S&P Capital IQ

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Cincinnati Financial Corporation NasdaqGS:CINF

FQ2 2017 Earnings Call Transcripts

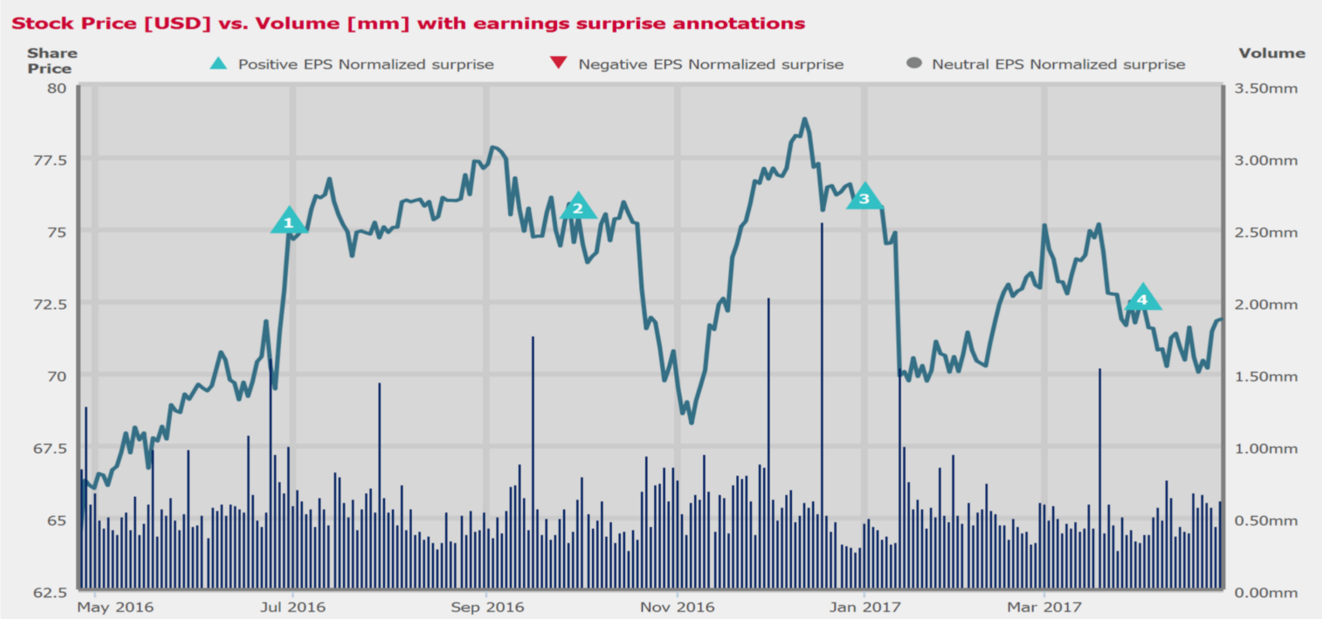
Thursday, August 03, 2017 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2017-			-FQ3 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.50	0.64	28.00	0.83	2.76	3.07
Revenue (mm)	-	1386.00	-	-	-	5878.05

Currency: USD

Consensus as of Aug-03-2017 10:38 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2016	0.39	0.57	1 46.15 %
FQ3 2016	0.78	0.86	2 10.26 %
FQ4 2016	0.65	0.75	3 15.38 %
FQ1 2017	0.51	0.59	4 15.69 %

Call Participants

EXECUTIVES

Dennis E. McDaniel
Vice President, Investor Relations Officer and Vice President of the Cincinnati Insurance Company

Jacob F. Scherer
Chief Insurance Officer and Executive Vice President

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

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good morning. My name is Jesse, and I'll be your conference operator today. At this time, I would like to welcome everyone to the second quarter 2017 earnings conference call. [Operator Instructions]

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

Dennis E. McDaniel
Vice President, Investor Relations Officer and Vice President of the Cincinnati Insurance Company

Hello. This is Dennis McDaniel from Cincinnati Financial. Thank you for joining us for our second earnings conference call.

Late yesterday, we issued a news release on our results along with our supplemental financial package, including the quarter-end investment portfolio. To find copies of any of these documents, please visit our investor website, cinfin.com/investors. And the shortest route to the information is the Quarterly Results link in the navigation menu on the far left.

