S&P Global
Market Intelligence

Cincinnati Financial Corporation NasdaqGS:CINF

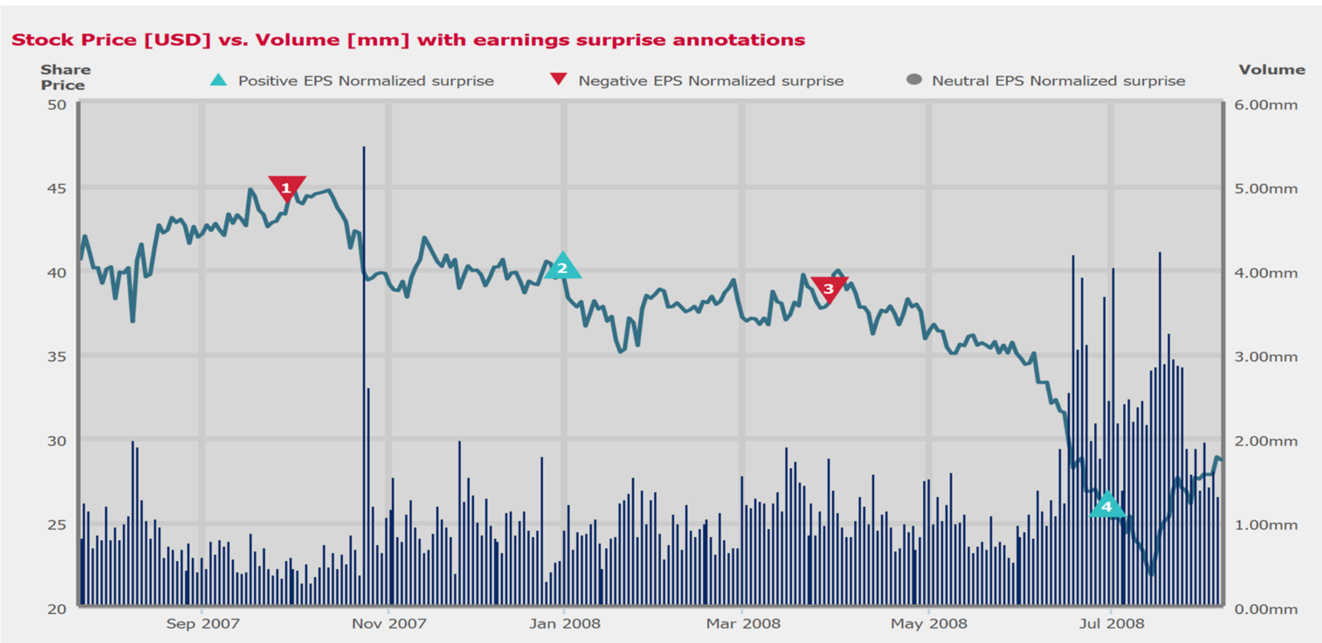
FQ3 2008 Earnings Call Transcripts

Wednesday, October 29, 2008 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.50	0.45	▲(10.00 %)	0.57	2.15	2.31
Revenue	-	-	▲29.63	-	-	-
Revenue (mm)	914.90	1186.00	-	913.27	3646.82	3611.18

Currency: USD
Consensus as of Oct-29-2008 1:19 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	0.78	0.66	▼1 (15.38 %)
FQ4 2007	0.73	1.07	▲2 46.58 %
FQ1 2008	0.71	0.66	▼3 (7.04 %)
FQ2 2008	0.28	0.42	▲4 50.00 %

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EXECUTIVES

Heather Wietzel

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Non-Executive Chairman of the Board

Steven Justus Johnston
President, CEO & Director

ANALYSTS

Beth Malone
KeyBanc

Dan Schlemmer
FPK

J.F. Scherer

Marty Hollenbeck

Marty Mullen

Michael Phillips
Stifel Nicolaus

Paul Newsome
Sandler O'Neill & Partners

Scott Heleniak
RBC Capital Markets

Presentation

Operator

My name is [Avogal] and I will be your conference operator today. At this time, I would like to welcome everyone to the Cincinnati Financial third quarter conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session (Operator Instructions)

Thank you. Ms. Wietzel, you may begin your conference.

Heather Wietzel

This is Heather Weitzel, Cincinnati Financial's Investor Relations Officer. Thank you for joining us today for our third quarter conference call.

This morning we issued the news release on our results along with our 10-Q supplemental financial package and the listing of the securities we own. If you need copies, please visit www.cinfin.com for all the information related to the quarter can be found on the Investors page under the quarterly results quick link.

On the call today, President and Chief Executive Officer, Ken Stecher, Chief Financial Officer, Steve Johnston will give prepared remarks, after which we will open the call for questions.

