![S&P Capital IQ]

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Cincinnati Financial Corporation NasdaqGS:CINF

FQ4 2015 Earnings Call Transcripts

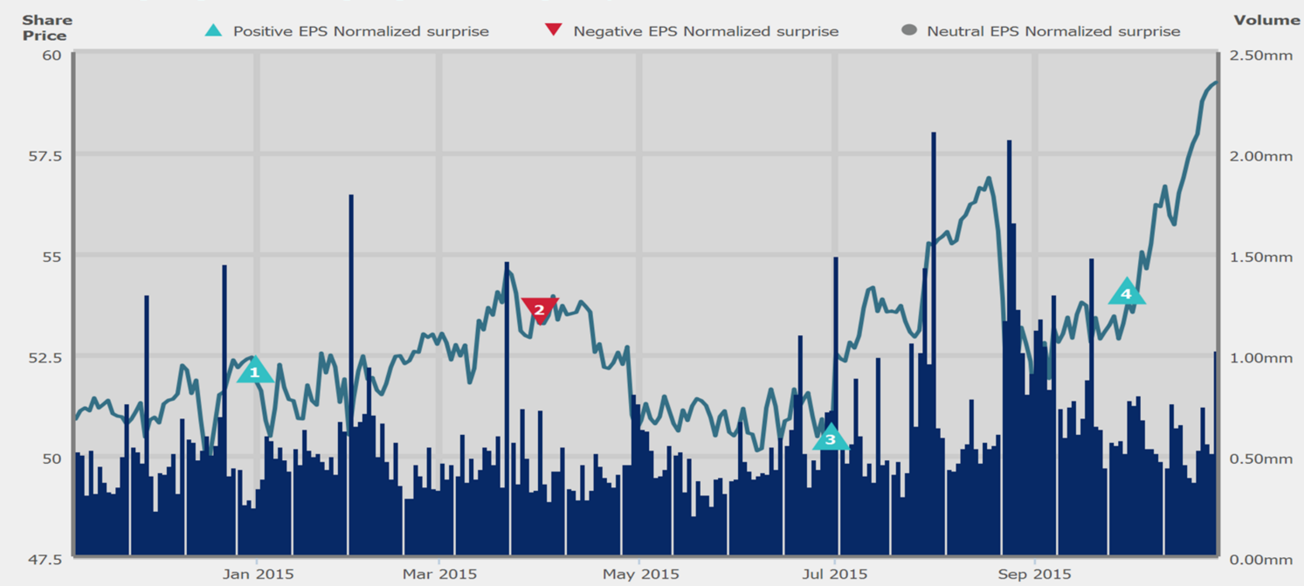
Thursday, February 04, 2016 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.87	1.10	▲26.44	0.71	3.32	3.56
Revenue (mm)	1281.00	1263.00	▼(1.41 %)	1197.00	5160.00	5142.00

Currency: USD
Consensus as of Feb-04-2016 10:33 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	0.83	0.89	▲(1) 7.23 %
FQ1 2015	0.72	0.59	▼(2) (18.06 %)
FQ2 2015	0.41	0.83	▲(3) 102.44 %
FQ3 2015	0.65	1.04	▲(4) 60.00 %

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

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

Joshua David Shanker
Deutsche Bank AG, Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good morning, ladies and gentlemen. My name is Sally, and I will be your conference operator today. At this time, I would like to welcome everyone to the Cincinnati Financial Corporation's Fourth Quarter 2015 Earnings Conference Call. [Operator Instructions]

I will now turn the conference over to Dennis McDaniel, Investor Relations Officer. Please go ahead, Mr. McDaniel.

Dennis E. McDaniel
Vice President and Investor Relations Officer

Hello. This is Dennis McDaniel. We thank you for joining us for our Fourth Quarter 2015 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 Cincinnati Insurance Company's Executive Committee Chairman, Jack Schiff, Jr.; Chairman of the Board, Ken Stecher; Chief Insurance Officer for the Cincinnati Insurance Company, J.F. Scherer; Principal Accounting Officer, Eric Mathews; Chief Investment Officer, Marty Hollenbeck; and Chief Claims Officer for Cincinnati Insurance, Marty Mullen.