On today's 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 Chief Insurance Officer for Cincinnati Insurance, J.F. Scherer; Chief Investment Officer, Marty Hollenbeck; Chief Claims Officer for Cincinnati Insurance, Marty Mullen; and Senior Vice President of Accounting for Cincinnati Insurance, 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.

Now, I'll turn over the call 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 second quarter results. We are pleased to report second quarter 2017 operating results that outperformed last year's second quarter. Our 98.3% property casualty combined ratio for the second quarter of this year was 1 full point better than a year ago.

It's also important to note that 98.3% was an improvement from the first quarter of 2017 despite an unfavorable effect from higher catastrophe losses. On a basis before catastrophe effects, our second quarter 2017 combined ratio was better than both the first quarter of this year and the fourth quarter of last year. We believe these improving trends bode well for the second half of 2017.

Other good news for the second quarter of 2017 includes another solid quarter for our investment results and premium growth that continues to outpace the industry. Our associates continue their steady efforts to support the outstanding local independent agents who represent Cincinnati Insurance as they carefully underwrite each policy and provide personal service to agents and their clients. We believe we'll continue to see benefits over the long term from our various initiatives designed to support profitable growth in each of our insurance segments.

Our commercial line segment grew net written premiums 2% and returned to producing an underwriting profit in the second quarter and for the first half of the year. Overall, commercial line's estimated average pricing improved slightly from the first quarter of 2017, most notably for commercial auto. As Mike will explain further, our commercial casualty line of business returned to a more typical level of profitability.

Although a high level of catastrophe losses continues to challenge our personal line segment, it reported another quarter of nice growth for both middle-market and high net worth premiums. Estimated average pricing for personal lines in total was in line with the first quarter of 2017, again with significant personal auto rate increases where needed.

Our excess and surplus lines segment reported another excellent quarter, including a combined ratio of 66.2% and premium growth of 20%. Cincinnati Re logged another quarter of strong underwriting results with steady premium growth in the combined ratio just under 80%.

The third quarter of 2017 marks 2 years since Cincinnati Re began assuming risks and generating premiums. Through the second quarter of this year, its cumulative net underwriting profit totaled $20 million on $183 million of net written premiums and an estimated combined ratio of 81%.

Our life insurance subsidiary continued its steady contribution to net income while growing second quarter 2017 term life insurance earned premiums by 8%. The steady growth of our life company, our E&S company and our reinsurance assumed division diversifies our business, helping to smooth results over time.

Our primary measure of financial performance, the value creation ratio was 3.2% for the second quarter and 7.0% for the first half of the year.

We are on pace for another year that reaches our long-term target of 10% to 13% annual average. Each day brings new challenges to insurance companies. We see them as opportunities for our associates to compete and to deliver value to agencies and policyholders. We know that can translate into long-term shareholder value.

Next, our Chief Financial Officer, Mike Sewell, will highlight other key areas of our financial performance and financial condition.

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 start my remarks with some highlights of our investment results.

Second quarter 2017 was our 16th consecutive quarter of investment income growth, rising 1% for the quarter, and 2% for the first 6 months. As in recent quarters, both interest and dividend income growth contributed or contributed to growth.

Our equity portfolio again reported growth in unrealized gains, up 6% for the quarter to nearly $2.6 billion. The bond portfolio's pretax average yield was 4.42% for the second quarter of 2017, down 22 basis points from last year's second quarter.

Taxable bonds purchased during the second quarter of 2017 had an average pretax yield of 3.75%, and purchased tax-exempt bonds averaged 3.33% for a blended yield of 3.53%.

Our bond portfolio's effective duration at June 30 was 5.2 years, matching March 31, and up slightly from 5 years at the end of December.

Cash flow from operating activities continued to provide funds for our investment portfolio. Funds generated from net operating cash flows for the first 6 months of 2017 totaled $445 million, down $54 million or 11% from the first half of last year. An $85 million increase in catastrophe losses paid this year was a key contributor to the decrease.

Careful management of expenses continues to be a priority, including investing strategically in our business. Our second quarter 2017 property casualty underwriting expense ratio improved slightly, and the 6 month ratio was in line with a year ago.