But 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, reconciliation of non-GAAP information as required by Regulation G was provided with the release and also is available on our website. Statutory data is prepared in accordance with statutory accounting rules and therefore is not reconciled to GAAP.

With that, let me turn the call over to Ken.

Kenneth William Stecher
Non-Executive Chairman of the Board

Thank you, Heather. Welcome and thanks to all of you for joining us today. We are all aware that this has been a challenging quarter on many fronts for our country, our economy, and for many individual companies including ours.

As we join you today, Cincinnati remains a strong, healthy and forward-looking regional insurance company. Our relationships with our local independent agencies are as good as ever and so as the franchise value those agents leverage across the 34 states, where we operate.

One of the concerns this year has been a record level of catastrophes especially the surprising Midwest windstorm component of Hurricane Ike. Storms are a chance to shine for our claims associates and our agents. They deserve thanks for their special efforts to handle the almost 18,000 claims we received since September 14th more than 80% of which are already closed.

Another source of concern has clearly been the capital markets. Our portfolio withstood the events of the third quarter fairly well. We are taking the right actions to diversify, selling stocks to lock in gains and reinvesting the balance in future performance. But the rebalanced portfolio remains subject to external forces and has experienced some market value declines in October. We have ample capital to withstand these short term disruptions and to support our current dividend.

Our financial results also show our company's resilience with profits on both a net and operating basis for the three and nine months and book value of $28.87 was just $0.12 below the June 30 level. In a moment, I will turn the call over to Steve to cover many of the details on the financials.

But first, we talked last quarter about positioning Cincinnati's executive team for the future. Since July, I have been President and Chief Executive Officer. My new role has given me a fresh appreciation for our company and our agents. I have had the opportunity to spend time with our agents, when they visit us here and I have gone out into the field to travel with several of our field marketing representatives.

I have learned that our agency, the market with a realistic eye. They are appropriately concerned about the insurance market and trends and pricing, and competition hoping, but not certain that recent signs of market firming will continue.

At the same time and regardless of the state of the market, our agents like to hear that Cincinnati plans to continue to be agent focused offering local decision making and products to meet their customers' needs.

They appreciate that. We will continue to offer best-in-class claims service. They listen with interest to our plans for managing our capital to ensure that we remain a highly rated carrier. They all emphasize the importance of following through on our technology initiatives and other efforts to make Cincinnati, an even easier company to do business with.

I can assure them that we are not planning to change our philosophy. But we are working very hard to continuously improve our execution whether it's with technology or other tools. I am personally supporting our leadership team and their efforts to make doing business easier for agents. I have taken a personal interest in encouraging our risk management programs. So, we can identify and address potential issues before they become concerns.

Finally, I am also encouraging a variety of initiatives that will allow Cincinnati to come out of the soft market prepared to resume healthy and profitable growth. Before I talk more about those growths and strategies, let's have Steve go through some of the numbers. Steve?

Steven Justus Johnston
President, CEO & Director

Thank you, Ken. I am going to cover the third quarter and nine month numbers as well as talk about our outlook for the full year of 2008. And there are two primary concepts that I want to discuss as the high level. First, our balance sheet is strong and transparent with level III assets representing less than 1.6% of total invested assets. Second, even in these tough times, our income statement performed relatively well.

Regarding the balance sheet, as Ken mentioned, GAAP book value per share was $28.87 at September 30th, 2008 down less than one half of 1% sequentially from the prior quarter. Also during the third quarter, the Cincinnati Insurance Company statutory surplus increased by $37 million.

Although the statutory surplus is down from year end, the annualized premium surplus ratio remained strong at approximately 0.8 to 1 putting us in a strong position to grow profitably. The holding company is also in a strong position with over $1 billion in invested assets to support our dividend paying philosophy and provide for financial flexibility.

On the income statement, reported net income per diluted share for the third quarter was $1.50 up from $0.72 for the third quarter of 2007. On an operating basis, third quarter earnings were $0.45 per share compared with $0.66 per share for the third quarter of 2007.

Realized capital gains represent the only difference between reported and operating earnings. In an effort to lock in gains and diversify the portfolio, we sold common stocks during the quarter that more than offset the $121 million in non-cash impairment charges, we had previously announced.

The gains included $472 million from sales of financial sector stocks plus partial sales of a few non-financial common stock holdings. Adding everything up, realized after-tax capital gains contributed $1.05 to third quarter earnings.

Investment income was down 14.5% for the quarter and 8.5% through nine months. In terms of our outlook for the full year of 2008, we still believe that investment income may be down at least 10% due to dividend cuts announced by some of our holdings earlier in 2008.