Please note that some of the matters to be discussed today are forward looking. These forward-looking statements involve certain risks and uncertainties. With respect to these risks and uncertainties, we direct your attention to our news release and to our various filings with the SEC.

Also, a reconciliation of non-GAAP measures was provided with the news release. Statutory accounting data is prepared in accordance with statutory accounting rules and, therefore, is not reconciled to GAAP.

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

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

Thank you, Dennis, and good morning. I'm speaking with you today from Murfreesboro, Tennessee. This week, we began our annual tour of sales meetings with our independent agents in more than 20 states. Meeting with agents is essential to our relationship-oriented agency-centered strategy that reflects our culture, where we believe actions speak louder in person.

There are many benefits to strengthening those relationships and getting information on a first-hand basis. And being with agencies, energizes our local and headquarters' management teams. We enjoy this chance to thank our agents in person for all they contribute to the success of Cincinnati Insurance. Their trust in us to serve the people and businesses in their communities produced another great year of underwriting profit and premium growth.

Next, I want to highlight our financial performance and reiterate our confidence in our strategy and our ability to execute it well. The strong operating results we reported for the fourth quarter and for the full year 2015 continue to reflect the steady effort by our associates as we carefully underwrite and price policies, provide overwhelming claim service, manage investments and provide support for our operations and agency partners.

Excellent company performance in 2015 provided the opportunity to further reward shareholders and was the main driver of the special dividend paid in December.

We are very satisfied with our recent overall underwriting results as we reported a fourth quarter 2015 combined ratio of 87.0%, and a full year ratio of 91.1%. More favorable weather in 2015 contributed to the full year combined ratio improvement compared with 2014. It's also important to note that most of the underlying measures also improved due to contributions from all areas of the company.

Our commercial insurance results were a highlight this quarter as our associates and agents achieved profitable growth and steady pricing. We continue to further segment our renewal and new business opportunities using pricing precision and risk selection decisions that combine data models and underwriter judgment on a policy-by-policy basis. We know that work is critical as we seek to further improve underwriting results.

We believe we can successfully balance prudent underwriting and business growth to maintain 2016 combined ratios in the low to mid-90% range and 2016's property casualty premium growth rate within a percentage point of 2015. Our 2015 catastrophe loss ratio was 2.3 points below the average of the previous 10 years. We recognize that weather and significant changes in the industry market conditions that influence insurance policy pricing trends are variables that will affect the property casualty results we ultimately report.

In 2015, it looks like we met our premium growth objective of outpacing property casualty industry growth based on the industry's 9-month result. We continue to experience outstanding policy retention and average renewal price increases for each of our property casualty segments. That's a tribute to the excellent way our agencies conduct business as well as to how our underwriters do their jobs.

Policy retention rates for both personal and commercial lines were generally consistent with a year ago. For commercial lines, our policy retention continues near the high end of the mid-80% range. And for personal lines, we continued in the low to mid-90% range. Our long-term growth strategy includes appointing agencies in areas where we are underrepresented, taking care to preserve relationships with established agencies and the franchise-like benefit they value.

In 2015, we appointed 114 new independent agencies. Similar to recent years, in 2016, we plan to appoint approximately 100 additional agencies that will offer most or all of our property casualty insurance products. We also plan to appoint other agencies that focus on high net worth personal lines clients.

In 2016, we are targeting approximately $25 million in high net worth new business written premiums. That includes premiums from our Executive Capstone suite of insurance products and services. We continue to earn new business through our agencies in part through new products and services like our high net worth expansion initiative. For full year 2015, each of our property casualty segments reported an increase in production of new business written premiums.

One of the bright spots was the increase in high net worth new business. While its contribution was a relatively small amount of overall 2015 new business increase, its growth rate was approximately double the rest of the personal lines operations.

The launch of Executive Capstone and prudent expansion of our reinsurance-assumed operation provides additional confidence in our abilities to continue to diversify and profitably grow premiums in an increasingly tough operating environment.

