S&P Capital IQ

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Cincinnati Financial Corporation NasdaqGS:CINF

FQ1 2014 Earnings Call Transcripts

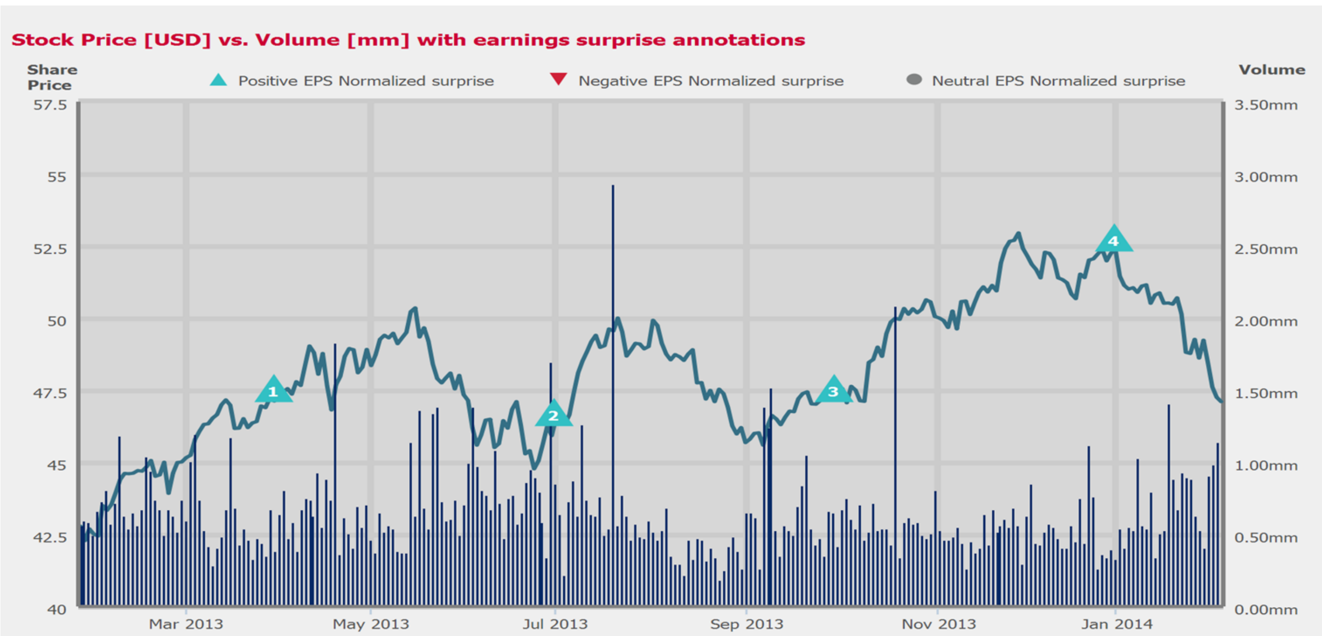
Friday, April 25, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.46	(14.81 %)	0.55	2.46	2.89
Revenue (mm)	1145.75	1189.00	3.77	1171.50	4733.30	5156.97

Currency: USD

Consensus as of Apr-17-2014 9:33 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.65	0.78	20.00 %
FQ2 2013	0.42	0.61	45.24 %
FQ3 2013	0.62	0.70	12.90 %
FQ4 2013	0.69	0.72	4.35 %

Call Participants

EXECUTIVES

Dennis E. McDaniel
Vice President and Investor Relations Officer

Jacob F. Scherer
Former Chief Insurance Officer

Martin J. Mullen
Chief Claims Officer of the Cincinnati Insurance Co. and Senior VP of the Cincinnati Insurance Co.

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

ANALYSTS

Bijan Moazami
Guggenheim Securities, LLC, Research Division

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

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good morning. My name is Jay, and I will be your conference operator today. At this time, I would like to welcome everyone to the Cincinnati Financial first quarter 2014 earnings conference call. [Operator Instructions] I will now hand the call over to Mr. Dennis McDaniel, Investor Relations Officer. Please go ahead.

Dennis E. McDaniel
Vice President and Investor Relations Officer

Hello. This is Dennis McDaniel from Cincinnati Financial. Thank you for joining us for our first quarter 2014 earnings conference call. Late yesterday, we issued a news release on our results, along with our supplemental financial package, including 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 the 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 Executive Committee Chairman, Jack Schiff, Jr.; Chairman of the Board, Ken Stecher; Chief Insurance Officer, J.F. Scherer; Principal Accounting Officer, Eric Matthews; Chief Investment Officer, Martin Hollenbeck; and Chief Claims Officer, Marty Mullen.

