S&P Global
Market Intelligence

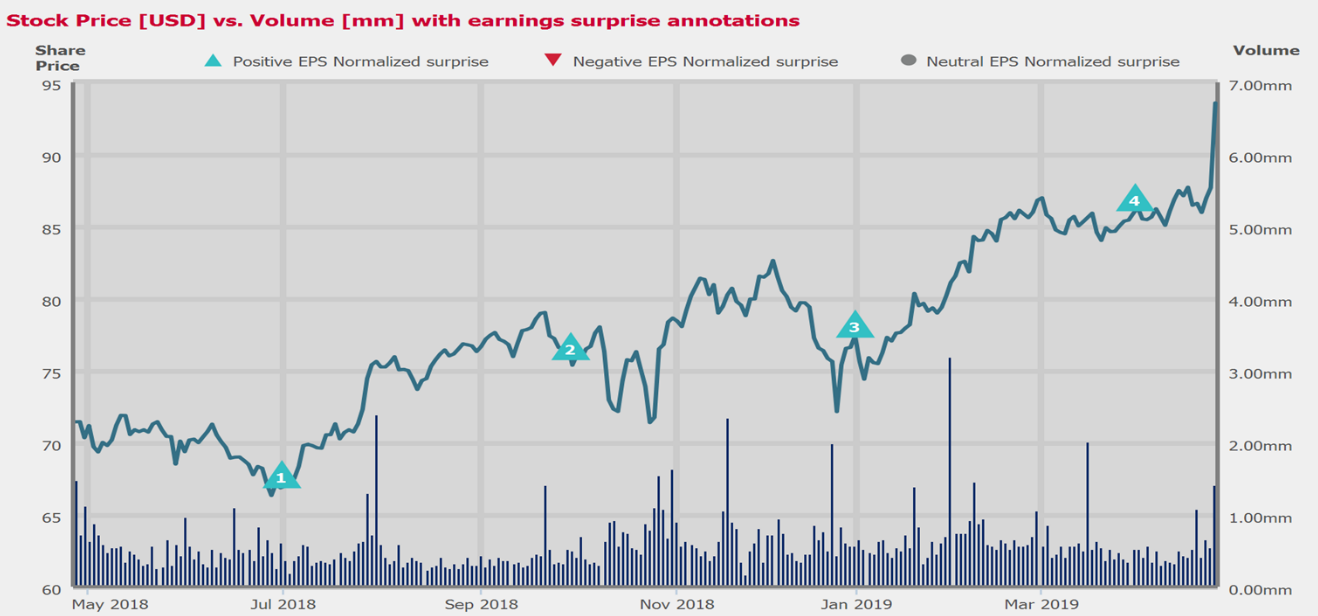
Cincinnati Financial Corporation
NasdaqGS:CINF
FQ1 2019 Earnings Call Transcripts

Thursday, April 25, 2019 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.88	1.05	▲19.32	0.68	3.59	3.65
Revenue (mm)	1472.60	2159.00	▲46.61	1500.35	5994.70	6270.40

Currency: USD
Consensus as of Apr-25-2019 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	0.55	0.81	▲1 47.27 %
FQ3 2018	0.73	0.84	▲2 15.07 %
FQ4 2018	0.87	0.98	▲3 12.64 %
FQ1 2019	0.88	1.05	▲4 19.32 %

Table of Contents

Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

Michael James Sewell
CFO, Senior VP & Treasurer

Stephen Michael Spray
Chief Insurance Officer & Director

Steven Justus Johnston
President, CEO & Director

ANALYSTS

Amit Kumar
The Buckingham Research Group Incorporated

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
Crédit Suisse AG, Research Division

Presentation

Operator

Good morning. My name is Heidi, and I will be your conference operator today. At this time, I would like to welcome everyone to the first quarter 2019 earnings conference call. [Operator Instructions] Thank you.

Dennis McDaniel, Investor Relations Officer, you may begin your conference.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our first quarter 2019 earnings conference call. Late yesterday, we issued a news release on our results, along with our supplemental financial package, including our year-end -- our quarter end investment portfolio. To find copies of any of these documents, please visit our investor website, cinfin.com/investors. The shortest route to the information is the Quarterly Results link in a navigation menu on the far left.

On this call, you'll first hear from Steve Johnston, President and Chief Executive Officer; and then from Chief Financial Officer, Mike Sewell. After their prepared remarks, investors participating on the call may ask questions.

At that time, some responses may be made by others in the room with us, including our Board of Directors' Chairman, Ken Stecher; Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance Chief Insurance Officer, Steve Spray; Chief Claims Officer, Marty Mullen; and Senior Vice President of Corporate Finance, Theresa Hoffer.

