2013 Second Quarter Conference Call

August 13, 2013

8:30 AM ET

Operator: Greetings and welcome to the Atlas Financial Holdings 2013 Second Quarter Financial Results Conference Call. At this time all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star-zero on your telephone keypad.

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Mr. Scott Wollney, Chief Executive Officer of Atlas. Thank you. Mr. Wollney, you may begin.

Mr. Scott Wollney: Thanks, Melissa [sp]. And good morning, everyone. With me today is Paul Romano, our Vice President and CFO. On this morning's call, I'll provide a brief update on our business and second quarter 2013 results. Paul will review our financials, and then I'll return with concluding remarks. As Melissa mentioned, we will then open it up for questions and answers.

During this call, we'll make reference to a presentation which is available in the Earnings Release Info section of our Investor Relations page of our Web site. Before I begin, I'll turn it over to Paul to read the Safe Harbor Statement.

Mr. Paul Romano: Thank you, Scott.

This morning Atlas issued its 2013 second quarter financial results. Copies of this press release are available at the Investor Relations section at the company's Web site at www.atlas-fin.com. As Scott mentioned, we will be utilizing a slide show presentation in conjunction with this call.

This presentation is available on our Web site's Investor Relations section, and then under the Earnings Release Info selection. We welcome each of you to review this presentation and follow along.

On this call, Atlas may make forward-looking statements regarding the company, its subsidiaries, and businesses. Such statements are based on the current expectations of management of each entity. The words "anticipate", "expect", "believe", "may", "should", "estimate", "project", "outlook", "forecast", or similar words are used to identify such forward-looking information.

The forward-looking events and circumstances discussed in this call may not occur and could differ materially as a result of known and unknown risk factors and uncertainties affecting the companies, including risks regarding the insurance industry, economic factors, and the equity markets generally, and the risk factors discussed in the Risk Factors section of its Form 10K for the year ended December 31st, 2012.

No forward-looking statement can be guaranteed. Except as required by applicable security laws, forward-looking statements speak only as on the date on which they are made. And the company and its subsidiaries undertake no obligation to publically update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise.

When discussing our business operations, we may use certain terms of art, which are not defined under US GAAP. In the event of any unintentional difference between the presentation material and our GAAP results, investors should rely on the financial information in our public filings. All amounts discussed in this call are in US dollars, unless otherwise indicated. With that, I'd now like to turn the call back over to Scott.

Mr. Scott Wollney: Thanks, Paul.

In the second quarter, Atlas continued the momentum that we built in previous quarters. And we're pleased with the steady growth in our core lines. We reported strong underwriting improvement, including considerable increases in premiums written, net premiums earned, and net income.

Our primary focus for the first half of the year was to continue to strengthen relationships with our core independent agents, integrate Gateway completely into Atlas's infrastructure, and continue to leverage the nationwide geographic platform we've established. Throughout all of this, we're vigilant with respect to pricing trends in our core taxi, limo, and paratransit lines, which to date have been steadily improving and remain favorable.

Let me touch on some of our basic financial and operating results from the quarter as summarized on slide four of our presentation. Gross written premium increased 79.2 percent with 90.6 percent improvement in our core commercial auto lines. We improved our financial ratios across the board, resulting year-over-year improvement in our combined ratio, which was 95 percent during the second quarter, driven primarily by a $1.7 million improvement in underwriting results.

And our net income for the quarter was 1.7 million, or 16 cents per diluted common share, net of accounting treatment for preferred shares. Before I go into greater detail about Atlas's operations, let me address our recent announcement surrounding the redemption of outstanding preferred shares. The details of this transaction are found on slide five of our presentation.

On August 1st, 2013, Atlas entered into a definitive agreement to purchase for cancellation $18 million of outstanding preferred shares. The negotiated purchase price was 16.2 million, or a $1.8 million discount to liquidation value. In addition to providing 22 cents accretion in the book value common share as a direct result of the discount, this transaction also eliminates potential future dilution to common shares, as the preferred shares we redeemed could have converted to 2.286 million common shares in the future.

This potential dilution was factored into our actual per share income figures for the second quarter 2013, but will not be included in these calculations going forward. To help provide clarity as to what earnings would have been on a post-redemption basis, we've included pro forma figures in our earnings information for the quarter.

For example, on a pro forma basis, factoring in the redemption of the preferred shares as if this redemption had occurred in the second quarter would have resulted in diluted earnings per ordinary share for three-month period ended June 30, 2013, of 40 cents, of which 21 cents per share relates to accretion from the discounted purchase, and 19 cents per share relates to net income available to common shareholders.