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, please, 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.

With that, I'll turn the call over to Steve.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Good morning. And thank you for joining us today to hear more about our first quarter results. While the severe winter weather interrupted our recent string of quarterly property casualty underwriting profits, we continue to be confident that our initiatives will drive long-term profit and will steadily grow our insurance operations.

We had another solid quarter of price increases in excess of our loss cost trends and our mix of business continued shifting in the favorable direction as we get more rate on lower margin policies and retain higher margin policies.

We continued to outpace the industry in premium growth, delivering new services to help our agents grow while we carefully underwrote and priced each risk. And we grew investment income by 5% over the first quarter of last year.

Our first quarter combined ratio was just over 100% with a catastrophe loss ratio roughly 2/3 higher than our 5-year average for the first quarter. For our Commercial Lines segment, we experienced the highest first quarter catastrophe loss ratio in at least 10 years and still generated a small underwriting profit.

In addition to higher-than-typical first quarter effects from natural catastrophes, we experienced an unusually high amount of weather-related losses that were not part of the main catastrophe event for the industry.

On a total property casualty basis, our ratio of non-catastrophe weather for the first quarter of 2014 was 3.6 percentage points higher than last year's first quarter and was at its highest level, since the first quarter of 2009.

Premiums continued to grow within the range we expected. Our property casualty net written premiums grew by 7% and we continued to benefit from greater pricing precision. Commercial policies that renewed during the first quarter had estimated average price increases in the mid-single digit range. The average was near the lower end of the mid-single digit range and includes the muting effect of 3-year policies that were not yet subject to renewal pricing during the first quarter. As usual, some lines of business had average renewal price increases that were stronger than others. For instance, our smaller commercial property policies had an average increase near the upper end of the high single-digit range.

Consistent with the fourth quarter, renewal price increases for our Excess & Surplus Lines segments continue to be in the high single-digit range. And for our Personal Lines segment, that increase was in the mid-single digit range.

Our first quarter 2014 new business premiums slowed compared with the year ago, reflecting pricing and underwriting discipline. The first quarter decrease in our commercial lines new business premiums was essentially due to a reduction in new, larger workers compensation policies. New business written premiums for our major package lines, commercial casualty and commercial property, grew 10% and 6%, respectively.

The reduction in our Personal Lines and new business premiums was as expected, reflecting the efforts of our recent underwriting profitability actions, higher premium rates and greater precision in our pricing. We believe the new business we are getting is a higher quality. The homes we are writing have new roofs, and more of them are higher value homes. A larger portion of our Personal Lines new business is packaged to include both home and auto.

We also experienced satisfactory premium growth in both our Excess & Surplus Lines segment and in our Life Insurance segment, both producing operating profits. We continued executing on initiatives to improve insurance profitability and to drive premium growth. One initiative that adds premium growth over time is our careful selection and appointments of new agencies. In the first quarter of 2014, we appointed 27 new agencies.

We also reported investment income growth for the third quarter in a row. First quarter 2014 investment income would have been higher than a year ago, even without the effect of suppressed first quarter 2013 dividends. You will recall that we reported about $5 million of special or accelerated dividends at the end of 2012 as issuers responded to anticipated tax law changes.

I'll conclude with our primary measure of financial performance the value creation ratio. While that measure is most applicable for measuring long-term performance and creating shareholder value, our 2.6% first quarter result gives us a good start towards our longer-term objective of an annual ratio averaging 10% to 13%.

Our Chief Financial Officer, Mike Sewell, will now add his comments about performance in related financial items.

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

Great. Thank you, Steve. And thanks to all of you for joining us today. I'll begin with a few important details about our investment portfolio. The first quarter of 2014, again illustrated the benefit of our equity investing strategy. Our book value benefited from appreciation in our stock portfolio valuation and the bond portfolio also made a positive contribution.

Our stock portfolio's pretax net unrealized gains are approaching $1.9 billion and the dividend income from the portfolio continued to increase.

Yields for our bond portfolio again moved slightly lower as the first quarter 2014 pretax yield of 4.82% was 11 basis points lower than a year ago. Taxable bonds, representing about 70% of our bond portfolio, had a pretax yield of approximately 5.29% at the end of the first quarter of 2014. The average yield for a new taxable bonds purchased during the first quarter of 2014 was 4.51%.

For the same period, our tax-exempt bond portfolio yield was 3.85% and purchases during the quarter yielded 3.19%.