First, please note that some of the matters to be discussed today are forward looking. These forward-looking statements involve certain risks and uncertainties. With respect to these risks and uncertainties, we direct your attention to our news release and to our various filings with the SEC. Also, a reconciliation of non-GAAP measures was provided with the news release. Statutory accounting data is prepared in accordance with statutory accounting rules and, therefore, is not reconciled to GAAP.

And now I'll turn the call over to Steve.

Steven Justus Johnston
President, CEO & Director

Good morning. And thank you for joining us today to hear more about our first quarter results. Operating performance was quite good, and we believe it reflects our prudent strategy and careful execution as we seek to continue growing profitably over the long term.

Net income for the first quarter of 2019 was up $726 million from a year ago. Changes in the fair value of equity securities still held accounted for $672 million of the increase. Non-GAAP operating income, which we believe is a better indicator of short-term core operating performance, also improved significantly, up 43%. Our 93.0% property casualty combined ratio was 4.9 percentage points better than the year ago. Slightly worse catastrophe, weather effects in 2019, had an unfavorable effect of 1.4 points, while improved underwriting was indicated by several underlying measures.

The first quarter again demonstrated experienced management in pricing individual policies, which -- with average renewal price increases for each of our property casualty segments. That, along with excellent service, helped us to again earn more business through our agencies, contributing to 10% growth in net written premiums with healthy amounts of new business written premiums.

The Commercial Lines segment had first quarter 2009 (sic) [2019]estimated average price increases that were similar to the low single-digit percentage increases of the fourth quarter. That segment's 90.8% combined ratio improved by 7.5 percentage points, while the ratio for catastrophe losses was slightly worse than last year's first quarter. Our personal lines segment continued to experience average rate increases in the high single-digit range as the first quarter was similar to the fourth quarter. The personal lines fourth quarter combined ratio was challenged by severe weather. The combined ratio remained a little above 100% as the ratio for catastrophe losses was 4.4 points higher than a year ago.

Our excess and surplus lines segment reported another strong quarter, including double-digit growth in net written premium and a 2019 combined ratio of 83.5%.

Cincinnati Re continued to grow as planned and contributed nicely to underwriting profit with a combined ratio in the low 90s. Our life insurance subsidiary again grew term life insurance premiums, with first quarter up 10% on an earned basis. It's contribution to net income was down by $3 million primarily due to less favorable FX from the unlocking of actuarial assumptions and a net investment loss of approximately $1 million.

Results for the first quarter also included the month of March for our recently acquired global specialty underwriter and Lloyd's integrated vehicle, MSP Underwriting. We closed the transaction at the end of February with a payment of $64 million, which represents a multiple of 1.9x book value as of the closing.

MSP contributed $21 million to our first quarter net written premiums and generated an underwriting profit with a combined ratio in the low 50s, lower than typical, in part due to favorable aspects of purchase accounting for the first few periods following an acquisition.

We remain confident in future prospects for its profitable growth and plan to implement a new name next week for better alignment with Cincinnati's brand and highly regarded reputation.

I'll conclude with the value creation ratio, our primary measure of long-term financial performance. It was very good for the first quarter at 11.1%. The contribution of net income before investment gains was 2.2% and a strong stock market in the early part of the year helped boost the contribution of investment gains to 9.1%.

Next, our Chief Financial Officer, Mike Sewell, will comment on other key areas of our financial performance.

Michael James Sewell
CFO, Senior VP & Treasurer

Thank you, Steve, and thanks to all of you for joining us today. Investment income growth was very strong, up 5% for the first quarter of 2019. Dividends from our equity portfolio were up 10%, a result of dividend rates rising for many of our holdings. Interest income from our bond portfolio was up 1%. The pretax average yield was 4.15% for the first quarter, down 11 basis points from the first quarter a year ago. We continue to invest in bonds, including $19 million in net purchases during the quarter.

Taxable bonds purchased had an average pretax yield of 4.99%, 88 basis points higher than we experienced a year ago. Tax-exempt bonds purchased averaged 3.52%, up 20 basis points from a year ago. Despite the higher purchase yields, we continued to experience redemptions of relatively high-coupon bonds. Our investment portfolio valuation again experienced volatility from security market trends. But for the first quarter of 2019, that was favorable for both our stock and our bond portfolios.

The overall net gain was $905 million before tax effects. That included $656 million from our equity portfolio and $244 million for our bond portfolio. We ended the quarter with a net appreciated value of nearly $3.5 billion, including $288 million in our bond portfolio.