On the same pro forma basis, book value per share would have been $6.29, as compared to the actual figure of $6.07. We are very pleased to complete this transaction, which will have an immediate positive impact on our income per common share and book value. We negotiated what we felt were favorable terms, purchasing the entirety of the preferred stock available for redemption at a meaningful discount to liquidation value.

Now let me move on to a discussion of our core lines of business as summarized on slide six and what we're seeing in the market. We continued to see positive trends on our core lines of business, which consist of specialty insurance products for users of light commercial vehicles, specifically taxi cabs, limousines, and paratransit operators.

Atlas's growth rate has been achieved through our strong independent agency network. These are focused agents with considerable experience selling our core products for one or more of our insurance subsidiaries. We do not distribute through wholesalers, managing general agents, or other intermediaries who are disconnected from the point of sale.

This close contact with our agents and policy holders is critical to effective underwriting as well as understanding of exposures and loss reserving. Just a few years ago, our insurance subsidiaries wrote more than $100 million in those lines of business that today are considered core to Atlas. And the majority of this business was written in a relatively small number of states.

Much of this business was transitioned away from our companies in 2009 and 2010 as a result of challenges which have successfully been addressed under Atlas's ownership during the past two years. We're now seeing a recommitment from existing agents and a strong demand for new agents in response to Atlas's value proposition, coupled with positive trends in the market.

Having expanded into 40 states plus Washington, D.C., we expect not only to recapture the volume of business that was written historically, but to continue growing to a point where we have what we believe to be a proportionate market share of the--proportionate share of the market.

It's important to note that as a rule our agents didn't lose their relationships with their customers when the businesses moved from our insurance subsidiaries pre-Atlas. They just placed that business elsewhere. As we've strengthened our value proposition over the past two and a half years and reestablished credibility with agents and policy holders, much of our premium growth has been winning that business back.

But it's a process. Through the first six months of 2013, we wrote 38.9 million in premium and feel that there's considerable room to recapture incremental business through continued strengthening of our relationships with these agents and our policy holders. Atlas's independent agents know their customers, understand their value proposition, know how to sell it, and are as committed to our specialty niche as we are.

The positive effect of progress in the area of business development can be seen in our increasing volume of opportunities to grow business and approximate 85 percent renewal retention ratio as graphed on slide seven, as well as our target level hit ratio and growing volume applications from both new and existing agents as graphed on slide eight.

Including the addition of Gateway, we greatly expanded our geographic footprint, illustrated on slide nine. As we enter into what increasingly appears to be an improving market environment, our focus is now to achieve proportionate market share in each of the states in which we write. The states shown in blue are those who are actively distributing our core lines of business.

When we established our expansion plan, we identified states in which we felt Atlas could generate between $1 and $5 million in premium in the first 12 to 24 months. All active states must be areas where our value proposition, which includes effective claims handling and specialized customer service, has comparative value relative to local competitors.

Further, they must be markets that we deem favorable in terms of achieving underwriting profitability. That is, we need to be able to properly gauge in value potential loss cost and achieve target hit ratios at adequate price levels. We also actively avoid where there's a high propensity for fraud, and within active states, take relative exposures from territory to territory into consideration.

We review each state in which we're writing business regularly to evaluate rate sufficiency and to validate that our assumptions are holding up. On slide 10, you'll see that geographically we continue to diversify our book of business. As well mentioned last call, while these percentages can vary from quarter to quarter, the general trend is that we're becoming far more diversified than in previous years.

Illustrating this fact, only 46.7 percent of our gross written premium in the second quarter of this year came from the five states currently producing the most premium volume as compared to 63.8 percent in the same quarter last year. Compared to the three-month period ended June 30th, 2012, we experienced growth in gross written premium in 33 states in the three0month period ended June 30th, 2013.

We experienced more than 100 percent quarter-over-quarter growth in 24 of those 33 states. This includes the impact from the Gateway acquisition as well as organic expansion. Regarding Gateway, we're continuing operations in St. Louis and have successfully integrated reporting structure and work flows into the Atlas platform.

We were pleased with this progress in a relatively short period of time. Policy retention is on target, which we believe is a testament to the experienced and dedicated professionals working for our organization and the relationships that Gateway has with its agents.

Let me take a moment to address what we're seeing in the market in terms of rate. We've been quite open that our attention in 2011 and 2012 was focused on expanding geographically in preparation for a hardening insurance market.

