S&P Capital IQ

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CNA Financial Corporation NYSE:CNA

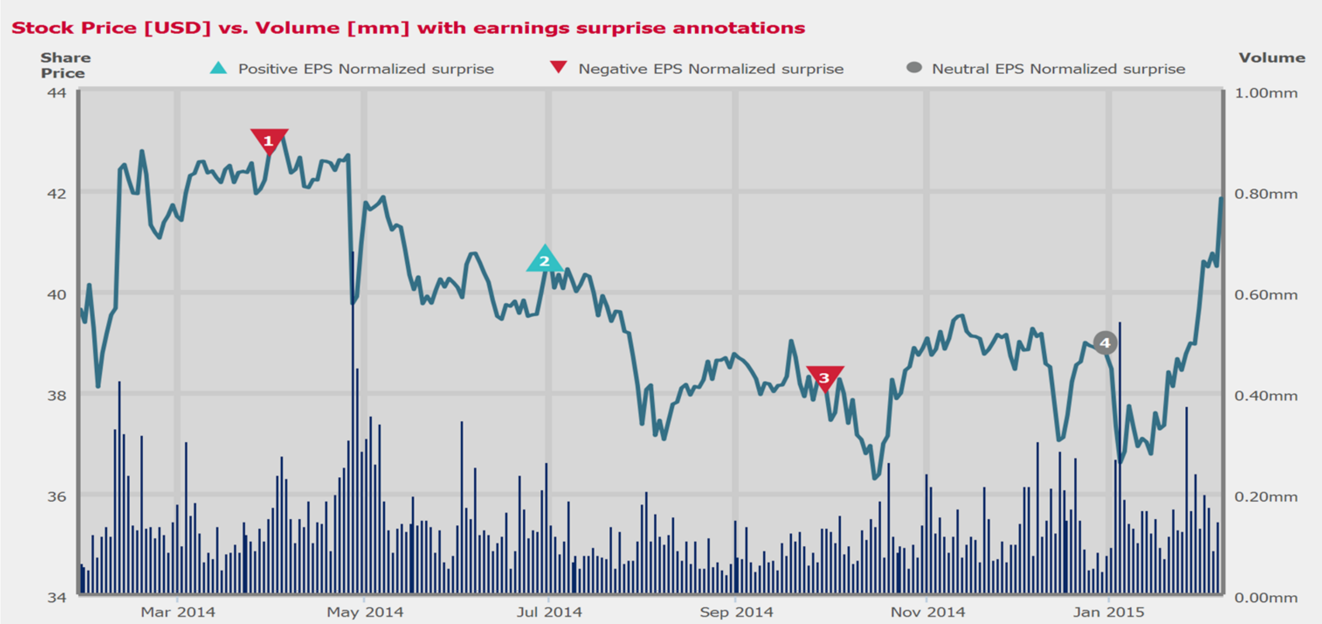
FQ1 2015 Earnings Call Transcripts

Monday, May 04, 2015 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2015-			-FQ2 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.81	0.83	2.47	0.91	3.48	3.63
Revenue (mm)	-	1669.00	-	1687.00	-	6800.00

Currency: USD
Consensus as of May-04-2015 11:09 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2014	0.83	0.70	(15.66 %)
FQ2 2014	0.82	1.00	21.95 %
FQ3 2014	0.78	0.68	(12.82 %)
FQ4 2014	0.76	0.76	0.00 %

Call Participants

EXECUTIVES

D. Craig Mense
Chief Financial Officer and Executive Vice President

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

Thomas F. Motamed
Former Chairman and Chief Executive Officer

ANALYSTS

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good day, and welcome to the CNA Financial Corp. First Quarter 2015 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the conference over to James Anderson. Please go ahead.

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

Thank you, Lexie. Good morning, and welcome to CNA's discussion of our 2015 first quarter financial results. By now, hopefully all of you have seen our earnings release, financial supplement and presentation slides. If not, you may access these documents on our website, www.cna.com.

With us on this morning's call are Tom Motamed, our Chairman and Chief Executive Officer; and Craig Mense, our Chief Financial Officer. Following Tom's and Craig's remarks about our quarterly results, we will open it up for your questions.

Before turning it over to Tom, I would like to advise everyone that during this call, there may be forward-looking statements made in references to non-GAAP financial measures. Any forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made during this call. Information concerning these risks is contained in the earnings release and CNA's most recent 10-Q and 10-K on file with the SEC.

In addition, the forward-looking statements speak only as of today, Monday, May 4, 2015. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

Regarding non-GAAP financial measures, reconciliations to the most comparable GAAP measures have also been provided in the financial supplement.

This call is being recorded and webcast. During the next week, the call may be accessed on CNA's website. I'd also like to remind you that presentation slides have, again, been posted to our website and provide additional perspective on our financial and operating trends.

With that, I will turn the call over to CNA's Chairman and CEO, Tom Motamed.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, James. Good morning, everyone, and thank you for joining us today. In the first quarter, CNA produced net operating income of $225 million, an increase of 18% from the first quarter of 2014. Our results reflect continued underwriting margin improvement in Property & Casualty Operations, lower catastrophes and strong limited partnership returns.