Cash flow from operating activities generated $200 million, up 30%, again, fueling investment income. Speaking of healthy cash flow, that helped to pay for the MSP acquisition without additional borrowing. Also remember, the acquisition can be characterized as bolt-on in nature. Much of the integration work relates to financial processes, and it's proceeding well. As we previously disclosed, for the foreseeable future, we plan to report MSP results as part of other, along with Cincinnati Re.

Turning to expense management. We continue to invest in our business strategically, while working to avoid wasteful spending. The first quarter 2019 property-casualty underwriting expense ratio decreased by

1.2 percentage points compared with the 2018 period, and it was basically in line with the full year 2018 ratio.

Regarding loss reserves, our approach remains consistent and again resulted in property-casualty net favorable development on prior accident years. Favorable reserve development for the first quarter of 2019 benefit our combined ratio by 5.3 percentage points with our commercial lines segment driving the more favorable result compared with a year ago.

For commercial casualty, our largest lines of business, we experienced $31 million of favorable reserve development representing nearly half of the property-casualty total. Most of our major lines of business experienced favorable reserve development during the quarter. On an all-lines basis by accident year, it included 24% for accident year 2018, 33% for accident year 2017 and 43% for 2016 and prior accident years. As for capital management, we've proven to be steady over the long term. Our financial strength remains in excellent shape with plenty of financial flexibility.

I'll conclude my prepared remarks as usual with a summary of the first quarter contributions to book value per share. They represent the main drivers of our value-creation ratio. Property-casualty underwriting increased book value by $0.44. Life insurance operations added $0.07. Investment income, other than life insurance and reduced by noninsurance items, contributed $0.47. Net investment gains and losses for the fixed income portfolio increased book value per share by $1.18. Net investment gains and losses for the equity portfolio increased book value by $3.18. And we declared $0.56 per share in dividends to shareholders. The net effect was a book value increase of $4.78 during the first quarter to a record-high $52.88 per share.

And now I'll turn the call back over to Steve

Steven Justus Johnston
President, CEO & Director

Thanks, Mike. The first quarter was another good one, and we remain optimistic about the future of Cincinnati Financial. Our confidence is enhanced by what we hear from our appointed agencies as we meet with them at our annual sales meetings around the country. They are enthusiastic about their business and how we partner with them to serve their clients for our mutual success. We'll continue to focus on execution of our proven strategy, seeking profitable growth for the benefit of all stakeholders and creating shareholder value over time. As a reminder, with Mike and me, today, are Ken Stecher, Steve Spray, Marty Mullen, Marty Hollenbeck and Theresa Hoffer.
Heidi, would you please open the call for questions?

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Michael Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question, just given it's a lot of carriers you're talking about some rate hardening. It seems to be more on the large commercial size of the market. Maybe you can comment whether you guys are seeing any meaningful changes in rates, sounds like you're not. And can you remind me, does Cincinnati do any of the kind of, large -- I don't know if it's Fortune 1000 or how to think about it also, but do you do any of the large account business currently?

Stephen Michael Spray
Chief Insurance Officer & Director

Yes, mike. This is Steve Spray. Fortune 1000, that would not be a target for us. We are moving up with expertise and specialization in some larger commercial lines risks, and that would be -- we would identify that as in excess of $250,000 in premium just to give you an idea because some national carriers would consider that more middle market.

As far as rate increases go, we have noticed a change in the marketplace, a noticeable change, since January 1. It's kind of hard candidly to put our finger on exactly where all that is coming from, and I think it's going to continue to evolve. We are certainly seeing commercial auto continue to firm. And as an example, surplus lines traditionally has always been a leading indicator for affirming market, and the number of submissions that are being sent to our E&S subsidiaries, CSU, are up substantially. And there are some traditional classes that kind of float in and out of standard markets and surplus lines market, as an example, habitational risks that they're seeing. But the majority of what they're seeing is kind of validating what I'm saying as far as auto. They're seeing a lot of excess liability, capacity issues in the marketplace for heavy fleet and such.

So long-winded answer, but I think that the commercial auto marketplace is still firming. I think that -- I believe that we're out in front of it by taking the action we took. And I also think one thing to pay attention, we talked about it last quarter, pay special attention to the average rate increases that are announced. I think the rising tide raising all boats of the past is, it's certainly not the future of Cincinnati Insurance company. We are really focused on executing on segmentation. So while you might see an average rate increase that we have disclosed, that certainly doesn't tell the full story of how we are executing with our agents at the ground floor.

We are segmenting the book, in that, really attacking the most inadequately portion of our book -- adequately priced portion of our book and doing all we can to retain the most adequately portion of the book and at that price.