On the underwriting side, we posted GAAP combined ratios of 101.3 for the third quarter and 101.1 for the nine months up from 97.3 and 91.9 posted for the third quarter and nine months of 2007. Underwriting results continued to be adversely impacted by catastrophe losses in the third quarter. We believe the high storm activity might lead to a full year 2008 combined ratio that also is modestly above 100%.

The big storm of the quarter was Hurricane Ike, which reached the Gulf Coast on September 12 and moved into the Midwest on the 14th. Ohio, Indiana, Kentucky were hit with hurricane strength winds. We estimate our gross losses from Ike to be $105 million making it the single largest catastrophe in the company's history. Net of reinsurance, the loss is estimated at approximately $57 million.

All catastrophe losses contributed 8.4 and 9.7 percentage points to the combined ratio in the three and nine months compared with the unusually low 1.7 and 1.2 points in the same three and nine months of 2007. We continue to believe catastrophe losses could contribute as much as nine percentage point to the full 2008 combined ratio.

We remain consistent in our practice of setting sound loss reserves. Savings from favorable development on prior period reserves during the current periods improved the combined ratio by 13.7 points and 8.9 points in the three and nine months ended September 30th, 2008 compared with 6.5 and 5.4 percentage points in the same three and nine month periods of 2007. The contribution rose primarily because of savings in the commercial casualty line of business.

Commercial casualty is benefiting from an initiative, where we use a claims mediation process that promotes earlier liability settlement resolution and from revised expectations for related loss expense inflation. On the growth front in a competitive market, net written premiums for the quarter were $727 million down just 1.3% from the third quarter of 2007. For the nine months, net written premium was down 4.2%. New business remained strong up 12.1% for the quarter and 9.6% year-to-date.

To restore the affected layers of our cat treaty, we booked a reinstatement premium of $11 million, which reduced written and earned premiums for the three and nine month periods. We are taking a conservative position on our premium growth outlook, when we say we continue to believe 2008 full year written premiums could decline by 5% or slightly more, if the market firms, premium growth would obviously be better.

While there are many uncertainties involved with predicting the timing of market changes, one thing we do know is that our local field associates will be close to the action and making sound decisions at the local level.

With that, I turn it back to Ken.

Kenneth William Stecher
Non-Executive Chairman of the Board

Before I talk in more detail on our growth strategies, I wanted to mention again our risk management initiatives. Steve talked about some of the recent actions we have taken in the investment portfolio. At Cincinnati, we make risk management an important part of our planning processes folding it directly into our corporate and department business plans.

Our processes have helped us identify and develop risk plans that consider items like business continuity, exposure concentrations, risk convergence and reinsurance. We are modeling our business plans including our risk profile to identify and manage to acceptable tolerances.

Complementing these efforts are initiatives that expand the reach of our property casualty insurance operations, diversifying us geographically and also creating opportunities to expand our scale. Our first growth opportunity is entering the new states. We entered Washington and New Mexico in 2007, writing more than $3 million in new business in those states in the first nine months of this year. We are now on the ground in Texas.

In early October, our first field representative began calling our prospective agencies in the Greater Austin area. We are expecting our second territory, located in Dallas to be staffed late in November with another experienced Cincinnati marketing representative. We would anticipate our first Texas agency appointments and first policies before the end of the year.

We will add a third Texas territory soon likely in the first quarter of 2009. We see Texas as an exciting opportunity. The Austin and Dallas/Fort Worth markets have a population about 10 times that of Montana. We entered Montana about 10 years ago and now write $31 million in premiums there.

In addition to our activities in new states, we are appointing agencies in our current territories to help round out our market coverage. Not including our planned appointments in Texas, we expect to add a total of about 75 new agencies across all of our states this year.

The agencies appointed in 2007 and 2008 contributed $21 million to $229 million in new commercial lines business, we recorded in the first nine months. Over the course of the first five years of a new agency relationship, we usually see our premiums move up quickly reaching an average of about $2 million in premiums [in the] sixth year. Both existing and new agencies benefit from new products and services, we developed to stay competitive.

In 2008, the highlight of this effort has been our introduction of excess and surplus lines. Through nine months, the E&S operation added $8 million in premiums and this month we have already hit the $10 million mark for the year. Our agencies write in the range of $2.6 billion of Excess and Surplus lines business and we believe, we are positioned to get a meaningful share.

Further, we are leveraging our personal lines policy processing system using it to rollout Personal Lines to traditional agencies that previously wrote only our commercial lines products. Since the beginning of 2007, 110 additional agencies have begun marketing Cincinnati's homeowner and auto products. Importantly, many of those agencies are in states, where we previously had little or no personal lines market share.

