. Our first question comes from Matt Carletti with JMP, please proceed.

Matt Carletti

Thanks. Good morning.

Mac, I wanted, first question you made a mention about the recent actions taken by the CEA I was hoping you could expand on that. One, I just want to make sure I'm understanding it right that is the thought that by buying less reinsurance more assessment risks just to the member companies, and therefore they're going to be less eager to sell a CEA quake policy, and two is, I saw the news, it was rather late in the quarter and how much of that—are you seeing any of that yet? Or is this something you expect impact results as we go forward?

Mac Armstrong

Hey, Matt, good afternoon, good morning depending on which coast you're on.

Yes, it's a great question and I think, first and foremost, you're right, it was—the actions of the CEA were later in the quarter and the declaration of the reduction of around 1.2 billion of claims paying capacity, really hadn't taken full root in the market in the first quarter and I think the market, frankly, is still digesting it. As it pertains to the participating insurers, I think what it does do is create a circumstance where there is less claims paying capability, which means there's a higher potential assessment applied to them and as you recall that would mean that they had to put more capital up, but also it means they're likely to be more inclined to find alternatives to the CEA.

There was a decree in December, which did allow participating insurers to explore alternatives in conjunction with the—to the CEA and in conjunction with the mandatory offer. Long story short, we think this is something that will really probably impact or extend the growth in this line on a prospective basis vs. this year into next year and when you marry that with just overall dislocation in the California homeowners' market, which we've talked about, it's a nice catalyst for extended growth for an indefinite period of time.

Matt Carletti

(Multiple speakers). Yes, sure. Go ahead.

Mac Armstrong

Oh, sorry. I think the one thing also that the claim's paying capacity does potentially impact is just the ratings of the CEA and I think Fitch took some action. There has not been others, but that could also lead to a bit more tumult too. Sorry.

Matt Carletti

Thanks, again, it's great.

There's one quick just numbers follow up, maybe for Chris, we saw you broke out the Palomar Front premiums as a separate line this quarter. Can you just remind us what—I think last quarter, Q4 was kind of its first full quarter of operations? What was the gross written premium in Q4 for that business?

Chris Uchida

Yes, it was modest in Q4. I don't think we've disclosed the exact number of what that was yet. But I'd say less than $5 million in Q4 of last year and last year in the other bucket? It was modest.

Matt Carletti

Yep. Okay, great. Thank you for the answers. Appreciate it.

Mac Armstrong

Thanks, Matt.

Operator

Our next question comes from Pablo Singzon with JP Morgan, please proceed.

Pablo Singzon

Hi.

The uptick in your loss ratio was a bit higher than I would have thought and I assume a lot of that was driven by the new lines you're writing. Was there anything unique about this quarter? Are the losses of the new lines consistent with your expectations? I guess given that they're growing faster in those lines, I was hoping you could provide some perspective on how that loss ratio could progress over time. Thanks.

Chris Uchida

Thanks, Pablo. Yes, no, that's a great question. When we look at the loss ratio, it's important to remember a few things. First and foremost, our business is still anchored by the binary lines, by Hawaii Hurricane, our earthquake lines are relatively binary and obviously not contributing to the attritional loss ratio. If you exclude the fronting premium from that, that book has remained relatively consistent, about 55% of that premium is still from those binary lines, and about 45% of the premium is from the lines of additional loss. It hasn't changed the dynamic too much.

It's also important remember anything about fronting does not add anything to the loss ratio, or to the veteran premium, the only thing that really does is it kind of reduces the acquisition expense. We also want to think about the loss ratio, it's important to note that these lines are still very profitable lines; these are lines that we're comfortable with.

When you look at it these—obviously, we've said this before, as long as they're sub-100, they're accretive to the ROE and the bottom line. But when you look at it on a gross basis, and you look at Q4, and these lines, we're writing probably around a 40% loss ratio in total. Still very profitable lines of business, specifically, on the first quarter, obviously, it is up a little bit from where it was in Q4. I think if you remember, our adjusted number for Q4 was about 15.7%. I had indicated that I expect that to go one to two points a quarter up, but on an annualized basis, I expect it to be around three to four points up for the year. This is well within that range, and we're very comfortable with where it's at.

I do also want to reiterate that generally, the first and second quarter of the year are a little bit heavier for us, we are exposed to hail, and other exposures that definitely are higher in the first few quarters of the year. It is potential for that number to decrease or stay flat for the year, but when I look at it on an annualized basis, three to four points up is well within the range, it's probably a little higher sequentially than the call one to two points that I had indicated, but well within our comfort zone. With that I don't expect it to move a ton further into the year, it could be lower, it could be higher, but I would expect that three to four points on an annualized basis to be a good target for the full year results.