Michael David Zaremski
Crédit Suisse AG, Research Division

That's good color. Do you -- as a follow-up, do you think -- do you sense that the industry's trend line in terms of expense inflation is rising as well? And maybe that's part of the impetus of rates moving north?

Steven Justus Johnston
President, CEO & Director

This is Steve. I think that we still see the loss cost inflation very much manageable by the rate that we are taking. And as Steve mentioned, looking at it risk-by-risk, policy-by-policy, and as we look at our loss cost trends versus where we see our premium trends, we're still comfortable, as we've mentioned in the past, in terms of our position.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Great. My next question was on personal lines, and this might be a long-winded question or more complex answer, but I'm just trying to understand how to better think about the growth dynamics. So I believe pricing, you guys have been pushing pricing in the middle -- mid-single digit, if not higher levels, recently. But the top line's growing by 4%, which is less than pricing, which kind of implies that maybe you're -- on an organic basis, you're shrinking a little bit. But then on the other hand, you're point -- you're talking about appointing a lot more personal lines agencies, and maybe that's the separate high-net-worth initiative that isn't yet substantial. So just trying to -- there's kind of some conflicting dynamics, trying to understand how -- what the competitive dynamic is in personal lines and how to think about that going forward for you guys?

Stephen Michael Spray
Chief Insurance Officer & Director

Yes. Great question, Mike. This is Steve Spray again. And you're absolutely right. We are, for our personal lines segment, all in. We are seeing high single-digit rate increases. The homeowner right now is still in the mid-single digit, but we expect it to continue to tick up, and auto is in the -- on the high end of the high single-digit range.

As far as the growth, personal lines is, rightfully so, under a little bit of pressure to the written premium growth. They are taking prudent, deliberate underwriting action, both underwriting and pricing action, across the country and really focusing on some specific states that need maybe a little stronger action than others. Michigan would be an example. Indiana, Kentucky, Georgia, those are just 4 that come to mind where they're really taking strong underwriting and rate action. And it is putting -- those are larger states for us, and it's putting some pressure on the growth as well.

But we continue to write new business. As you can see, we do continue to appoint new agencies. A lot of those do tend to have a high net worth focus on the personal lines only. But there is committed to the middle market and getting it profitable as well.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. And then -- and in terms of the high net worth, can you remind us how large that book of business is currently? And also just remind us how you define high net worth?

Stephen Michael Spray
Chief Insurance Officer & Director

Yes. So first of all, high net worth is, for us, is defined as the Coverage A, so the home value Coverage A replacement cost in excess of $1 million. And right now, it's about 25% of our overall personal lines book.

Operator

And your next question comes from the line of Paul Newsome with Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I wanted to see if you could give us a little bit more color on the reserve releases in the quarter, in particular, the change in the commercial-casualty piece that seemed -- It seemed a little bit bigger perhaps than we've seen in the past. And I realize, the fourth quarter tends to be a quarter with a decent amount of reserve releases in general. But is there something there that changed? Is it case -- I mean -- or anything that you can give me that just sort of tells me kind of what happened there with the reserve release?

Michael James Sewell
CFO, Senior VP & Treasurer

Paul, this is Mike. And maybe I'll make a few comments, and then if Steve wants to jump in with anything more, he can. So the -- for the commercial casualty, yes, it was about $31 million. So it was approaching half of the total favorable development for the quarter. If I think about it, and looking at it from the accident years, it was kind of spread across. There was about $9 million from accident year '18; $8 million, accident year '17; $1 million, '16; and then $13 million favorable development for the prior years to '16.

Generally speaking, as you know, and I've said on these calls before, we [indiscernible] consistent approach in what we do and setting the reserves. We've got the same actuarial folks who are setting those reserves, so we haven't had any changeover in that area. We don't know how paid losses will actually occur. We're watching that come in quarter-to-quarter, plus other factors that the actuarial folks will think of. So paid loss -- or paid losses, cost trends have been improving if you look back at Footnote 4 from our 10-K. Even in the first quarter, our case incurred has improved. So in the supplement that we also put out on Page 10, it gives kind of a -- little bit of a preview there, but you'll see our case incurred is down about 20% versus the average per quarter for 2018. So at this point, let's see how the reserves develop, and we're going to follow our actuaries' consistent process in setting reserves.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

That's great. Completely different topic. So you've got Lloyd's operation, the reinsurance business, the [E&S] business continues to grow nicely. How has that changed or potentially changes your reinsurance use? To me like -- I was thinking that -- as I was looking at results today, the makeup's changing a fair amount, even with high-net-worth business, right in the personal lines bigger limits and such? Does that mean you might look at reinsurance usage differently in the future?