We recognize that commercial auto in general is a competitive sector and are laser-focused on achieving incremental underwriting profit throughout our book with a focus on small- to mid-sized customers in our niche markets. In determining opportunities for incremental rate, we analyze risk and loss cost trends as regular discussions with agents, evaluate retention rates, and listen to our customers.

Rates have been going up in increasing marginal levels for the past two years. Over the past quarter, we continue to see room for increased rates in our specialty commercial auto sectors. We currently anticipate ongoing moderate pricing activity for the balance of the year, continuing the trends seen on slide 11 of the deck. It's important to recognize that rate increases are now compounding, as we saw increases in each quarter of 2012 as well.

In the past 12 months, a number of lower-priced competitors, primarily those who are distributing products through managing general agents have exited. This should have a positive impact both on pricing as well as our growth rate. With that, I'll turn the call over to Paul for a review of our financial results.

Mr. Paul Romano: Thanks, Scott.

I'll briefly go through the quarterly highlights. I'll welcome each of you to review our press release and filings should you have any further questions. As shown on slide 13 of the presentation, Atlas's gross premium written increased 79.2 percent to $16.6 million in the second quarter of 2013, a 90.6 percent increase from our core commercial auto lines.

Please note that approximately $1 million of surety business is included in this figure and is 100 percent reinsured as it continues to transition off our books. Our net premium written of $15 million consists entirely of commercial auto writing. For a bit more color, of the $7.2 million improvement in total net premiums written, $2.6 million was due to Gateway writings in Q2 of 2013, while the remainder was largely due to geographic expansion and the recapture of business that Scott noted earlier.

Net premium earned was $17 million in the three month period ended June 30th, 2013, a 124.7 percent increase compared to $7.6 million from Q2 of 2012. Net premium earned related to core commercial lines increased 171 percent in the three month period ended June 30th, 2013, relative to Q2 of 2012. As we wound down our personalized business at the end of 2011, virtually 100 percent of all premium earned in 2013 and going forward will relate to our core commercial lines.

Let me take a moment now to summarize our operating ratios for the quarter. The second quarter 2013, Atlas's loss ratio was 64.6 percent, compared to 71.6 percent in the prior year period. This reduction is almost entirely due to the shift in business to higher retention, better underwritten core auto lines. It's important to note that the acquisition of Gateway has not had any material impact on the loss ratio during the quarter.

As we have discussed in previous calls, our business focus is not on what is largely considered a high severity sector of commercial auto. However our insured's can crash a lot, and our ability to handle this higher frequency of claims is one of the primary drivers of our value proposition. We believe that our extensive experience and expertise specific to underwriting and claims management in our commercial lines will allow continued loss ratio improvement during the remainder of 2013.

Acquisitions cost were $2.2 million in the second quarter 2013, or 13.1 percent of net premium earned, as compared to 18.5 percent in the prior year period. This reduction is attributable to the reduction of the non-core personalized business that had carried higher commission rates and seating commissions on the discontinued, 100 percent reinsured Gateway work comp program that has an offsetting impact to other underwriting expenses that I will explain in a moment.

The ratio for other underwriting expenses, or OUE, was 17.3 percent in the three-month period ended June 30th, 2013, compared to 21.4 percent in the three-month period ended June 30th, 2012. Approximately 1 percent of our OUE ratio in the quarter was offset by seating commission related to the discontinued worker's compensation program at Gateway.

Backing this out, along with backing out other integration and short-term costs related to Gateway, our normalized ratio would have been 15.5 percent for the second quarter of 2013. As previously communicated, we anticipate the OUE ratio to continue trending towards our target of 10 to 12 percent of net premium earned.

We continue to see progress being made each quarter as we are beginning to reach our minimum efficient scale of an annualized $50 to $60 million in net premium earned. As a result of these--as a result of improvements across each line of our financials, and including additional integration and short-term costs associated with the acquisition of Gateway, the company's combined ratio for the second quarter 2013 was 95 percent, compared to 111.5 percent in the prior year quarter, and 98.1 percent for the first quarter of 2013.

In slide 14, we display a historic view of our combined ratio, which provided perspective on the progress we've made in past two years. Net income for the quarter ended June 30th, 2013, was $1.7 million, compared to net income of $130,000 in the prior year period. This equated to 16 cents of earnings per diluted common share, net of the accounting treatment for the company's preferred shares.

Now let me move to the balance sheet and investments. On slide 15 of our presentation, Atlas's cash and invested assets at June 30, 2013, were $145 million, as compared to 120.8 million at December 31, 2012. Investment income in the quarter was $942,000, which represents an annualized yield of 2.6 percent.