The premiums they write are new opportunities to grow and to diversify our exposures particularly to catastrophe losses. We plan to continue this effort in 2009. In January, we will supplement the expansion with more pricing refinements to better improve our competitive stance.

Last but most definitely not least, we see opportunities with our current agencies. Tapping their potential relies on developing new and improved products and on services that go that extra step particularly claims service that makes the agency look good in this community.

Sometimes we go out personally and ask what we can do to earn their quality business. I had the privilege of doing just that in Indianapolis last week with a few agencies. I am eager to see the results in a few months. When you add it all up, we think we have got what it takes to build a great future.

Cincinnati is a strong and healthy company. We are not immune to the external forces that have stressed our financial markets and economy in the past year, but we are set to manage risk and be ready to move ahead, when things stabilize.

We have the strong capital and liquidity to invest in systems and people. We have the capital and flexibility to support growth. We have the capital to support our cash dividend to shareholders. We believe our current capital position can withstand short term pressures such as the market volatility that we have experienced in October.
With that, let me open the call for questions. Just a reminder that Jack Schiff, Jim Benoski, Marty Mullen, J.F. Scherer and Marty Hollenbeck are here, as well Steve and myself and available to respond. Avogal, we are ready for questions.

Question and Answer

Operator

(Operator Instructions) Your first question comes from Michael Phillips, Stifel Nicolaus. Your line is open.

Michael Phillips
Stifel Nicolaus

Thank you. Good morning everybody.

Kenneth William Stecher
Non-Executive Chairman of the Board

Good morning, Michael.

Michael Phillips
Stifel Nicolaus

Questions, I guess first on just the underwriting profitability. If we back out things like the cats and the prior period development, we are still pretty far north of 100% on both commercial and personal lines part of that is probably conservatism in your current period reserves, but hard to think that it's worth seven or eight or nine points, which is where I think we are once we back that stuff out?

Your comments sound like for both personal and commercial, you described the rate environment is still challenging. So with all that together, how do we get back to where we probably need to be on a current accident basis for both commercial and personal lines?

Kenneth William Stecher
Non-Executive Chairman of the Board

First of all, I think we need to be looking long term, which is what we try to do and we think that by developing the relationships with our independent agencies and helping them with their important customers, we are positioning ourselves for the future growth.

That being said, the current pricing does produce the numbers. I haven't done the math exactly, Steve may have, but you are in the general area, where the accident year combined ratios are. I think that we just need to continue to build our book along with the technology we are developing. It really put us in a position to take advantage of the hard market.

Our long term goal has always been that we want to outperform the industry. The combined ratio getting to where it is at, I think we are still able to do that. But the profitability is not quite there like it has been historically. To some extent, I think, getting us there is going to take some rate hardening of the market. But I would like to see if Steve or J.F. will have any additional comments to that question.

Steven Justus Johnston
President, CEO & Director

In regards to the reserves, Michael, actually that the number you were getting; you were doing the third quarter, right?

Michael Phillips
Stifel Nicolaus

That’s correct, yes.

Steven Justus Johnston
President, CEO & Director

It's a lower than that for the year-to-date. I guess, I have been talking about the reserves; you made a very good point there that when you go through that exercise of removing cats and the impact of favorable development, you do arrive at an estimate of the current accident year that I think, you made the good point, but that is very immature. It's very volatile. In this case we are talking about nine months of accident year 2008 at nine months of development.

Just a couple of points, I would like to make is one is, we haven't changed anything in the reserve setting process. We are continuing our track record of setting solid conservative reserves and nothing has changed. Then the other point, I want to make it is the key driver is the commercial casualty line of business.

It represents over 60% I believe of the favorable reserve development and it’s the result of a good positive initiative, where we have instituted a few years ago, claims mediation process that gets to the parties to the table earlier, brings in experts and I think has a favorable outcome for everybody.

As kind of proof of that, the assumptions that were made in setting the reserves in prior accident years were not including as good development as favorable development as we have seen through that process. So I think that’s the driver. Marty Mullen here may have some data on the claims mediation process, I don't know.

Marty Mullen

Thank you, Steve. Michael, just to comment a little bit on our historical reserving process. We always reserve to reflect the severity of injury in our general liability line of business. The favorable development results from positive developments in those liability analyses which result ultimately in settling claims timely and fairly.

So, I think, to consider the developments and the liability issues, they are unpredictable and depend on numerous issues and usually have a long tail. So that reconfirms that the nine month data is a little premature as far as the accident year data is concerned.

Michael Phillips
Stifel Nicolaus

Thanks. That mediation process that you mentioned, does that translate at all over to a personal auto liability, cannot?

Marty Mullen

Yes, correct. It’s a process in which we utilize the availability of a mediator to intercede and even pre-suit claim activity in personal and commercial lines.