Our bond portfolio's effective duration measured 4.5 years at the end of the first quarter, unchanged from year-end. Cash flow from operating activities continues to benefit investment income. At $129 million for the first quarter of 2014, net operating cash flow more than doubled the same period a year ago. We continued to carefully manage expenses, helping to reduce the first quarter underwriting expense ratio by a full point compared to a year ago.

Moving to loss reserves. We continue to follow a consistent approach, seeking to remain well into the upper half of the actuarially estimated range of net loss and loss expense reserves. For the first quarter of 2014, favorable development of prior accident years at 3.1% was close to the full year 2013 ratio of 4.1%.

We added net IBNR reserves in the first quarter and property casualty gross reserves in aggregate for all accident years rose $82 million or 2% from year end.

As a result of larger-than-expected accident year 2013 loss payments for umbrella and general liability, we recognized $8 million of unfavorable development during the first quarter in our commercial casualty line of business. Despite recognizing that development, the loss and loss expense ratio for that line to accident year 2013 is in line with accident years 2012 and 2011 after updating reserve estimates for all years as of March 31.

Commercial casualty has historically been among our largest and most profitable lines of businesses. In each of the last 10 years, we've reported favorable annual reserve development, and our consistent approach to reserving gives us confidence in the adequacy of current reserves for that line.

Our first quarter reserve development by accident year was $18 million unfavorable for accident year 2013, driven by the commercial casualty lines of business and $23 million favorable for accident year 2012, $11 million favorable for accident year 2011, and $14 million favorable for all older accident years in the aggregate.

Our financial strength and liquidity remained in excellent condition. We repurchased 150,000 shares during the first quarter, an average cost of $47.71 per share. This repurchase activity was again, a maintenance type action intended to partially offset the issuance of shares through equity compensation plans. Cash and marketable securities at the parent company remain at over $1.5 billion at the end of the first quarter.

Our property casualty premiums to surplus ratio remained at 0.9:1, providing plenty of capital to support continued premium growth of our insurance business.

I'll conclude my prepared comments as usual by summarizing the contributions during the first quarter to book value per share. Property casualty underwriting decreased book value by less than $0.01.

Life insurance operations added $0.06. Investment income, other than life insurance and reduced by noninsurance items, contributed $0.36. The change in unrealized gains of March 31 for the fixed income portfolio, net of realized gains and losses, increased book value per share by $0.35. The change in unrealized gains at March 31 for the equity portfolio, net of realized gains and losses, increased book value by $0.19. And we declared $0.44 per share in dividends to shareholders.

The net effect was a book value increase of $0.52 during the first quarter to $37.73 per share.

And with that, I'll turn the call back over to you, Steve.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Thanks, Mike. While the insurance business will always be challenging and challenged by the weather or other forces, investors, agents, associates and others, can count on Cincinnati Financial to remain steady in the execution of our strategy. That includes openness and integrity in how we operate and we are pleased to be recognized again by Forbes. In its inaugural list of the Americas 50 most trustworthy financial companies, we are the top-performing company. This marks the fourth time in a row that Forbes has recognized us on one of its lists of trustworthy companies.

We appreciate this opportunity to respond to your questions and also look forward to meeting in person with many of you, throughout this year. As a reminder, with Mike and me today are Jack Schiff, Jr., Ken Stecher, J.F. Scherer, Eric Matthews, Marty Mullen and Martin Hollenbeck, Jay, we're ready for you to open the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Bijan Moazami with Guggenheim.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

If I'm looking at the accident year loss ratios, typically, if you look at the industry 2011, 2012, they were bad accident year ending up decision 2013, it looks to be positive. Could you talk a little bit about what's going on in the Commercial Lines casualties, commercial casualty, why are you seeing adverse losses there in 2013, is there anything in particular happening? And I understand that you guys have historically been incredibly conservative. So in terms of loss cost trend, if you could provide a little bit more color, it would be great.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Sure, Bijan, good question, and thank you for asking. We have, as you mentioned, been very consistent in our approach, conservative in our approach, and that is reflected in what you see today by posting some upward movement in our pick for the most recent accident year of 2013. I think the important thing to look there is that we did see a little bit in terms of more or higher payments and so we reacted to it. But when you look at the accident year, even after we adjusted the pick upwards, it's still very consistent in the mid-50 loss ratio range for where we've been the last few years, and we still feel very confident about the line, very confident about our reserving position, feel we're getting rate in excess of our loss cost trends. And probably more important, are really segmenting the book there and are getting more rate on those that need more rate and really working hard to retain those that have the highest profit potential.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