For renewal business in the fourth quarter, overall average renewal price increases were similar to the third quarter. Average renewal price increases for commercial lines continued at percentages in the low-single-digit range. That average includes the muting effect of 3-year policies that were not yet subject to renewal during the fourth quarter.

For commercial property and commercial auto policies that did renew during the fourth quarter, we continue to obtain meaningful price increases with property averaging in the mid-single-digit range and auto averaging near the high end of the low single-digit range.

Our most profitable line of business in recent quarters, workers' compensation, averaged negative renewal price changes during the fourth quarter. While the average pricing change may have turned negative, we continue to price on a policy-by-policy basis. Certain policies that we determine needed a price increase received it. Approximately half of our workers' compensation 2015 renewal premiums were for policies with price increases.

Our personal auto policies averaged renewal price increases in the mid-single-digit range, while homeowner policies averaged a low-single-digit range, down from the third quarter. For our excess and surplus line segments, fourth quarter 2015 average renewal price increases were near the high end of the low-single-digit range, down slightly from the third quarter measure.

Our Life Insurance subsidiary again grew term life insurance premiums; its largest product line. This business supports account retention for our agents and provide steady contributions to our earnings as it has less correlation to the weather than our property casualty business.

On January 1 of this year, we again renewed all of our primary property casualty treaties that transferred part of our risk to reinsurers. For both our per risk treaties and our property catastrophe treaty, terms and conditions for 2016 are similar to 2015. While we did receive some modest rate reductions, we expect the amount of seasoned premium for both years to be similar because our direct written premiums subject to those treaties are growing.

In conclusion, our primary measure of long-term financial performance: The value creation ratio was 3.4% for full year 2015. The contribution from operating income was the highest it's been in the past 5 years. However, VCR total was below our range due to a decline in securities market value.

For 2016 and beyond, we'll stay focused on areas where we have more influence, underwriting profitability and growth. Our insurance business remains in excellent shape. We are as confident as ever in our associates, in the relationships we build with independent agencies and in the ongoing benefits of our strategic initiatives that aim to continually improve performance.

I'll now ask our Chief Financial Officer, Mike Sewell, to comment on investments and other important aspects of our recent financial performance.

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 with some analysis of investment results. Investment income growth for the fourth quarter 2015 was especially strong at 7%, boosting the full year result to just over 4%. Fourth quarter dividend income was up 14%. Dividend amounts in the last quarter of the year tend to be the most variable, as some entities return capital or pay special dividends near the end of the calendar year.

Interest income rose 4% in the fourth quarter and 3% for the year as we continue to invest the majority of annual net operating cash flow in our bond portfolio.

Other-than-temporary impairments to securities and our stock and bond portfolios totaled more than a typical quarter at $40 million. Most of that related to energy stocks affected by declining oil prices. Securities market trends took a toll on the valuation of our investments during 2015. The company has experienced that before and we've maintained our current proven investment approach for over 5 decades and we have no plans to change it.

Our stock portfolio valuation rebounded nicely in the fourth quarter, but its year-end 2015 fair value was 3% below where it began the year. The stock market's rocky ride so far in 2016 has been well publicized, but we choose to keep our focus on long-term investment strategy and performance.

Fair value of our bond portfolio rose 2% for the year despite a significant drop in unrealized gains due to rising interest rates. That drop was offset by net purchases of additional bonds for the portfolio as its amortized cost was up almost 5%.

In terms of bond portfolio yields, we reported a fourth quarter 2015 pretax average yield of 4.66%, 6 basis points lower than a year ago. That measure on a full year basis also declined by 6 basis points.

Taxable bonds purchased during the fourth quarter had an average pretax yield of 4.34%, while tax-exempt bonds purchased averaged 3.36%. Our bond portfolio's effective duration at the end of 2015 was 4.7 years, up from 4.4 years at year-end 2014. That increase was due primarily to the impact from rising interest rates on our callable bonds and does not represent a change in strategy.