Michael Phillips
Stifel Nicolaus

Okay. On the personal lines side, I guess trying to get a sense of, where your rate process is and I guess year-to-date a lot of the metrics that we look at we are seeing something a little different from some competitors and actually a lot of competitors and just some external metrics of rates are actually going up in personal lines both for homeowners and personal auto. So it sounds like you are a little different there and I am wondering how different might you be? I guess, firstly, is it true? Then how different might you be?

J.F. Scherer

This is J.F. I think in looking at our numbers and our rate making process, I think we have announced previously that we have instituted significant changes in our rate making process and predictive modeling adding additional tiers.

We are not in the commodity market. What we are trying to do is within our own agency force sight in, if you will proper rate levels for both homeowners and private passenger auto insurance.

We are hearing in the marketplace, seeing in the marketplace that there is some slight increases in rates out there. So, much of that gets masked by the level of modeling and scoring that's going on. So, I don't know that it would be very easy to really take a look at our particular numbers because we are in the middle and nearly in every state that we are in we are doing quite a bit of tweaking on getting our rates where they need to be.

Michael Phillips
Stifel Nicolaus

Okay. Thanks. I will jump offline. I appreciate it.

Steven Justus Johnston
President, CEO & Director

Michael, while you are off, I would just like to throw in one other comment. When we look at the rate changes as J.F. described and I think they are averages and there is a lot of movement going on within the various classes, and as J.F. mentioned the rating classifications relative to predictive modeling.

So it is important to recognize we are tailoring where rate decreases, and are being taken to the risks with the better scores. So, to the extent that there is a shift in the business, there can also be some movement to a lower rate just on business shift.

Steven Justus Johnston
President, CEO & Director

Onto the next question?

Operator

Your next question comes from Dan Schlemmer with FPK. Your line is open.

Dan Schlemmer
FPK

Hi. Good morning. Couple of questions on the equity portfolio, if I could. I think its $4 billion ballpark is the total equities and then a little more than a billion to $1 billion in the financial sector and actually that's been reduced just since September 30th. How do look at that going forward?

Are you happy with that concentration or do you think that's something you are going to continue to try to reduce or are the decreases we have seen there such that maybe you see opportunity is still in the financial sector for your investment portfolio?

Marty Hollenbeck

Dan, this is Marty. We are still cautious out there. Our portfolio was about 32% financials as you observed at 930 that drops down to about 30.4 pro forma for the Fifth Third sales we did in early October that we announced. That's down from about 56% at the end of last year.

So, we have made tremendous strides at reducing that. But with what's going on with the cuts and issues with dividends, we are still very cautious and we will continue to assess the situation and mold the portfolio as required.

Dan Schlemmer
FPK

Then it sort of related to that. I think one of the reasons you had a concentration in financials, is your focus on dividend paying stocks. Is that something that's still a key criteria for you going forward?

Then if it is or to the extent that it is, can you comment on dividends during the current quarter and if there were any abnormalities or if the lower level during this quarter, sort of what to expect going forward?

Marty Hollenbeck

Dividends are still very important to us and that's really the core of our philosophy. That part hasn't changed. I mean, we are going to look for some diversification and risk management going forward.

But again, we would like dividends for a lot of reasons. Clearly, we are in a troubled period. I think a lot of the hit, we took in the dividends, is what you saw in the first two quarters and that's going to take a while to roll through.

But again, we will reposition the portfolio for the long term and we anticipate getting back on track of getting, those kinds of increases that we have been accustomed to in the past.

Dan Schlemmer
FPK

I guess then so it sounds like the year-over-year, I think, its $75 million in dividend income down to $46 million. Is that maybe the level we should be looking for going forward? There were no timing issues or anything else that are distorting that at least short term going forward that's sort of where it's at?

Marty Hollenbeck

It was down 30% earned dividends were in the quarter and that's marginally as I said, the effect of Fifth Third was the big one in there, and then earlier in the year with Huntington, National City, Wachovia, et cetera. Those comps in that regard if all well stays the same should start looking better about the second quarter of next year.

Dan Schlemmer
FPK

Okay. Then separate question changing gears real quick. I think a year ago you started talking about where you wanted to go with the E&S and there was, I don't think you have thrown out much in terms of here is where we think it can go and trying to be cautious and not put pressure for the growth at any cost mentality.

Almost a year into this, do you feel like you have some kind of forward-looking expectation or can you put any future guidance a year out, two years out on, where the E&S can go in terms of size. Is there any increased clarity at this point?

J.F. Scherer

This is J.F. We have said repeatedly we do want to walk before we run with Excess and Surplus lines to have hit the 10 million marks here in October was very satisfying for us. We do step back and take a look at what our agencies write.