Great. As far as the Personal Lines goes, there was a very significant increase in current accident year loss ratios before cat, even when I adjust for the non-catastrophe weather-related losses. Is there anything in particular going on in there, or I'm counting my non-catastrophe weather-related losses somewhat in a wrong way?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

No, I think your analysis is good. It's a line we're keeping a close eye on. Again, I think we feel confident and that the trends are within achievable rate increases. I think it is a first quarter, which there's a lot of uncertainty there that we reflect, in terms of really, for an accident quarter that the claim has to have occurred in the first quarter and been reported and reserved, so I think we're taking a cautious approach there. But to your point, one we'll be keeping a close eye on, and I think, whether it's weather or not weather, a lot of it was driven by the physical damage part of it.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

Great. One last question, if you could talk a little bit about what you expect the property inspections that you're planning to do for 2014 impacting your level of rate increases this year?

Jacob F. Scherer
Former Chief Insurance Officer

Bijan, this is JF Scherer. What we're trying to concentrate are on the property inspections, and in addition to that, more loss-control inspections, is taking more underwriting action, not necessarily by raising rates, but by recognizing conditions of property that would cause us to perhaps raise deductibles, suggest to the policyholder changes that they should make to minimize the possibility of a loss or to reduce a large loss. There are a number, and we've mentioned this before, there are a number of accounts but once we inspect them, on homeowners, for example, we discover that a house is in a different protection class than what we've had in our file. And so consequently, we will get a rate increase there from time to time. We'll also note that there is an undervalued circumstance, both in commercial property or our Personal Lines property or homeowner, that will increase the coverage amount and there'll be a corresponding increase in premium from that. So the inspections, really, are designed to just provide us with a better look at the quality of the overall book of business that we have. Sometimes of which, as you point out, there would be rate increase associated with it. Most times, however, we're taking underwriting action to improve the profile.

Operator

The next question comes from Paul Newsome with Sandler O'Neill.

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

If we look at the reserve charge from the -- in the casualty item, are we able to -- maybe you can just tell me in that, pull out, maybe those discrete items and then look at what happened there from a reserve perspective? Are we still at a sort of typical level of reserve releases if we exclude those items?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

I think that the reserves, in terms of how we are doing, that is very consistent with our approach. The actual overall reserve release was pretty consistent with the full year of 2013, maybe a little bit more favorable than it was first quarter a year ago. As we point out, with the first quarter, we've just completed the full year analysis, just a few weeks ago, so we're not going to be making a whole lot of changes there. But we are prudent, we are conservative and so when we saw, and to your point, dug down a little bit deeper, we saw a little bit more higher-than-expected payments in the commercial casualty on a package, our CMP liability and also our umbrella. And so we reflected it.

Operator

The next question comes from Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Just going back to one of your initiatives that we talked about a couple of quarters ago, on the predictive claims launch that I think was supposed to go live in the third or fourth quarter for workers comp last year. I'm just curious, maybe, how the launch went? And if you happen to have any early thoughts on how might -- that process, from a loss cost savings, might be trending so far?

Martin J. Mullen
Chief Claims Officer of the Cincinnati Insurance Co. and Senior VP of the Cincinnati Insurance Co.

Good morning, Vince, this is Marty Mullen in Claims. Yes, actually, April 1, we went live with our first iteration of the predictive model for workers comp's claims. We're quite encouraged with the initial results of the model. It's providing data and metrics on new claims as they move forward, projecting the outcomes or projecting potential for outcomes for loss costs and return to work issues. So we're pretty excited with what we've experienced so far. What we're looking forward to is the next generation will be to identify and apply the model to existing claims that have been open for 1 month, to highlight tendencies in those claims, which may require a different type of attention via nurse case management or certain prescription attention. So it's live, active, and we're pretty encouraged.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

All right. Sounds good. And then Marty, just to stick with you. I guess, it would be the right way to go on this any way. So on an earlier call today, there is some discussion around some of the harsher winter weather impacting contractor activity and that basically leading to a little bit of a benefit on workers comp. And I'm just kind of curious if some of the underlying loss trends, I guess particularly on frequency, if you happen to be seeing anything similar to that in the sense you [ph] workers comp book?

Martin J. Mullen
Chief Claims Officer of the Cincinnati Insurance Co. and Senior VP of the Cincinnati Insurance Co.