Next, I'll comment on reserves. We again experience net favorable development on prior accident years as we apply a consistent approach to setting overall reserves. For the second quarter of 2017, favorable reserve development benefited our combined ratio by 3.2 percentage points. That was down 1.2 points from a year ago but fairly close to the 3.5 points we averaged over the past 3 calendar years.

Our largest line of business, commercial casualty, returning -- returned to experiencing favorable reserve development for the second quarter of 2017. With a ratio of 2.5%, that line was similar to its longer-term ratios, which averaged 2.6 points over the past 3 calendar years.

Our commercial casualty second quarter 2017 loss and loss expense ratio of 57.7%, combined with an estimated underwriting expense ratio of 32-or-so, indicates an estimated combined ratio of just under 90%.

Favorable reserve development for the first 6 months of 2017 continued to be spread over most of our major lines of business and over several accident years, including 51% for accident year 2016, 12% for accident year 2015, 15% for accident year 2014 and 22% for 2013 and prior accident years.

Touching briefly on capital management. Our approach and financial strength remains stable. During the second quarter, we repurchased 800,000 shares at an average price per share of $69.73. As usual, I'll conclude with a summary of contributions during the second quarter to book value per share. They represent the main drivers of our value creation ratio.

Property casualty underwriting increased book value by $0.09. Life insurance operations added $0.07. Investment income other than life insurance and reduced by noninsurance items contributed $0.41. The change in unrealized gains at June 30 for the fixed income portfolio net of realized gains and losses, increased book value per share by $0.29. The change in unrealized gains at June 30 for the equity portfolio, net of realized gains and losses, increased book value by $0.54, and we declared $0.50 per share in dividends to shareholders. The net effect was a book value increase of $0.90 during the second quarter to a record $44.97 per share.

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

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

Thanks, Mike. In closing our prepared remarks, I'd like to share some additional positive news about our company. In June, S&P Global Ratings affirmed its A+ financial strength rating for our standard market and life insurance subsidiaries. And in April, A.M. Best, affirmed with a stable outlook, its rating of A excellent for The Cincinnati Life Insurance Company.

We were also pleased to be recognized for a sixth time by Forbes Magazine as one of the Most Trustworthy Financial Companies in America, and to be included in the Fortune 500 for the second consecutive year.

Our solid performance combined with this news gives us confidence that Cincinnati Financial is on track to deliver shareholder value far into the future. We appreciate this opportunity to respond to your questions, and also look forward to meeting in person with many of you during the remainder of the year.
As a reminder, with Mike and me today, are J.F. Scherer, Marty Mullen, Marty Hollenbeck and Theresa Hoffer. Jesse, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Can you -- do you have high net worth premiums in force? I know -- I think you had $7 million of new business. So I just wanted to get the in force number.

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

We have -- let's see here. Estimating for the first half of the year, we have about $180 million in the high net worth segment.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And I saw that commercial casualty, as you mentioned, turned favorable this quarter. I guess, while just looking at the loss environment more broadly. Are you seeing, year-over-year, any changes in inflation trends? Are you seeing juries paying higher, awarding higher awards? Or any changes in that sense?

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

No, we haven't. We haven't noticed that, to tell you the truth.

Operator

Your next question comes from Scott Heleniak with RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

I was just wondering if you could -- the E&S unit had a very good performance again. I just wonder if you can go into any detail on some of the lines or the industry sectors, where you're seeing performance where that's really standing out? Anything that comes to mind?

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

And did you say in the E&S segment?

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Yes, yes.

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

Yes. It's largely casualty and casualty-driven. We do point out that -- I don't know, with 40%, 45% of the risk that we write an E&S policy on, we might have a standard Cincinnati policy. So there are a lot of situations where we'll write the property on a standard basis through Cincinnati Insurance, the casualty through the E&S company with appropriate terms and conditions. But the largest percentage of the premium is in casualty in the E&S company.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then I'm just wondering, in E&S, too. If you could talk about the -- some of the submission flow, I'd imagine you're getting a lot more looks at business given where the size of Cincinnati is. And so just wondering if you might be able to comment on what you're seeing as far as new submission flow.