Duration of our investment portfolio matches the expected liquidity requirements for our client payments needs. Our current duration is 3.8 years, and fixed maturities represent over 99 percent of our investment holdings. Based on Atlas's invested assets at June 30th, 2013, a 1 percent increase or decrease in interest rates would result in approximately $104,000 of increase or decrease, respectively, to investment income.

At June--at the quarter ended June 30th, 2013, Atlas had 3.9 million of unrealized losses as a result of the impact of rising interest rates and the market value of the securities we own. As I mentioned, the duration of our portfolio is well-matched to our liquidity needs. And we expect to hold our investment securities until the maturity. Therefore, we do not expect to realize this near-term change in market value of these securities.

Our view is very simple. As an investor, you're evaluating our company on our ability to achieve underwriting success. Our investment philosophy is centered around preserving statutory capital to support our continued above average growth rate. As illustrated on slide 16, our portfolio has an average S&P rating of AA and is predominately comprised of corporate and government bonds.

Book value for common share at June 30, 2013, was $6.07, compared to $6.20 at March 31st, 2013, and $6.55 at December 31st, 2012. Through the first six months of 2013, book value has changed relative to December 31st, 2012, as follows.

A reduction of 37 cents related to the dilution from our US IPO, a reduction of 4 cents from legal and professional fees related to our acquisition of Gateway, and increase of 27 cents from net income attributable to common shareholders, and a decrease of 34 cents related to the change in unrealized gains and losses.

Before I turn the presentation back over to Scott, let me explain the triggering event under 382 that was originally announced via press release on July 22nd, 2013. As a result of shareholder activity, there was an ownership change for tax purposes, which is basically defined as a cumulative ownership change of more than 50 percent during any three-year period of the company's shareholders.

Let me quantify this and explain its impact on the company. As of June 30th, 2013, Atlas had 8,166,891 common shares outstanding and had a total tax effective federal net operating loss carried forward of approximately $16.1 million, or $1.97 per common share. Also at June 30th, 2013, the company had an overall evaluation allowance against these tax assets of $1.47 per common share.

Following this triggering event, the company estimates that at June 30, 2013, it would have retained total tax effective federal net operating loss carried forward of approximately $14.6 million, or $1.79 per common share based on the outstanding shares at June 30, 2013. Book value per common share is expected to be unaffected by this event, as the amount of lost tax assets are anticipated to be well within the valuation allowance, which is already held against the majority of these assets.

In basic terms, approximately the first $2.4 million in net income for the next 18 years will be tax free, effectively lowering our tax rate for the foreseeable future. The adjustments associated with this triggering event will be recorded in Q3 2013 financial statements, since the triggering event occurred after the financial statement date of June 30th. With that, let me turn this call--the call back over to Scott for his concluding remarks.

Mr. Scott Wollney: Thanks again, Paul.

We continue to see favorable trends in our target niche markets within the commercial auto sector. Atlas is continuing to win back business from existing agents and build new relationships as our taxi, limo, and paratransit customers are increasingly recognizing the attractiveness of a focused carrier with a product offering solely dedicated to their business.

We believe the niche market in which we operate is approximately $1.5 billion of premium. And we feel Atlas is well-positioned to achieve our goal of proportionate market share of approximately 20 percent of this specialty segment over time.

We also intend to continue pursuing strategic M&A on an opportunistic basis, both to accelerate our growth in key areas within our current niche markets and to potentially expand our focus into other specialty commercial auto markets at appropriate times in the future. Everyone at Atlas remains focused on driving growth through diligent and effective underwriting, disciplined claim handling, and highly specialized customer service.

While our growth rate has been and is expected to continue to be above average for some time, underwriting profit is our paramount objective. We believe that as a specialty provider, the structure Atlas has in place can deliver better than industry bottom-line results in both hard and soft markets. Both employee and agent performance are based on ROE.

We think this approach is critical to maintaining a culture than emphasizes the importance of underwriting profit. Last but not least, I want to thank our extraordinary employees, agents, and customers for an excellent quarter. While we expect to continue to build on the success seen in the second quarter, it's important to acknowledge the meaningful progress delivered to date. With that, let's open it up for questions.

Operator: Thank you.

If you would like ask a question, please press star-one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star-two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

One moment please while we poll for questions. Our first question comes from the line of John Barnidge with Sandler O'Neill. Please proceed with your question.

Mr. John Barnidge: Good morning, guys.

Your expense ratio has come down in recent quarters. And you mentioned and OUE target of 10 to 12 percent. What do you, uh, consider your target acquisition cost ratio?