As Ken mentioned in his remarks, they write about $2.6 billion in Excess and Surplus lines business. A very large part of what we are writing is less than $10,000 in premium mostly casualty at this point. We are encouraged as we rolled this out in all states.

Within the $2.6 billion, there are a lot of very difficult risks that we won't be a market for. But we are encouraged by our potential there. But I don't know that we are ready to say in two years, we think we will be at some particular level. I would just say to you that the receptivity has been excellent.

Kenneth William Stecher
Non-Executive Chairman of the Board

Dan, this is Ken. I mean one big opportunity that we did miss last year was January 1 renewals and we are not quite sure what impact that may have. So I think we will consider some kind of guidance probably in the first quarter during our year end conference call. But for this point in time, I don't think we are ready yet to announce anything.

Dan Schlemmer

FPK

All right. Great. Thank you.

Operator

Your next question comes from Beth Malone with KeyBanc. Your line is open.

Beth Malone
KeyBanc

Thank you. Good morning. A question on the Fifth Third position. The strategy historically has been said that if a company cuts their dividend then that would be the argument for your selling out of that position. If that were true does that mean that you are going to sell the remaining ownership of Fifth Third? Should we make that assumption at some point?

Kenneth William Stecher
Non-Executive Chairman of the Board

Well. We are still assessing the situation. I mean certainly we have taken that position from a $72.9 million down to $20 million in less than a year now. We will continue to look at it. There is some recent developments obviously that we need to take note of. So at this point, no decisions have been made. But we will continue to assess that.

Beth Malone
KeyBanc

All right. Then as you look at the markets and you did have some good new business growth. Was the majority of that coming from new markets that you have recently entered or is that from existing markets?

J.F. Scherer

Majority would be from existing markets, but we have got a nice start in New Mexico and Washington. The Excess and Surplus lines company has added nicely to the new business. We continue to do well. As we have introduced loss control and some sophisticated capabilities for our agencies in some of their larger accounts.

We have identified $39 million in consolidation of carrier business rollover business from within our agencies. So Beth, there isn't any one thing. It continues to be an aggregation of a lot of things that we have done very well.

For example, you don't want to grow this way. But here in Ohio, as the result of the hurricane Ike, the satisfaction with our claims service has been enormous and we would expect that we will probably see an increase in new business here in Ohio. So, a lot of things are going right in a lot of areas. I think, the combination of all the strategies are helping us with our new business.

Beth Malone
KeyBanc

Okay. Thank you.

Operator

Your next question comes from [Scott Heleniak] with RBC Capital Markets. Your line is open.

Scott Heleniak
RBC Capital Markets

Hi. Good morning.

Kenneth William Stecher
Non-Executive Chairman of the Board

Good morning, Scott

Scott Heleniak
RBC Capital Markets

First question about the investment portfolio. Equities are about 40% of vested assets now and you mentioned in your release, you are comfortable with that number. Do you see that going to the 50% to 60% range longer term or would you try to limit that now with new targets given I guess the situation? I guess is there any target where you would limit equities to percent of invested assets is the question?

Marty Hollenbeck

Scott, we don't have any real hard targets. But as we mentioned that 40% is something we are comfortable with. We do have an internal policy now some guidelines. Again, they are not extremely hard numbers, but we do want to manage around that.

So I think by and large you will see an equity portfolio in the size of where it is at give or take. Again, we don't start selling, when it reaches a necessarily certain spot nor do we start buying others. It's a flexible criteria, but this is the range that we feel comfortable right now, yes.

Scott Heleniak
RBC Capital Markets

Okay. Then share repurchases; you didn't make any in the quarter. Should we expect to probably not see any in the fourth quarter as well unless the market stabilizes? Obviously the priority is the dividend but would you say new business are more of a priority over share repurchases right now and when do you expect to start doing that again I know, it’s difficult to say?

Kenneth William Stecher
Non-Executive Chairman of the Board

Scott that is something that we look at all the time, but I think what you just mentioned is a reasonable assumption. I think for the rest of the year, it would probably be unlikely. I think capital preservation is very important to us in these volatile times. When you watch the market move 350 points in the last 15 minutes of the market, I think the preservation of capital that puts us in a position to write good profitable business is important to us.

The dividend philosophy, where we have increased dividends now for 48 years in a row, that’s very important to us. But over longer term, we will continue to look at all the avenues in the capital management including repurchases.

Scott Heleniak
RBC Capital Markets

Okay, sure, makes sense. Then the final thing was workers comp loss ratio was up. Are you seeing a major up tick in claims there either for you or just industry wide based on what’s going on now? Is that where you are seeing the big increase in severity of larger claims that you reported this quarter, is that the area, where you are seeing that?