Mac Armstrong

Yes, Pablo, this is Mac and Chris described it well, but the only thing I would add is if you look at the lines that are major contributors, it tends to be the specialty homeowners' book and as a reminder that a good portion of that specialty homeowners' book is going into runoff. When you combine the fact that it's going into runoff, I think that adds some stability to what Chris is talking about in maintaining it in that plus or minus three to four points year over year. But then also that is--this tends to be seasonally aberrant. There's higher PCS activity in the first and second quarters of the year. We think it's well confined and moreover, the newer lines, casualty real estate, D&O and flood are within our targets and frankly performing better than the expected loss ratio.

Pablo Singzon

Yep, thank you for that.

A follow up, a numbers question here. How much fee income did the fronting produce in the quarter? Thanks.

Chris Uchida

We haven't broken out specifically what that fee income is, obviously we wrote about $30 million. We are earning that premium in earning that fee; I would say it's generally going to be plus or minus around that 5% range. You can do the math on depending on when that came in the quarter and how you're earning it. But no, so we'll take that, let's call it 5% fee over the next 12 months from when it was written. We haven't disclosed the specific number, but the one thing you can note, when you look at it sequentially, and you look at the acquisition expense on a gross earned basis, it was about 22% in Q4, and that has decreased to about 20% in the first quarter of this year. You can kind of see that ceding commission or additional ceding commission run through and that's really driven by the fronting premium. There's a little bit of mix differential from quota shares on the other attritional lines of business, but the main driver is that fronting premium or that fronting ceding commission, lowering the acquisition expense.

Pablo Singzon

Got it, thanks Chris.

Operator

Our next question comes from Mark Hughes with Truist Securities, please proceed.

Mark Hughes

Yes, thank you.

Could you talk about the capital situation, you talked about your bifurcated strategy, you're obviously growing very rapidly and buying back some stock. How much more room do you have in terms of your current capital base? Obviously with your returns being pretty high that's adding to it. Just some thoughts about your runway from here.

Mac Armstrong

Sure, Mark. This is Mac and I'll take a first crack at it and Chris can chime in.

I think in the first quarter, we bought $13 million of stock back and that was in conjunction with the $100 million share repurchase program that we authorized, that's over a two-year period of time. Kind of on a $50 million run rate, if you would, but that's also a reflection of where the stock was trading and the values that we saw.

I think it's important to point out that holding aside the unrealized changes in the investment portfolio we still generated increased surplus on a pure cash flow basis. Our net income was $17.6 million, and we bought back 13 million of stock. I think we're going to want to continue to build our surplus, opportunistically buyback stock as we see it present itself and then where we are writing right now from the net premiums earned a surplus basis, we still feel that we have ample capital to do both those things. There's certainly cushion to grow free cash flow, buy back stock opportunistically and not have our growth plans impeded at all.

Chris Uchida

Specifically on numbers that Mac was talking about, on our ability to write premium, trailing 12-month basis, net written premium to any capital, it was a little bit higher than it was last quarter. It's about 0.85x right now, but still well within the range. If we were purely a cat company, we would have said that we will be comfortable riding up to a one to one, but with the growth in other lines that are not as cat exposed, some of the attritional lines, whether it be inland marine, whether it'd be the casualty lines that are longer—can have a longer tail, we definitely feel comfortable going over that one-to-one ratio. We still have ample capital room from a net written premium basis to grow the premium base and still look at buybacks opportunistically at the share price still, as we feel a little undervalued.

Mark Hughes

Then, from the cyclical standpoint, Mac, you pointed out that the pricing increases were sustained and accelerated in some cases. When you say sustained, are you saying sustained at the same rate of increase? Or are you seeing any kind of deceleration there seems to be a bifurcated, to use the word, discussion about that, whether there's some deceleration or sustained or acceleration. A little more on that would be helpful.

Mac Armstrong

Yes, absolutely. I again, I think it is sustained, or excuse me, it's sustained in certain products, it's accelerated others, it really is bifurcated. The segments of our book where it's you're still seeing increases, call it 5% to 7% tends to be the newer lines like the casualty lines.

That being said, there are within the casualty segments pockets where you're getting better increases in that 10% to 20%, a GL package they may have some auto exposure, for instance, or subclasses within there, that's had higher loss activity. For us, where we're seeing it accelerate again is in earthquake and the commercial All Risk so that what we call our national layer and shared property program. That's where we're seeing accelerate and then I think what you have in the residential business earthquake, we are increasing our inflation guards; we are using our E&S company more effectively, especially for higher value accounts where we can get, again, better risk adjusted returns. It really is product specific, but we don't have any line within our portfolio where rate increases are flat; we are seeing it either up modestly, consistent levels or accelerating.