Our Property & Casualty combined ratio for the quarter was 98.9, an improvement of 2.7 points compared with the prior year quarter. Excluding catastrophes and development, the combined ratio was 96.7, which is a half point better than last year's first quarter.

Specialty continued to produce good results in an increasingly competitive environment. The first quarter combined ratio was 94.6, a half-point higher than the first quarter of 2014, as a 1.1 point improvement in the underlying loss ratio and lower catastrophe losses were offset by higher expenses and less favorable development. Specialty rates increased 2% in the first quarter with retention of 84%.

We are pleased to report continued progress in Commercial. The first quarter combined ratio of 103.3 was a significant improvement compared with the prior year period. This improvement is a result of the disciplined underwriting actions we have been taking, coupled with a lower level of catastrophes and the absence of unfavorable loss development. Commercial's combined ratio, excluding catastrophes and development, was 100.5 or approximately 1 point better than last year's first quarter. Notably, the loss ratio, excluding catastrophes and development, was 64.1, 3.1 points better than the prior year period. Commercial rates increased 3% in the first quarter with retention of 76%.

International's first quarter combined ratio of 98.3 was 4.8 points higher than in the prior year quarter. The increase was primarily due to the decline in premium, which was driven by adverse premium development and the impact of foreign currency exchange rates.

With that, I will turn it over to Craig.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Thanks, Tom. Good morning, everyone. As Tom mentioned, we reported first quarter net operating income of $225 million or $0.83 per share, an 18% increase over the prior year period. The operating return on equity was 7.4%. Net operating income from our core P&C Operations was $264 million, 21% higher than the first quarter of 2014. The increase is attributable to continued improvements in our underlying Commercial underwriting results, lower catastrophes and increased limited partnership investment income.

Our Property & Casualty underwriting results continue to improve. The loss ratio was 64.5%, a 3.8 point improvement compared with the first quarter of last year. The underwriting loss ratio of 62.3% was 1.6 points better than the prior year quarter. As importantly, the underlying loss ratio showed consistent improvement from where we ended the full year 2014, as you can see on Slide 11 of our earnings presentation.

P&C operations expense ratio was 34.1%, higher than previous quarters due to lower earned premium and the absence of any favorable expense recoveries, which have benefited each of the last several quarters.

Specialty's loss ratio was 63.1% in the quarter, an improvement of 8/10 of a point compared with the prior year quarter. The underlying loss ratio improved by more than 1 point period-over-period to 62.2% and was essentially unchanged from where we ended the full year 2014. Expense ratio increased 1.3 points to 31.3%, primarily the result of ongoing investments in underwriting resources and technology.

The Commercial loss ratio was 66.9%, which represents more than a 10-point improvement compared to the first quarter of last year. The underlying loss ratio was 64.1%, a 3.1 point improvement period-over-period and a further 0.5 point lower than where we ended the full year 2014. Expense ratio was 36%, an increase of 2.1 points, primarily as a result of lower earned premium and the absence of favorable expense helps that I mentioned earlier.

International's loss ratio in the quarter was 60.7% compared with a 54.2% result in the prior year quarter. The increase was primarily due to the unfavorable effect of net prior year earned premium development and a higher current accident year loss ratio. The previous year also benefited from the favorable impact of commutations. The underlying loss ratio was 56.7%, which was almost a point higher than the same period last year, but more than 3.5 points lower than our full year 2014 result. International expense ratio declined 1.7 points to 37.6%, reflecting efficiency gains.

Life & Group produced a $17 million net operating loss in the quarter compared with a $2 million loss in the first quarter of last year. The unfavorable comparison was primarily driven by morbidity in our long-term care business this quarter compared with the 9 morbidity [ph] in the prior year.

Our corporate segment produced a net operating loss of $22 million compared with a $27 million loss in the first quarter 2014. The full impact of last year's debt refinancing has meaningfully lowered our interest expense.

Net investment income was $558 million in the first quarter. Income from limited partnership investments was $114 million, a return of 3.9% compared with $73 million, a return of 2.7% in the prior year period. Income from our fixed maturity securities in the first quarter was $443 million, down slightly from the prior year period but relatively unchanged on an after-tax basis, as you can see on Page 17 of the earnings presentation.

Our investment portfolio of net unrealized gains is approximately $3.7 billion at quarter end, an increase of 8.7% since the end of the fourth quarter.

At March 31, shareholders equity was $12.4 billion, a reduction of approximately $350 million compared with year-end 2014. Book value per share was $46.02 a share, a 2.9% decline over the same period. The reductions reflect the dividend payments in the first quarter of $608 million or $2.25 per share. Adjusting for these dividend payments, book value per share increased approximately 2% since year-end 2014.

Cash that was surplus at March 31, 2015, was an estimate $10.7 billion for the combined insurance operating companies, and we continue to maintain ample dividend capacity.