Steven Justus Johnston
President, CEO & Director

Paul, this is Steve. Excellent question. We have thought about that a good bit. And -- we did a year ago, July 1, actually put -- buy a new contract. Part of that contract, specific to the reinsurance, was a clash cover that we wanted to have, where there might be losses to both traditional Cincinnati Insurance and Cincinnati Re. And basically, even though we disclosed everything, I didn't want the market to be surprised by thinking that we had this clash cover in place when we didn't. Through the modeling, through working on being cognizant of not writing reinsurance where we are exposed on the primary side, we think that the lack of correlation there works in our favor. But just the same, we wanted to get some clash cover.

So the Section A of the contract that we bought last July 1, provided $50 million of coverage excess of $125 million where we might have a loss that would come in from both parties. And that would be one instance where we've looked at reinsurance differently, and we'll continue to look at the growth. We have a very vigorous risk management area that does a lot of modeling and gives us insights into where we could have exposure that might need additional cover.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Would that clash cover also cover the Lloyd's operations prospectively or not? Just curious.

Steven Justus Johnston
President, CEO & Director

No, not at this point.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I was looking at the premium volume in the personal auto section and saw it flat, which hasn't been flat since 2011, I guess. And you're taking a lot of rate, I guess, and losing some customers. But I assume you're keeping their homeowners with you? Or can you talk about the -- how the bundle fell? And whether there's a movement for customers to unbundle and seek a different carrier for their auto as time progresses with higher pricing?

Stephen Michael Spray
Chief Insurance Officer & Director

Josh, Steve Spray again. Thanks for the question. Yes, unbundling, we're not -- we watched that. We're not seeing that. It's an excellent question. We're a package writer. We are looking to write package business. What you're seeing with our auto is again what I had mentioned earlier, it's just taking appropriate underwriting and rate action. And like I said earlier, high single-digit rate increases on auto have put pressure on the growth there. So the retention on our auto is a tick below what our homeowner is, and it's even more so in those specific states that I mentioned. And I'd say Ground Zero for us, quite frankly, is Michigan with that.

Now one other thing to think about as we continue to write more high net worth and change the mix of our business. High-net-worth homeowner -- or excuse me, high-net-worth packages typically have a lower auto premium as a total percentage of the package versus middle market. So that's showing up there a little bit as well.

Joshua David Shanker
Deutsche Bank AG, Research Division

Sorry, I don't mean to put words in your mouth. But if I look at -- I think you said that pricing was up high single digits and the auto is flat, which says to me that policy count is down. I mean it might not be exact but somewhere between 5% and 10%, I would think. Are you losing 5% to 10% of the homeowners' policies as well or a tick below that? Is it -- am I reading that correctly? Or how should I think about what happens to that package as you lose the auto?

Stephen Michael Spray
Chief Insurance Officer & Director

I think it varies account-by-account and situation-by-situation, Josh. We may have auto that is distressed. That would go to another market, and we would keep the homeowner or the entire package might go.

Steven Justus Johnston
President, CEO & Director

And, Josh, this is Steve Johnston. Just as I heard, you kind of, I think, restate what Steve said. I just want to make sure to clarify. The rate increases we're getting on the auto, personal auto side is in the high single digit.

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. That's -- I think that was clear. So I guess -- yes, go ahead.

Steven Justus Johnston
President, CEO & Director

And just one more little bit of information is that about 84% of our personal lines accounts are on a package basis.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. And in terms of the -- I guess the policies that you're losing, do they tend to be more or less on the high-net-worth side or are they on the, I guess, the more mainstream part of the portfolio?

Stephen Michael Spray
Chief Insurance Officer & Director

It would -- Josh, it would be more on the middle-market portion of our business.

Operator

Your next question comes from the line of Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Some of my stuff's already been answered. But with respect to the -- just since it's new, can you break apart within the other segment, what portion of that was the right -- the previous reinsurance business as compared to how much was new premium from MSP?

Michael James Sewell
CFO, Senior VP & Treasurer

Yes. Mark, this is Mike Sewel. And so if you think about the other section that is a part of the -- that was in the press release, and I believe it was about -- hold on here.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

$105 million of written premiums was in the other...

Michael James Sewell
CFO, Senior VP & Treasurer

Yes. It was about -- for the -- what have we got here, it was -- about $40 million of earned premium was related to Cincinnati Re for the quarter and $10 million of earned was for MSP underwriters.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And what about on a written basis? Is that -- would that same ratio apply?

Michael James Sewell
CFO, Senior VP & Treasurer

It's probably going to be fairly close. Although for the Cinci Re business, what they wrote for the quarter was they had -- $84 million is what they wrote for the quarter, and it was $20 million written for MSP.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. And then the last question that I had related to that, I guess, was -- I mean we know that Cincinnati Re business has a certain amount of seasonal variation to it. Is the MSP similarly seasonal? I know it's a lot of property or is it more steady throughout the year?