Cash flow from operating activities continues to help us grow investment income. Funds generated from net operating cash flows for the year 2015 were up 22% to just over $1 billion, contributing to the $631 million of net purchases of securities for our investment portfolio.

Turning to property casualty underwriting results. I'll first comment on 2 typical items. Number one, careful expense management is still one of our top priorities and is balanced with strategically investing in several parts of our business. That approach, combined with premium growth, resulted in a slight increase of 0.3 percentage points for our full year 2015 underwriting expense ratio, bringing it to 30.9%. That increase was largely due to investments to support our expansion of high net worth personal lines markets.

Number two, the primary measures pertaining to our reserves for losses and loss expenses continued to fairly -- continued in a fairly steady pattern as we continued to follow a consistent approach. We have now experienced 27 consecutive years of overall favorable reserve development. Full year 2015 favorable reserve development on prior accident years benefited our combined ratio by 4.3 percentage points. That was better than the 2.4 points for 2014 when we strengthened commercial casualty reserves. But the 4.3 points was consistent with the 4.1 points we reported for the year 2013.

Other than commercial and personal auto, each of our major lines of businesses developed favorably in 2015. We continue to take underwriting and pricing actions to improve our auto results and maintain what we believe is a prudent level of reserves.

Our full year 2015 net favorable development was again spread over several accident years, including 33% for accident year 2014, 22% for accident year 2013, 26% for accident year 2012 and 19% for all older accident years in aggregate.

Consistent with past years, we continue to aim for reserves reported on our balance sheet to be at levels reflecting net amounts well into the upper half of the actuarially estimated range of net loss and loss expense reserves. Our consolidated property casualty gross and net carried reserves rose 5% during 2015.

I also want to highlight the $33 million of fourth quarter 2015 net written premiums we reported for our reinsurance-assumed operation known as Cincinnati Re. At the end of the year, 7 diverse treaties were in effect. We are recording written premiums in the period treaties become effective and will follow the common practice of estimating assumed premium amounts for each treaty's term based on current information. Premiums will be earned over the coverage period on a pro rata basis, similar to our other property casualty policies. Net of applicable retrocessions Cincinnati Re's 2015 net earned premiums totaled $10 million.

One capital management item I'll touch on is additional share repurchases during the fourth quarter of 2015. Shares repurchased during the quarter totaled 200,000 shares at an average price per share of $60.11. That brought the full year 2015 share repurchases to a total of 1 million shares at an average price per share of $53.08.

As usual, I'll conclude my prepared comments by summarizing the contributions during the fourth quarter to book value per share. Property casualty underwriting increased book value by $0.57; life insurance operations added $0.06; investment income, other than life insurance and reduced by noninsurance items, contributed $0.47; the change in unrealized gains at December 31 for the fixed income portfolio net of realized gains and losses decreased book value per share by $0.45; the change in unrealized gains at December 31 for the equity portfolio net of realized gains and losses increased book value by $0.70; and we declared $0.92 per share in dividends to shareholders with half of that representing a special dividend. The net effect was a book value increase of $0.43 during the fourth quarter to $39.20 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

Thank you, Mike. In concluding our prepared remarks, I want to acknowledge the fourth quarter ratings upgrade by A.M. Best for our excess and surplus line subsidiary; the Cincinnati Specialty Underwriters insurance company, also known as CSU. With that upgrade, A.M. Best rates CSU's financial strength with a rating of A+ superior. Performance of our EMF company has been outstanding. For the past 2 years, its combined ratio has been under 80%, while it has maintained double-digit premium growth. We salute our CSU team and the agents who bring us excess and surplus lines business.

Also in the fourth quarter, A.M. Best affirmed their strong ratings on our standard market property casualty and life insurance companies. With all of our operating segments delivering another year of strong performance, we remain confident that we can deliver long-term shareholder value for years to come.

The Board of Directors demonstrated that they share that confidence by recently increasing the quarterly cash dividend to $0.48 per share, setting the stage for 56 consecutive years of shareholder dividend increases by your company.

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 Jack Schiff Jr., Ken Stecher, J.F. Scherer, Eric Mathews, Marty Mullen and Marty Hollenbeck. Sally, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Paul Newsome with Sandler O'Neill.