Cash and short-term investments at the holding company were approximately $460 million at quarter end. We continue to target cash at the holding company equal to approximately 1 year of our annual net corporate obligation.

In the first quarter, operating cash flow, excluding trading activity, was $81 million. Cash principal repayments through paid down bond calls and maturities were approximately $1.1 billion. Fixed income assets that support our long-duration Life & Group liabilities had an effective duration of 10.3 years at quarter end. The effective duration of the fixed income assets which support our traditional P&C liabilities was 4.1 years at quarter end. These durations are both in line with portfolio targets.

Average credit quality of our fixed maturity portfolio remained at A. Overall, investment portfolio remains well-diversified, liquid, high-quality and aligned with our business objectives. We continue to maintain a very conservative capital structure. All our capital adequacy and credit metrics are well above our internal targets and current ratings.

With that, I will turn it back to Tom.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, Craig. Overall, we had a good quarter and a strong start to the year. While premiums were down 6%, about 1/2 of the decline was due to specific underwriting actions and foreign exchange effects. Nonetheless, our highest priority continues to be improving profitability. As market conditions get more challenging, it is important that we maintain focused on the strategy that has driven our recent loss ratio improvement.

We continue to shift our portfolio away from less profitable lines and segments while building scale and further enhancing capabilities in our targeted customer segments. We have changed our mix significantly over the years, and the result is evident in our improved profitability.

We continue to execute our tier strategy differentiating rates on an account-by-account basis. We're taking a disciplined approach to new business. In this phase of the market cycle, it can be easy to loosen up your standards to show growth. But we are focused on keeping our hard-earned margin improvement.

Within the focus segments, we are still finding some opportunities for profitable growth as we re-underwrite other parts of the book. We have confidence in our strategy, the management of our portfolio, our approach to the market and must continue to execute regardless of the market conditions that the rest of 2015 brings.
With that, we would be glad to take your questions.

Question and Answer

Operator

[Operator Instructions] And we'll take your first question from Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First, can you identify just the FX impact on premiums and specifically just in the International segment? In other words, what would the growth have been in original currency?

D. Craig Mense
Chief Financial Officer and Executive Vice President

In International segment, it would have been about half of the impact in International in terms of the decline. On the total place, it had about a 2% effect.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That is helpful. And then secondly, in the Specialty segment, the expenses were a bit higher. You talked about making investments in underwriting and technology. Is this kind of a run rate going forward? Or were some of these onetime investments?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, Jay. I think that's a run rate going forward. If you -- you might recall the conversation we had at the end of last year in the fourth quarter where we had talked about that we had about 1.5 of help across the whole place in expense -- from some expense recoveries, from prior. So we are making investments in both technology and underwriting in that business and in the -- also in the Commercial businesses. But if you look at the total, I think you'll also see that where we are spending money, so it's not -- it is more incremental in Specialty than it might be in Commercial. So we are harvesting productivity improvements and reducing expenses in a lot of places in the business. You could see the constant underwriting dollars across the place are pretty steady. And then we're reinvesting that in the future of the business.

Operator

And we'll take our next question from Bob Glasspiegel with Janney Capital.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Question on long-term care morbidity. How big was the penalty this quarter and what drove it?

D. Craig Mense
Chief Financial Officer and Executive Vice President

It's really volume-related, Bob. So maybe we should talk a little bit about the -- we've had pretty benign morbidity for the first 3 quarters of '14, if you recall. And then we've had pretty significant increase in morbidity the last 2. So it's all volume-related. And we talked a bit about the variability. So it's a pretty big number like period-over-period. It's probably $20 million-plus in terms of earnings impact. But in terms of what we would have expected as the -- as this group or block of business ages, it's maybe a $10 million or $12 million bad guy relative to what our expectations were. And then we had some offsetting positives on persistency and rate increases, which kind of mitigate that effect, if that's helpful.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Yes. So incidence -- claims incidence or severity when you say volume.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Incidence, not severity.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. And in the good news category, we've had a couple of quarters of sort of benign reserve development. Can we declare a victory? Where are we on the trucking element turnaround and...

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I think the short answer is, we're not declaring victory, but we're pretty confident that the underwriting and pricing actions and portfolio management that we have been working on are starting to pay off. So we're -- we feel pretty good, but never declare victory at this point. The actuaries always telling me that.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Right. How much of the business have you repriced?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well we're always repricing the business. So I think the good news is, if you look at middle market, which is a big section in Commercial, we haven't given back rate in any of our tiers. Even our best tier has been flat. And all the other tiers were getting rate increases. So we're always trying to improve profitability. Rate is one of the factors we look at, but it's also risk selection and portfolio management, which we think we're doing a pretty good job at. And if you look at small business, which is a piece of our Commercial business, we're getting rate increases in all of the tiers. And we're throwing out a lot of stuff. So we're confident this strategy is going to work.

Operator

[Operator Instructions] It appears we have no questions in the queue at this time. I'd like to turn the conference back over to Tom Motamed for additional or closing remarks.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Okay. Thank you very much. See you next quarter.

Operator
And this concludes our conference for today. We thank you for your participation.