Michael James Sewell
CFO, Senior VP & Treasurer

Yes. It's going to be also a little bit seasonal. Some of their policies will be, kind of, like when you think about revenue recognition, that will be recognized over straight line over the year. But they are -- they've got a lot of more seasonality related to wind. And so as we watch the earnings pattern over that, you'll probably tend to see more of their earned premiums occurring later in the year, and it will not be as consistent as you see the rest of our business.

Steven Justus Johnston
President, CEO & Director

And I might just tag on there, and it's a little bit of a follow up to the reinsurance buying question and that as we've modeled, while we don't have additional reinsurance for Beaufort at this point we have been significant modeling in this place, and it's our 10-K, Page 34, if you want to read more about it. But for a single hurricane at the 1 and 250 level, we estimated Beaufort would add about $55 million in terms of after-tax, after-reinsurance-estimated loss. So that's about 1 loss ratio point. So we will continue to look at that seasonality as you asked and are definitely doing a good job of managing the risk there.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. And the other question I wanted to ask about was really just within your workers' comp book. I know that -- I mean you indicated that, that area, that remains a line of business but is not seeing much rate, in fact, probably still some declines. But what are -- how are the loss trends holding out there? I know they've been favorable for quite some time. Have you begun to see any shift in that?

Stephen Michael Spray
Chief Insurance Officer & Director

Mark, Steve Spray. Yes, our rate is still under pressure there. And I think it is for the industry as well, as in, Cinci continues to decrease base rates. We're down mid-single digits year-over-year on written -- or excuse me, on our net rates. We're still feeling very good about the underwriting and the pricing of that book. The analytics tools we use show that we are still priced very adequately. The segmentation looks really good. But there's no doubt that the accident year quarter has deteriorated over first quarter of '18, and I think that those accident year results will continue to be under pressure. It's just simple math.

We are still managing, I think I mentioned it last quarter. We're managing workers compensation so well out of our claims area and our loss control underwriting and pricing and just feel really good about it. It's just -- it's a competitive environment, and we're just going to have to continue to pick our opportunities.

I mentioned this last quarter as well, I think one thing that's different about workers' compensation that gives us a little hedge there is that unlike other commercial lines, major coverage lines. If the comp isn't favorable to us, whether it be the underwriting attributes or the pricing, we can typically still write that package and have the agent work with us to get that comp placed somewhere else.

So yes, we're still -- we still are looking for opportunities. And like I mentioned before, we still want to grow the work comp line, but there's no doubt that it's under pressure. I think it's under pressure for the industry.

Operator

Your next question comes from the line Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

One follow-up on workers' compensation, please. Is the best comparable for the first quarter accident quarter loss ratio? Is that the first quarter of last year or the full year number?

Steven Justus Johnston
President, CEO & Director

Well, I have -- Meyer, I have the current accident year before catastrophe losses here, and for the first quarter 78.8. For the same quarter a year ago, 73.1. So that's one quarter. Do those match what you're looking at?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

They do. But we saw a significantly higher number in the fourth quarter of last year, and I'm wondering whether that sort of represents a rebasing of accident year '18 as a proxy for the rate-driven compression that we're seeing?

Steven Justus Johnston
President, CEO & Director

No. I think we just call them as we saw them, and there's going to be some volatility in any line quarter-by-quarter. And to Steve's point, we feel good about our prospects and workers' compensation and Steve and his team are doing a great job of balancing the risk versus rate situation policy-by-policy.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. No, that's very helpful. Second, really a small ball question, I guess. If we take out the tax impact on the realized and unrealized gains, they get an operating income tax rate of about 15.7%. Is there anything unusual in that?

Michael James Sewell
CFO, Senior VP & Treasurer

No, probably not -- near too much. I would say if you're -- when you're looking at your models that you're building out for our investment income, so if you think with the same current mix that we currently have, our effective tax rate will probably be approaching 16%. But then really, almost everything else is going to be a 21%. So depending on the size of operating income compared to investment income, that's going to fluctuate in between there. So maybe if you put in a blended rate of about 17%, 18% effective tax rate, you'll probably get close on a long-term basis.

I will probably also say that for MSP, their effective tax rate might be just -- might be around 21%. But because of the size of it and the way that will fluctuate, it probably will not have a significant impact on your overall estimate for an effective tax rate.

Operator

Your next question comes from the line of Larry Greenberg with Janney Montgomery.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Mike, heard your commentary on reserves and commercial casualty. Just wondering if you could give us a little bit more color on the commercial auto reserves? I mean it clearly has been a little bit of a problem for you guys and everybody else in the industry. It looks like maybe in the first quarter turn the corner a little bit. Any more color you could provide there?