I think our first quarter for work comp was fairly quiet, fairly normal. I can't say that we saw an uptick in that type of activity as far as on a claim count basis. So no, I don't think we have experienced that.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just this is kind of a follow-up to the earlier reserve discussion here on this call, but if we go back to some of the older accident years, I'm looking at index reserve performance. One of the things that we've sometimes seen, and what society has responded to, some emerging trends is maybe a little bit of adverse reserve dollar [ph] in the immediately following the initial calendar year. But then, ultimately, if you track how that accident year develops, very often not you end up getting your net cumulative favorable reserve dollar [ph] , even including that initial kind of increase. And so what I'm just kind of curious about, and it kind of speaks to Paul's question a little bit, is -- does this, to you guys, feel like it's consistent with your historical prudence that potentially implies that we'll ultimately see, if things kind of, do not deteriorate, net favorable development on accident year 2013, or is it, kind of as we look at some of these more concrete payment trends, that really, no, maybe that's not the right way to think about it?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

I think it is the right way, Vincent, I think it's the same stable approach, and as you were making your question, I was thinking to those excellent charts you have in your reports, the line graphs that show as the time progresses, accident years develop favorably, and I don't think that we see anything that would make us feel differently.

Operator

[Operator Instructions] The next question comes from Mark Dwelle with RBC Capital.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A couple of questions. First on the expense ratio. Very good year-over-year improvement and -- although it was fairly consistent with the prior quarter. Anything unusual in either last year's number that made it higher, or this year's number that made it a little lower, or is it just continued blocking and tackling?

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

That's a great question, and thanks for it. There's probably a little bit of a combination that's going to be in there. Of course, you're going to have, in any given period, some accruals, timing of payments, things that occur that might make it bounce around a little bit. I would put the change here that you're seeing a little bit more along the lines of an overall, we're controlling the increase of our spending on expenses and we're letting the increase in premiums outrun it. And so I think that's really going to be the major driver that you're seeing. There was a full point improvement. If you were to look at the first quarter last year, which was at 32.2 and where we ended up the year at 31.9, I'm not sure if that trend will necessarily continue for the rest of this year when you look at the 31.2, because you will have some volatility. But I'm very encouraged at the way that we're controlling our expenses. There may be some fluctuations that are in there, and we'll probably end up in the low 31s by the end of the year.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

That's helpful, thanks. Second question, maybe for JF, as much as an anybody, but anybody can chime in. Are you seeing any change in competitive behavior, as far as competitors being, I'll say, either more defensive on defending their own books of business, or alternatively, more aggressive on attacking your books of business. Really, we've heard a number of comments from different carriers. We're seeing signs of higher overall premium retention ratios. Just curious what you're seeing on the ground as far as how that dynamic is playing out.

Jacob F. Scherer
Former Chief Insurance Officer

Mark, I think you hit an important factor on defending renewals. Last year, this time, for example, there were still carriers that were preannouncing, if you will, to their agents, but they intended to be very aggressive about increasing rates. Just trying to set the stage for it. I think it consequently, a lot of the business that would've been written with that carrier would've found itself in the marketplace being shopped. I think what we're seeing, just relative to the competitive environment, is that there is more defense of renewals. What I would say, is that carriers are a little more comfortable with where they had their rates. They're signaling that they will be happier with modest increases and therefore, more aggressive, perhaps, about defending the renewal, not wanting to lose it. So we're clearly seeing that in the marketplace. We're seeing some signs of a little bit of added competitiveness from some carriers. A few examples of bonus commissions being announced by some carriers to go after business. I can't say that we feel that our book of business is being specifically targeted by anyone. We haven't noticed that. One of the things about our new business, for example, for the first quarter, and we had a significant first quarter of last year. I mean, it was really a heck of an increase in new business in the first quarter. We were very pleased with what we saw in our ability to write business, both in property and casualty lines to have a new increase over a big increase last year. The only thing we saw in terms of new business in Commercial Lines, that -- and I don't think it was an example of a competitive marketplace, is that we just didn't write as many larger workers comp policies as new business as we would have. And I don't know, in the second quarter, we might write an extraordinary amount of them, simply because of, just, the timing, things of that nature. So I think as a general statement, as far as the marketplace is concerned, it seems that the marketplace has pricing more in line with the way it would want it to be. Somebody else's renewal will be less attractive or less easy to compete for this year, and so that's how I size up the whole marketplace in general.

Operator

There are no additional questions at this time. I'd like to hand -- turn the call back to Mr. Johnston for closing remarks.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Thank you. Thank you, all, for your excellent questions and for joining us today. We hope to see some of you tomorrow at our annual shareholders meeting. It's at the Cincinnati Art Museum. Others are welcome to listen to our webcast of the meeting, available at cinfin.com/investors. We look forward to speaking with you again on our second quarter call. Thank you very much.

Operator
This concludes today's conference call. You may now disconnect.