Marty Mullen

Scott that’s exactly right. This is Marty Mullen. There is a kind of flat on the frequency issue of work comp seeing a slight trend in the severity of injury in the middle market type claims certainly related to the type of injuries being sustained and the increased costs in medical and long term care.

Scott Heleniak
RBC Capital Markets

Thank you.

Operator

Your next question comes from Paul Newsome, Sandler O'Neill & Partners. Your line is open.

Paul Newsome
Sandler O'Neill & Partners

Good morning. I was hoping you could talk a little bit more about your personal lines business in general. How much do you think the difficult results are a result of the lack of use of credit scoring? Can you talk a little bit about the threshold of when and if you feel like you need to really pullback out of that market from a combined ratio perspective?

Kenneth William Stecher
Non-Executive Chairman of the Board

Paul, this is Ken. I will start then I will let others add in. I think what we have identified, when we have gone back and done some of our studies and really the result of the additional tiering that we have offered is that some of the prices on the higher credit scores were little too high and lower credit scores were a little too low.

So I think those are things we can fix. I think some of the other things that have impacted our results have been because we are not as diversified geographically on personal lines as many other carriers are. I think we also have an impact there. I think thirdly, the relationship with our agencies and I know J.F. can definitely add color to this.

When I traveled with them in Indianapolis earlier this month in my comments I noted, there was an agency there that currently does not write business with Cincinnati. But they are seriously looking at using us now because we are getting our rates more in line and our technology is now pretty stable.

It's working very well and it's providing the functionality and the service that they need. Most of our agencies write a fair amount of personal lines business and I think with the relationship that we try to build there is a lot of opportunity there.

So I think that with the pricing points that we have just moved into, the more tiering along with the other things we provide, I think we can be successful in this market. But so I think it's something we definitely want to continue in. But J.F, I would like to have your additional comments.

J.F. Scherer

Paul, I think if you were to canvas our agencies as to whether or not they would like to see us to be a more prominent part of their agency in personal lines that you would get a unanimous yes. The claims service that we provide of the agencies that don't write personal lines with us and beginning this year about third did not almost entirely because of automation issues, the direct billing issues.

We have added 124 agencies this year alone of which 33 were new to our company, but the balance were agencies that had heretofore represented us for commercial lines only. As Ken mentioned, the automation is there, the zeroing in on proper rates with the scoring is important and it's going in the right direction. We have mentioned before that our agencies write about $4.5 billion in personal lines business.

As they consider whether or not they went the personal lines accounts many of which are related to the commercial lines accounts, any claims that would be involved in the personal lines accounts, which adjustor, which company are they most interested in seeing handle those claims, I think they take great comfort in what Cincinnati Insurance Company can do in that area.

So, I don't think there is a person in the building that thought we might back out of this line of business, back out of personal lines. On the contrary, I think, we all view personal lines as being a great opportunity for us and I think we have a lot of things in place to capitalize on that.

Kenneth William Stecher
Non-Executive Chairman of the Board

I might add, Paul, just while we are on that subject is I had the opportunity this week to look at the results of the output from the predictive modeling work and looking at the lift curves, there is a lot of room to be optimistic.

From a predictive modeling work is taking place. It's already starting to be implemented. It's never over but it’s in the two stage process right now where the first steps took place for new business effective August 15th; renewals, October 1st. There is a second wave and that was for 17 states.

There is a second wave that’s going to be refining it further and moving towards the indicated factors that are demonstrated in these lift curves. So I think it is underway and there is a lot of positive momentum that’s taking place that we won't see the results from for a while, and that’s on the rate side.

Then on the technology side, we had, as J.F. mentioned, we have got the diamond system in place, where it provides for a certain degree of automation. But we also have on the table and ready to be implemented early next year on our dotnet platform which I think will just take us to another level. So I think there is, having said all that, I think there is some room for optimism there.

Paul Newsome
Sandler O'Neill & Partners

Maybe one follow-up. You said that you think that you lack diversification in your personal lines book, but heretofore and most folks I think figured that at least from a catastrophe event exposure you would be better off not being on the Coast and essentially that’s what your book is. I realize there are storms during the summer months, but you are not a small company. How could you not have the diversification enough scale wise to make money in the personal lines business?

Kenneth William Stecher
Non-Executive Chairman of the Board

Well, Paul, what I meant by the lack of geographic diversification is we are very concentrated in Ohio, Indiana, Illinois, Michigan, Missouri. That’s kind of one small area there where there is a huge concentration of our personal lines business. Mostly because we started out as a personal lines company in the '50s and didn't really transition into the commercial lines more into the late '60s and '70s.