Michael James Sewell
CFO, Senior VP & Treasurer

Yes. Let me give you a -- from what I can, and then if Steve or someone else would like to chime in. So for the commercial auto, that was favorable. $11 million for the quarter. If I kind of look out over which accident year was that, $10 million was accident year 2018. So a majority, obviously, a clear majority, is going to be right there with it being a short tail.

Accident year 2017 was a favorable $2 million. Accident year 2016 was unfavorable, so we've strengthened there by $2 million. But then accident year 2015 and before, it was favorable by $2 million. So it's -- a lot of it is more of the current accident year that we were seeing, just looking at that as a page-command case, it's still following that consistent process.

Steven Justus Johnston
President, CEO & Director

Yes, Larry, and this is Steve. And I agree with everything Mike said, and I do think that a lot of hard work over many months, quarters, years has been put into the line. And it's been a real team effort from claims to underwriting to loss control and do feel that through the consistent process that Mike mentioned, we have turned the quarter -- corner after some times when we've had some adverse development there to feel good about the position of the reserves for commercial auto.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Great. And then I know the purchase accounting for MSP was probably tiny this quarter, but it probably gets a little bit bigger, although still probably insignificant in subsequent quarters when you have it for the full period. But is there any way of quantifying that impact?

Michael James Sewell
CFO, Senior VP & Treasurer

For right now, it's -- there's probably more detailed analysis. We do have -- we went through a process. First, we had an estimate of what we thought we would pay, which was about GBP 102 million that we had disclosed that back in October. And really then, when it came to closing, which was at the end of February, a lot of those adjustments come with what's the net asset value or the estimated net asset value at that point? And then you add on the implied premium that we were paying for the organization. So.

There we -- when we did close, we paid $64 million for the closing. We have paid an extra $35 million in extra funds at Lloyd's. So that's extra capital. Had Munich put that in before we closed, we would have been closer to the GBP 102 million that we originally disclosed. Thinking about, once you take that, you revalue your assets and the liabilities assumed, you have to look at the intangibles then that fall out from that, goodwill. There's a couple of things that do, or at least one item gets written off. Deferred acquisition costs, that comes off. That doesn't continue on, so that gets written off.

We did have to relook at the deferred tax assets under U.S. GAAP. How much of that can be realized or you set up a valuation allowance against that, which we did do. And then you add on the premium. So when you add all that together, we really, at least, right now, we're estimating that we've got about $82 million of intangibles and goodwill that will be on our books, subject to further adjustments that can and will occur over the next quarter or 2.

If I'm thinking about the goodwill, that probably will make up maybe about -- I'm going to say 1/3 of the intangibles and goodwill. We'll have some syndicate capacity, distribution relationships, the value and force. So some of those will be amortized. Some of those will not be amortized. So when you don't have deferred acquisition costs being amortized, being replaced with a little bit of intangibles, you're going to pick up some benefit there, at least during the first 4 quarters, I'll say.

That's probably more than you wanted to hear, but it's a very complicated question that accountants love to answer.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Yes, yes. No, I was actually just really, kind of, focusing on the [deck] write-off and the benefit you get on the expense ratio from not having to amortize that, but I appreciate all of the commentary.

Operator

Your next question comes from the line of Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Just a few follow-ups. The first question I have is going back to the reserve releases coming out of the E&S segment, it seemed to have trailed off over the past 2 quarters. And before that, they were running at a meaningfully higher clip. Can you just talk about what is causing that drop-off in reserve releases?

Steven Justus Johnston
President, CEO & Director

Thank you, Amit. This is Steve Johnston. Good question. We have, and I think we've talked about this in some past calls. But as we start up any new operation and we look at how to set the reserves without a lot of actual experience for the E&S company, we look to industry, we look to Cincinnati Insurance, which [we generally write] similar risks at higher limits, and we use judgment, different methodologies. And over time, as we gather more actual data for the E&S company, we start to blend that actual CSU data into the computation and estimation of the reserves. And that is what is driving what you're seeing in terms of we're seeing favorable development for the E&S company.

So what we're focusing on, and I think where you'll see more consistency, is in that ex cat accident year number and combined ratio, that's been running in the low to mid-80s that we feel very good about that position and the consistency there and the strong performance of CSU, both in growth and profitability. But I hope that explains a little bit about what you're seeing in the change from quarter-to-quarter on the favorable reserve development.