Mark Hughes

Why the acceleration in commercial quake?

Mac Armstrong

It's capacity. The hardening reinsurance market and therefore, there's capacity limitations, or the cost of risk transfer is higher than the prior year. It's probably more pronounced in kind of the mid size to large commercial accounts and they're probably a catch up in small commercial accounts that you'll see. But as I mentioned, on the call we went from an average rate increase of 5% in the fourth quarter to 7% plus in the first quarter and that was a reversal of, I guess, probably three, four quarters of decelerating rate increases. I don't think that's going to reverse back. I think we're going to continue to see acceleration of rate increase.

Mark Hughes

Thank you very much.

Operator

Our next question comes from Dave Motemaden with Evercore ISI please proceed.

Dave Motemaden

Hi, thanks.

I just had a question just as a follow up for Chris, on the attritional loss ratio, continuing to hold the outlook of it being up three points to four points for full year 2022 versus 2021. I guess, could you just remind me what base I should be using? Because I know there were some exited lines that were—that are obviously gone now that impacted the ratio last year. I wonder if you could just help me out on that point.

Chris Uchida

Yes, so the right way to think about the base or the way I think about the base is when you look at the fourth quarter of last year, the blended or the adjusted loss ratio, after you back out the admitted all risk book that we were running off last year, and then we did still have some losses from in the fourth quarter, that blended loss ratio—or the adjusted loss ratio, excuse me was about 15.7%. For me, that's my starting point sequentially, as the book evolves, and I think about where it's going to go for 2022.

On an annualized basis, I think that's going to be up three points to four points for the full year and previously I'd also said that I'd say even I think about that sequentially that can be one point to two points a quarter, but also—I'd also say is that can be plus one a quarter or minus one a quarter and still kind of be within that comfort range. I think the number this quarter was definitely within that range. I think that it's a little bit higher than we'd like to see but well within the comfort zone, especially when you think about Q1 and Q2, being a little more volatile for our attritional lines. When we think about that tor-hail season in Texas, where we still have a large portion of our specialty homeowners' book inland marine, it does also have a little bit of exposure in there. Nothing surprising in that number and I think definitely something that we can still feel comfort about blending to those three points to four points up from that 15.7 that I talked about a little bit earlier, for the year.

Dave Motemaden

Got it. Thanks.

Mac, I guess just kind of a related question on just your loss trend assumptions and if you made any changes in the quarter in response to the inflationary environment on some of the short tail lines?

Mac Armstrong

Yes, it's a good question, David, I think on the short tail lines, the loss trends we think we have a very good sense of inflation whether it be how we are incorporating our third-party data analytics with our frontline information that we're getting from our builder's risk book. What we are doing is measuring and accurately gauging the ITB and making sure that the base level exposure is accurate and that's where we use those data sources, both third party and proprietary and taking what we're seeing in builders risking and using them for specialty homeowners. Then we're overlaying an inflation guard; then we're overlaying rate increases. It's kind of a three-prong approach.

I guess it's a long-winded way of saying that we feel that we have the right loss fixed in based on the utilization of those three tools. Then as we look at things going forward, we can continue to use the E&S company for potential certain selected residential risks to be even more nimble, so to speak, and not be reliant on Insurance Department approval for certain rate changes and that's probably most relevant for residential quake, hurricane and those short tail lines you're touching upon.

Dave Motemaden

Got it, okay. That's great color, thanks. I appreciate that.

Then if I can just sneak one more in, the adjusted expense ratio at 52.4, that was definitely better than I had thought, just wondering the sustainability and future improvement in that from these levels. I think, Chris, you made some comments that the underwriting—the other underwriting expense ratio would be flattish for the rest of the year. But I guess how should I think about the acquisition ratio as you ramp up the fronting business over the course of the rest of the year?

Chris Uchida

That's a great question. When I think about the other underwriting expense, I go back to my commentary in Q4 or for Q4, I definitely said that it could potentially be flat to up. It improved a little bit this quarter. We are still seeing some good dynamics there and like I said on the prepared remarks, I wouldn't be surprised if it was flattish for the near-term quarter, so maybe a quarter or two, but I definitely expect it to still improve and definitely improve compared to last year.