So, we still have that huge concentration there. You are right. We do have some coastal exposure, but that’s been limited. What I would like to see and I think, what we all would like to see is in some of these western territories and states that we are opening, if we start selling personal lines out there, there is not quite the same type of exposure to catastrophes. Plus up in the northeast, there is a lot more limited exposure to catastrophes.

So, my feeling is and it's just my feeling, is that the national carriers that are basically writing in all 50 states, they can have bad years in one part of the country; other parts of the country are pretty benign and the results look more positive because they don't have lower loss ratios there.

So, that was the reason for my comment. I think, if you look at our numbers, I don't have them right in front of me. But if you look at the personal lines, homeowner premium in the five states that I mentioned, I think you will see it’s an oversized part of our personal lines book.

Operator

Your next question comes from Beth Malone with KeyBanc. Your line is open.

Beth Malone
KeyBanc

Thank you. Just one question on the three year contracts that you all provide that somewhat unique in the marketplace and given where pricing is does that strategy still makes sense given that you might be locked in at relatively low rates even as pricing may start to improve?

J.F. Scherer

Beth, once again, our three year strategy, that's been with us since 1951. If we were to look at our book of business and our approach with agencies with a timeline of writing an account for a very short period of time, I probably accept the argument.

But on the contrary right now, I think it opens the door for us to take a look as we look at new business in our agencies for especially good accounts to write those accounts, write them over a very long period of time, reinforce stability for our agencies with those accounts.

Right now as far as our book of business is concerned, as we have mentioned before, we don't have our entire book of business turning over at any one period of time. That has benefited us over the last few years.

As we look forward, we will simply sharpen our focus in terms of what we will be writing new. But I think it's going to give us a nice opportunity as the market firms up to provide perhaps modestly increased rates, but with a three year guarantee that we will outperform our competitors. So, that's kind of a long way of saying that we are very much committed to the three year policy approach and it's really served us very well.

Beth Malone
KeyBanc

Is it offered always to the clients or is it selective depending on the quality of the client?

J.F. Scherer

It works out that about 98% of our accounts have that three year policy components within it. However, it's not offered to everyone. If we have an account that requires facultative reinsurance, which is renewed on an annual basis and we can't be certain of what will be charged on the facultative side, we will issue that policy on a one year basis.

On an account that's brand new to the agency, we think we have got a great one on our hands. But we have been asked to be somewhat aggressively priced, we may go one year on that. One thing to remember about the policy is that the package policy has the guarantee. But within any account, you have an auto component in some cases the auto component could be a very large part of that that is annualized. We underwrite and we price that on an annualized basis.

Workers comp is issued on a separate and one year policy. So, we are given the opportunity to reunderwrite and price that. Then the umbrella section of the policy also we have the opportunity to underwrite and price that on an annual basis.

So, it's not as though our hands are tied in terms of what we finally negotiate as far as the total account premium is concerned. But the fact that as a company, we offer sometimes large part of the account, but any part of the account that has the stability of the three year policy term.

A very attractive proposition for our agents and for the vast majority of the folks that are out there buying insurance, the fact that they have a commitment from a financially strong company to freeze some part of their account for a three year period is a relief to them that they don't have to shop their account every year and that they are satisfied that they are with a good company, a good agency and with some stability in the rates.

Beth Malone
KeyBanc

Then on the economy, are you seeing real evidence in demand for your products being affected materially by the economy yet?

Marty Hollenbeck

The demand for our products relative to the economy?

Beth Malone

KeyBanc

Right. Are you seeing customers cutting back dramatically in what they need because of slower economic effects? I know there was some discussion about construction. Has it gotten worse or is it relatively stable in some of the markets you are in?

Marty Hollenbeck

The payrolls and sales especially on the construction side have been going down. We are not a dominant residential contractor insurer that obviously is a segment of the construction marketplace, which have been hit the hardest.

But on the commercial side, we have seen decreases in our audits. They are still positive but they are down and had been tracking fairly consistently this year. The projections for 2009 as far as construction is concerned, is that nonresidential is going to be down 1.2%, residential down 6.7%.

So obviously it will show up in our book. We like to fee that we write an above average book of construction business. So I would think that our guys will be the survivors and that it won't hit us quite as hard.

Beth Malone
KeyBanc

Okay. All right. Thank you.

Operator

This concludes the question-and-answer portion of today's call. I will now turn the call back over to Mr. Stecher for any closing remarks.

Kenneth William Stecher
Non-Executive Chairman of the Board

Well. Thank you for joining us today. We appreciate your interest in Cincinnati Financial and we look forward to discussing our full year results with you in February. Thank you.

Operator
This concludes your conference call for today. You may now disconnect.