Amit Kumar
The Buckingham Research Group Incorporated

Yes, it does. The other question was maybe a bit broader. This goes back to the discussion on pricing in commercial that you talked about low single digit and E&S, low single digits. Is that pure pricing? Does that exclude exposure? If you included exposure, what would be -- the number be?

Stephen Michael Spray
Chief Insurance Officer & Director

Yes. Amit, this is Steve Spray. That number excludes exposure. If you added the exposure in, it would probably add about 2 points to those numbers.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. And maybe I can take this offline. I got a sense listening to some of the calls that E&S pricing discussion was a tad higher. I think I heard like a higher single-digit number. But maybe I can follow up offline as to why we're getting this, sort of, wide range of pricing metrics from different companies. Or I don't know if you have any thoughts on that.

Stephen Michael Spray
Chief Insurance Officer & Director

Yes. Amit, I think we can certainly address that here. I think E&S companies vary on their appetite, whether they look at property cat, whether they're in the tougher product liability, construction. It varies by -- from company-to-company. And as an example, almost 90% of the E&S business that our CSU writes is on the casualty side. And it can be tougher business, but it's stable. The pricing has been good for a long time. The underwriting has been solid. And so I think that's why you would, in effect, relative to others maybe that has -- may have, say, a Florida coastal book, the rate increases would be muted. But it wouldn't be apples-to-apples either. Does that make sense?

Amit Kumar
The Buckingham Research Group Incorporated

Yes, it does. I think that's all I have. I do want to commend you on your exhaustive letter introduction. That is always helpful in the 10-K. So I will stop here, and good luck for the future.

Operator

[Operator Instructions] And your next question comes from the line of Mike Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

One follow-up on the E&S segment, given how profitable it is. I was curious if there's something unique about your value proposition or -- and/or maybe distribution that's allowing you to capture business that's so profitable. And maybe along the same lines, if you're willing to talk about who do you feel your competitors to be in that space?

Stephen Michael Spray
Chief Insurance Officer & Director

Mike, Steve Spray calling -- or calling -- answering on this. Thank you very much. Good question. Yes, our value prop for CSU is multifaceted. First and foremost, the time -- at the time when we formed the company, nonadmitted carrier that takes the risk, we also formed a brokerage because you have to have a brokerage involved in the E&S business to take care of surplus lines, taxes and all the compliance that goes with a nonadmitted carrier. So the key with that is that only licensed and appointed contracted agents of Cincinnati Insurance Company have access to our E&S company.

We do not go through wholesalers, MGAs, MGUs. It's only appointed agents of Cincinnati Insurance company that in effect have direct access through our brokerage to our E&S company.

Another big factor is that I think you might know that our profit sharing, we would stack it up against anybody in the industry. We include the premium and losses from our E&S company into the agents' profit-sharing calculations. So we share in the profitability of that business with them. I'd like to think we can run the E&S operation leaner than what the marketplace does because we don't have so many cogs in the wheel. And so what we do is we return more of that to the agent. We pay 15% commission up front to the agencies, which in many cases, might be double what they would get in a traditional E&S placement.

I think most importantly, beyond the compensation is -- on our E&S company, many E&S risks are well-managed good people in the community. They just happen to be in a tough class of business. And when our agents know that our local claims rep that has a relationship with them that's assigned to the agency is also going to handle the E&S claims, that's a big, big deal. Because in many cases, those E&S claims in the other markets would be sent out to a third party, that may handle it just fine, but our agents know exactly what they're going to get from our local claims rep. And it gives them a peace of mind.

They also have access to all resources of Cincinnati Insurance Company, whether it's loss control, claims, premium audit. We've now introduced, about a year ago -- 18 months ago, direct bill into our E&S, which is unique. That's attractive for our agents and for policyholders as well.

So we think, again long-winded, we think we've got a really differentiating value proposition in E&S and think that we are just scratching the surface inside our own agencies today. Our E&S business is approximately $275 million, and we've identified that our agencies that we do business with write about $3.5 billion in the market. So our runway to write more business inside our agencies is -- as you can see, is really strong.

Michael David Zaremski
Crédit Suisse AG, Research Division

That's very helpful. Yes, sounds like there's some strong competitive advantages there, so best of luck.

Operator

There are no further questions in queue. I'd like to turn the call back over to Mr. Johnston.

Steven Justus Johnston
President, CEO & Director

Thank you, Heidi. And thanks to all of you for joining us today. We hope to see some of you at our Annual Meeting of shareholders on Saturday -- this Saturday, April 27, at the Cincinnati Art Museum. You're also welcome to listen to our webcast of the meeting available at cinfin.com/investors. We look forward to speaking with you again in our second quarter call. Thank you all very much.

Operator

And this concludes today's conference call. You may now disconnect.