Then on a long-term basis, I definitely feel that there is still plenty of potential in the other underwriting expenses for margin expansion, and to scale the organization. But a good lead in into the near term, I do expect to see more or faster improvement on the acquisition expense ratio, and that is really driven by the fronting premium. You saw it this quarter, especially compared to last year on a gross basis I talked about a little bit earlier. Acquisition expense in Q4 on a gross basis was 22%; it's 20% in Q1. I would expect that to continue to improve. I would expect to see continued improvement in the near term from the fronting business, seeding commission driving down acquisition expense and expect to see that throughout the remainder of the year. Especially as Mac talked about, we would like to get to $80 million to $100 million of fronting premium; we wrote 30 in the first quarter. I think we're on track for that, but with that premium, I expect the acquisition expense ratio to improve faster than the other underwriting expenses, but I do still expect long term improvement in the other underwriting expenses.

Dave Motemaden

Right. Thank you for the color.

Operator

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

Meyer Shields

Great, thanks very much for taking my question.

Mac, you talked about raising the inflation guard to 8%. Can you let us know I guess what the filing requirements and status of that is? I guess the second related question, is in the current environment, is 8% enough?

Mac Armstrong

Hey, Meyer, yes, that's a great question. Fortunately, there's no filing requirements associated with, or approvals associated with that so we can implement it. I do think 8% is enough, because you have to remember, this is for like residential earthquake. We have had a 5% inflation guard in place since we formed the company. If you think about a policy that was bound in year one of operations, and we average 90% plus policy retention for that line, you will have something that's since it's initial bind, the underlying TIV and the underlying exposure would have increased by more than 50%.

Furthermore, what we do is when we underwrite and price that risk, we take the greater of our estimate or the associated homeowner's policy. We take—we rely on the homeowner's policy estimate or our own to determine what is the base TIV. Then we also, again, manage the portfolio; we're constantly looking at using a tool like that, from CoreLogic and our own, what the underlying replacement cost is in the market and overlaying that again, that's how we can guard based level against the homeowner policy to calibrate. That's a very long-winded way of saying we think the 8% inflation guard is sufficient. But this is a tool that we've had in place well before 2021 and 2022 inflationary pressures start to rear its head.

Meyer Shields

No, that's okay. Look, the answer is more than welcome, so that's great.

Next question, I guess, and I apologize if I missed it, I was looking for an update on new money yields on the investment portfolio compared to book yields. Particularly because I assume that most of your investment portfolio is fairly short tenured.

Mac Armstrong

Yes, you're right, it is fairly short tail. Especially when you start thinking about the growth, from fronting premiums just to go with the investment portfolio. The new yields that we're seeing right now, around 3.8% or so compared to historical yields of a quarter; there is a pickup and it's obviously it's not at the expense of security. The credit risk remains identical. We think that is a good thing for us long term, but Palomar makes the majority of its money through underwriting, and it always will. But that's not a bad, I guess tailwind to half.

Meyer Shields

Yes, it's hard to see the downside.

One last question, if I can. Did you discuss how the fronting premium production in the first quarter compared to your expectations?

Mac Armstrong

Sure, we—it exceeded our expectation we said we wanted to do $80 million to $100 million, and we feel very good about that number. As I mentioned in my remarks, we have one large deal with a very reputable and strong performing cyber-MGA that has a terrific panel of reinsurers, are basically funding for those reinsurers. As you know, Meyer, the cyber market is very hard and the rates that they are seeing there exceeded our initial expectations. The one thing that I would temper that with is when we put a lot of these programs together, we do put premium caps on them, because we want to be mindful of collateral and not overextending our exposure. But when you have rates that are 50% to 100%, up, depending on the size and the count, the underlying PIF is meaningfully less than we thought. That's a nice dynamic to have. We are exceeding our protections, on the fronting side, and we have a nice pipeline of deals that we think will help us build this into a nice franchise.

Meyer Shields

Perfect. Thank you so much.

Operator

Our next question comes from Tracy Benguigui with Barclays, please proceed.

Tracy Benguigui

Hi, I like seeing the breakout in your disclosure of the subsidiary level premiums. I noticed that E&S premiums now represent nearly 40% of your mix. I'm just wondering prospectively how you think that could shift over time?

Mac Armstrong

Yes, Tracy. Yes, that's a good observation. We're pleased with how the E&S company is trending and it was 40%. We said that we think it can be 50% of the premium. Now the one thing that I would temper the 40% with is some of that is coming from fronting. Fronting, as I mentioned—the real number in the quarter on the E&S side was, I can't remember what I said, it was 50 million plus or minus, or 40 million, excuse me, it was 41 million. It is closer to 25%, 26% of the book, when you execute the fronting. When you include fronting, it was 67 million. That gets you to that 40% number.