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

I have a big picture question and a small one. The big picture is, have we gotten to the point where we want to have another sort of 5 year goal of pretty serious premium growth in the future? And if you've kind of solidified that more I'd love to hear about what you think of that?

And then the small question is, there was a pretty good-sized reserve release in the excess and surplus lines of business, that stuck out at me. I know it's not the biggest thing in your book, but just curious as to what that -- why that might have happened?

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

Good questions, both of them. In terms of the premium growth, we think obviously growing our company is important, especially given the profitability, the level of capital that we have, growth is important to us. In terms of our goal for 2016, net written premium is 6%. In terms of 2020, I'm not sure that we have publicly announced that yet. We are working on that, but we want to continue to have strong growth.

In terms of the excess and surplus lines, it was just the result of the normal, consistent year-end reserve analysis that goes on. I think we always want to be prudent, especially with something like excess and surplus lines. And over that period of time, we have been prudent and just the data, the actuaries felt, reflected the reserve release that we did during the fourth quarter. Very consistent approach.

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

Should we -- on the first question, should we expect some announcement if -- are you are working on another big strategy plan that you want to announce at some point? Or is that something you're -- I guess, should we expect an announcement sometime in the future?

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

I don't think anytime soon, but just rest assured that we continue to think long term, work towards a long-term growth. We have a long-term strategy and that we are really working on strategic planning and a more detailed approach to strategic planning than ever before, with a look towards the long term.

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

Great. Great quarter.

Operator

[Operator Instructions] Your next question comes from the line of Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

As the last caller said, very good quarter. Not much in the numbers that really was terribly surprising. I did want to ask on -- you did an awful lot of capital management in the quarter relative to your normal run rate. If you weigh in the dividend increase, which was not wholly unexpected, along with the special dividend, along with another quarter of modest but consistent buyback activity. I mean, it just strikes me that this is more capital management than I've seen from the company in a while. And I wonder how you're thinking about that in general and what expectations we might have in the future beyond just the normal couple cent dividend increase that is now pretty much expected.

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

Good question, Mark. And I think it just basically came down to having a really strong year on an operating basis. We wanted to return capital to our shareholders. I think I would look at it just kind of a rightsizing of capital or a step in that direction. I think in terms as we go forward, I would just think of us being steady. The yield on our dividend now is around 3.4%, I believe. I wouldn't -- would not automatically count in another special dividend next year just because we did one this past year. I think it was a special dividend and should be thought about in those regards. But we do recognize that capital management is important. And again, we just -- it's with the results, the reserving, the balance sheet, everything we would do, we want to be steady and with a long-term focus. I don't know, maybe Mike would have something to add to that.

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

I think that was exactly right. The buybacks that we did this year were maintenance, that we've been saying throughout the year, so we'll be looking at that for 2016. But looking at other ways of investing in our business, the way that we've been saying and with our high net worth, Cincinnati Re and investing in technology, we're going to be using our capital in various ways.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. Second question I had and maybe this is apropos of your meetings with your agency base. I'm interested in understanding kind of the customer mindset. We hear a lot about rate cuts and so forth. Is that -- do your agents begin their discussions with their customers anticipating that there'll be rate cuts? Or are people happy with flat renewals? I'm just trying to get a little bit into the mindset of what the average Cincinnati Financial customer is thinking when their policy renewal comes up.

Jacob F. Scherer
Former Chief Insurance Officer

Mark, this is J.F., the topics of conversation that we've had over the last 3 days of sales meetings, I think I would characterize it as being surprisingly fewer conversations about terrific competition or anything of that nature. I think the expectation right now is that the account has performed well, that they would have flat renewals, maybe some slight decreases is the way agencies would tee it up with us in their discussions with us. They also understand, and they hear from other carriers, that segmentation is the key here. Is that there's still policy holders out there that deserve and, in our book of business, are getting rate increases. So I guess I would characterize, Mark, place is not out of control. There's a few war stories that come through that there are some surprising things going on. Clearly, everyone's results are good. Everyone wants to increase shelf space in agencies. A lot of agencies would be discussing to prospective clients, saying that you should expect a price decrease. But I guess I've come away from these last 3 sales meetings feeling pretty good about stability. Our 3-year policy in a marketplace like this, in any marketplace, really, but in this marketplace, plays out well. There's a lot of policyholders that are appreciative of the consistency of our approach with them. Their policies aren't renewing this year just because there may be some chatter out there about rate decreases doesn't mean they want to go through the process of completely reevaluating their insurance program.