Jacob F. Scherer
Chief Insurance Officer and Executive Vice President

All right. Scott, this is J.F. Scherer. Yes, the submission flow is up this year, we're pleased about that. To tag on to Steve's comments a little bit earlier, the -- I guess, the classification, if you will, of the business we're writing is kind of reflective of a generalist approach that our agencies take. We don't really have a strategy of going after a line of business or an industry classification. We're pleased that 44% of what we write in the E&S is attached to a P&C account. But our agencies write closing in on $3 billion in E&S business in their agencies in total. And so what we're trying to do, just with the model we have is just to continue to compete for primarily, that book of business that they already have. We think we've got a pretty good value proposition on the E&S side, and do what we can to write that seasoned business just within those agencies right now. So we're very pleased with the submission flow. There's a lot of competition, particularly in larger accounts in the E&S where carriers are taking accounts out of the E&S business into the standard market. We've got a pretty conservative appetite in this. I mean, what we're -- I guess, in some respects, we play on the fringe of E&S versus standard. So it's not surprising that some of our accounts would go back into the standard market during a softer market the way that it is right now, but notwithstanding the fact we're losing some of that business to the standard market, we're -- the submission flow obviously has been very good which has allowed us to grow nicely.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then I'm just wondering on the commercial lines, the accident year loss ratio, it looked like that was up mostly because of property. Was there anything unusual in there, just -- was that just kind of an uptick in non-cat weather? Are you seeing any kind of large losses or anything in the quarter?

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

Scott, that was a good observation. I think if you compare the ex cat accident year, we had a very, very favorable quarter a year ago in the property with the 36.3% loss ratio. The 49.7% that we're posting this year is right in line with what you would normally expect. Maybe one other area where there would be some large losses, if we look to the personal lines to the Other category, we're up a little bit this year at 68.3% from where we were at 42% a year ago. And as we dig into that is some larger umbrella losses. So I think those would be the 2 points to describe other than the non-cat weather. I think I'd also like to make the point that if we just look at the ex cat accident year for the quarter, vis–à–vis longer-term trends, including each of the full last 3 years, it's very much in line.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. Yes, I just wanted to just make sure I wasn't missing anything there, but it makes sense. And then just, finally, the last question, was the tax rate was lower than it had been tracking, was that just the share-based compensation accounting change rule that came into effect, or was there anything else onetimer in there?

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

Yes, this is Mike. What that really is, is when you take a look at the -- what's driving that primarily is the underwriting profit for this quarter compared to other quarters. So that's really what dropped it a little bit. You've got your preference items of the dividends received, deductions, tax-exempt interest, et cetera. But the more underwriting profit you have, the more that, that's going to come in straight at the 35% less underwriting profit, you'll have a little bit less -- sorry, more. And then -- and so therefore, you've got your change there.

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

Excuse me, I might add, we've favored municipals over corporates to some degree over the last 12 to 18 months, so that's starting to have a little bit of an impact.

Operator

[Operator Instructions] The next question comes from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'd be interested in understanding how your model works in relation to the rise of insurance technologies. There's a lot of your competitors who are investing in heavily in digital distribution platforms, artificial intelligence, claims handling and whatnot. And you guys have benefited for a long time of a decentralized claims and distribution model. Do insurance technologies help Cincinnati be competitive against peers? Or is this going to be a time of change, where you -- Cincinnati's going to need to change to stay competitive?

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

Good question, Josh. We do see it as an opportunity. We do see people have tremendous financial assets on the line when they enter into an insurance agreement and we think that the -- as you mentioned, the decentralized personal approach that we take to things, both at the point-of-sale and during the claims, as a competitive advantage. Having said that, we just don't want to see disruption happen and we react to it. So we have actively sent our strategy team out to Silicon Valley to the various incubators. We actually have one here at Cincinnati. We've been up to Detroit to talk to those that are actually making the automated cars. So we're keeping our thumb on the pulse and really what I'd see us doing is to take away the things that we learned, try to find opportunities in the claims area, or whatever area that it is that we could execute our personal touch -- business model better by better using technology.

Joshua David Shanker
Deutsche Bank AG, Research Division

Are there any specific investments that you're making right now?

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

We have some. I don't think I'd like to go into the details on those, but particularly in more efficient delivery in the claims area, maybe in the underwriting area as well. We are in the investment stage.

Operator

There are no further questions at this time.

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

Very good. Thank you, Jesse and thanks to all of you for joining us today. We look forward to speaking with you again on our third quarter call. Thank you.

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