Still means we still believe that they can get to 50% and that's on the core business that we are underwriting and retaining risk on. The fronting will potentially inflate that as we use both the admitted and the E&S company.

Tracy Benguigui

Got it.

Then just looking at your fronting business. I mean, I recognize these days most reinsurers are hybrid. They also have primary operations. What structurally do they need to get from you versus maybe writing this risk on their own paper and then maybe doing an internal reinsurance back offshore?

Mac Armstrong

Yes, Tracy, it's really deal specific. We have one deal that we are fronting for another insurance company that has a statutory limitation. We have another deal where—that we just talked about where it's really an MGA that we have the relationship with; we bring them a panel of reinsurers. Those reinsurers could potentially try to go and do it on a primary basis, but they'd be dislocating the MGA or ourselves who are in the market. That's the deal, the MGA deals, they need a primary front, the reinsurers that we work with are the reinsurance business, not in the primary business.

Then we have other deals where it may be for another insurance company that doesn't have the requisite am best rating. It's a hodgepodge of transactions that we'll do as a fronting carrier. We also view fronting as a great R&D tool for us to learn about markets where we may end up taking some risk and time. In doing that, we are the risk there are to some degree, but really control the program and can steer the reinsurance as we deem fit.

Tracy Benguigui

Great, maybe one other question.

I remember years ago, there was an issue in industry, with reinsurance recoverable being a large part of the balance sheet. Just given that, did you see it a lot in your premiums? Is that a metric that you're watching?

Mac Armstrong

Yes, absolutely. I think we feel very good about the quality of our reinsurers and we also feel very good that we have a rather diverse reinsurance panel, that's over 60 panelists, and no one's more than 6% to 7% of the total limit. We also have cat bonds where it's collateralized. But that being said we constantly look at the underlying credit ratings of our reinsurers. Our brokers have security panels that they report back to us on, we have provisions in our reinsurance contracts, that gives us the right to call if someone is downgraded and force a redemption, so to speak. It's something that we actively look at. Fortunately, we've never had any issues to date with recoverables—knock on wood in my head when I say that.

Chris Uchida

Yes, financially, obviously, we were looking at this from a CECL standpoint or credit standpoint, we're looking at the activity that we had in 2020 and 2021. We did have some—we still do have some reinsurance recoverables; we evaluate that on a quarterly basis to see if any changes have happened to our reinsurers anything—any action needs to be taken, but we have not had to decrease a receivable or take a write down on any of our receivables because of credit quality.

Specifically on the fronting side depending on the quality of the reinsurer, we run each of our counterparties through a collateral analysis to determine whether or not we need and how much collateral we need to collect. We look at their size, capital structure, history, licensing and authorization to determine that type of capital. When we look at the unearned premium, we look at the expected losses and then depending on the counterparty, we could be collecting 100% to 150% of that required collateral from the reinsurer involved to make sure that we do have adequate capacity on hand and make sure that that is either interest. We're either holding it in kind or looking at different types of arrangements to make sure that we do have that cash available. It's something that we are very focused on and make sure that we understand and make sure that there is no call it additional risk that we are taking from the reinsurance parties that are involved in these transactions.

Tracy Benguigui

Great. Thank you.

Operator

Thank you. At this time, I would like to turn the call back over to Mr. Armstrong for closing comments.

Mac Armstrong

Terrific. Thank you, Operator, and thanks to all who were able to join. We appreciate your participation, questions and importantly your support. I also want to thank our team at Palomar for their exceptional work and commitment. They're instrumental in our success.

To conclude, I'm proud of our results and the progress we made executing against our '22 strategic initiatives during the quarter. We did indeed deliver strong growth; we monetized or continue to monetize our new investments. We are enhancing our earnings predictability, and we are scaling. We do believe that we can continue to cultivate the new businesses, harvest the existing ones and attract outstanding talent to the Company. We have a foundation in place to deliver strong growth at a better than industry average ROE that will generate value for our investors and shareholders.

Along those lines, we are thrilled to announce that we'll be hosting an Investor Day on June 15 in New York City to discuss these topics in more detail. We hope that you can join our full team and business heads for a deep dive into our strategic plan that we are calling Palomar 2x. We will be sharing further details on the event in coming days, which will be posted in the IR section of our website. We look forward to seeing you in New York, June 15.

Thank you again and enjoy the rest of your day. Take care.

Operator

Thank you. This concludes today's teleconference and webcast you may disconnect at this time and thank you for your participation. Have a great day.