So clearly there's going to be a fair amount of competition out there. We are seeing in the excess and surplus lines areas a little bit of a pickup of E&S business going back to the standard market which is pretty typical for this type of phase of the marketplace. So maybe that's a little more than you're asking for but that kind of gives you a little bit of flavor we're experiencing.

Mark Alan Dwelle

RBC Capital Markets, LLC, Research Division

No, that's very helpful. I guess the last question I wanted to ask, is I guess maybe more recent and somewhat dear to my own situation. Have you seen any kind of surge or unusual uptick in claims related to the various winter storms that hit the East Coast? And I guess now most recently the Midwest?

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

Hi Mark, this is Marty Mullen. Actually, our activity has been fairly light to modest as far as our activities from the East Coast. We have experienced certainly some freeze and winter storm losses but our ultimate claim count from those mid-January events is very light considering I think what's going on in the industry. I think from our perspective, it's been almost a nonevent. We've projected our ultimate loss to be somewhere in the area of $3 million. That gives you some idea of our experience.

Operator

[Operator Instructions] Your next question comes from the line of Joshua Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I wanted to know what you're hearing from customers, agents and underwriters regarding high net worth homeowners in the wake of the ACE Chubb merger?

Jacob F. Scherer
Former Chief Insurance Officer

Hi, Josh, J.F. here. We're getting a lot of real favorable feedback on that relative to our activity. As you can imagine, there's less choice out there for independent agencies that had represented Fireman's Fund and the -- Chubb and ACE. So they're looking for more choice. Feedback has been good, not only from our current agency force. In fact, in Atlanta, on Tuesday, we had a workshop, if you will, an introductory workshop for agents and 90 agencies attended, which you just have to take my word for that, that's a huge number of agencies that's showing interest in high net worth. We've been very successful in appointing our first wave of agencies in New York City, Long Island, Westchester County area. In New Jersey, which we will open in March, we've had quite a few agencies calling us interested in representing Cincinnati Insurance Company. I think it's worth noting the person that will be spearheading our East Coast strategy is a gentleman by the name of Joe Kinsey. Joe previously was President of Fireman's Fund personal lines. He joined us a few months ago. Joe had worked with Will Van Den Heuvel previously, so we're pleased to get that kind of talent into the company. Will was in California a couple of weeks ago, talking to agents out there, there's a lot of interest there. So I think between the talent of the people that are working with us in high net worth, the reputation we have among agents, the financial strength that we represent, the good claims reputation we have as a company, we're feeling really good about where we are right now in high net worth.

Joshua David Shanker
Deutsche Bank AG, Research Division

Will you appoint an agent who wants to use you as a high net worth resource even if they are not yet sure that they're going to use you for other lines?

Jacob F. Scherer
Former Chief Insurance Officer

Yes, we will.

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

In fact in New York City, Long Island, lower New York State, that's what we are doing, is appointing agencies for high net worth only. That will be the case in New Jersey. We're not active in commercial lines in New Jersey. We're also not active in -- when I say not active, we're licensed and write risk there but we don't have an agency force in New Jersey nor do we have in California. So in all those states, those will all be high-net-worth-only appointments.

Joshua David Shanker
Deutsche Bank AG, Research Division

That sounds like a great opportunity for you. Good luck.

Operator

There are no further questions at this time. Mr. Johnston, I'll turn the call back over to you.

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

Thank you, Sally and we appreciate all of you joining us today on our call and we look forward to speaking with you again in the coming months. Thank you very much.

Operator
This concludes today's conference call. Thank you for your participation. You may now disconnect.