Mr. Scott Wollney: Uh, that should remain in the range of 14 to 16 percent with an average around 15. Um, we pay our front commission of about 10 to 12 percent to retail agents. Um, premium packs can range anywhere from less than 1 percent to upwards of 2 percent. Um, and some of our larger agents also have profit sharing, which could result in another 2 to 2.5 percent.

Um, so, those are the components. Um, the key from quarter to quarter really is the business mix. So, depending on the states in which we write, um, the variations in, uh, state premium tax can cause that 14 to 16 percent range. But for the purpose of modeling, I'd suggest using, uh, a 15 or 16 percent number. And it won't really change with scale.

Mr. John Barnidge: All right.

Um, on the OUE target, I mean, you've mentioned, like, 50 million, um, total premiums to get there. How soon do you think you can get that 10 to 12 percent target?

Mr. Scott Wollney: Uh, we expect to be there by the end of the year on a quarterly basis. You know, and as you've seen every quarter, we've incrementally moved towards that. First quarter of this year, uh, there were some non-recurring integration cost related to Gateway that caused the percentage to be a little bit higher than it would have otherwise been.

Um, and, you know, as you see from our written premium, we're already writing premium at a level that would reach that scale. Um, it's a matter of time as those premiums earn in over the 12-month policy period.

Mr. John Barnidge: Okay. Great. Thank you.

Mr. Scott Wollney: Thanks, John.

Mr. Paul Romano: Thanks, John.

Operator: Thank you.

Our next question comes from the line of Adam Patinkin with David Capital. Please proceed with your question.

Mr. Adam Patinkin: Hey guys. Good morning.

Mr. Scott Wollney: Morning, Adam.

Mr. Paul Romano: Good morning, Adam.

Mr. Adam Patinkin: Hey.

Well, first off, congrats on a pretty strong set of results, both the headline numbers and the underlying peripherals. And as I kinda look at the figures, one thing I noticed was that the company earned 13 cents in Q1. But then consensus analyst estimate for this quarter was only 11 cents, versus, like, the 16 cents that you came in at.

And I think that one of the reason why folks might have had earnings lower in Q2 rather than Q1, I think a big factor of that is that historically there's been some seasonality in business. Can you speak to whether there will continue to be large seasonality going forward?

Or do you think that because the company is kinda more geographically diversified than it's been in the past, maybe not as reliant on places like New York and Chicago? Will there be less seasonality, or maybe no seasonality relative to the past?

Mr. Scott Wollney: Sure.

That's a great question. We do expect some amount of seasonality, but it won't be as significant as it has been in the past. You know, as I mentioned on the call, um, the percentage of business coming from our largest states is decreasing. At this point it's almost half, um, the concentration that it was even a year ago.

Um, and so, as we continue to diversify geographically, that seasonality will become less of a factor. Um, however, there will be some, um, common taxi renewal dates in January for Chicago, for example, um, and, um, some March common effective dates in New York, which are two of the biggest markets in the country. Um, we'll always have some impact.

One thing I could refer you to is slide 7 of the deck that accompanied this call. Um, in the upper left is a graph that shows new business submissions, um, actual and last year. That'll give you the dotted line for last year. It'll give you some idea of how the seasonality impacted new business applications.

Um, and when looking at that, I think it's safe to assume that the applications come in approximately 60 days before we typically write the business. Um, and so, that will give you some idea of what the trends have been. Uh, you know, again, you sort of see a lift in the first quarter, um, in terms of what's actually happened this year. Um, and then, you know, we also anticipate a lift coming towards the end of the year, um, which is really the business that's coming in for the January 1st renewal period.

Mr. Adam Patinkin: Got it. Got it. Great.

And then as I kinda look at the company going forward, and assuming, you know, maybe a little less seasonality than in the past--not none, but a little bit less than in the past, and I'm not looking for specifics, but just kinda directionally.

Assuming that Atlas is able to continue penetrating its markets and gaining scale to leverage its cost base, um, in these kind of steadily hardening markets, do you think it's fair to say that there will continue to be sequential profit growth going forward quarter over quarter.

Mr. Scott Wollney: Yes.

And particularly as we reach the minimum efficient scale in terms of earned premium, which we're really, you know, approaching that tipping point, as I mentioned when I responded to John's question. Um, we expect that our expense--our expenses in terms of dollars will grow at a marginally slower rate than the growth in earned premium.

Mr. Adam Patinkin: Um-hmm.

Mr. Scott Wollney: And so, we should see expanding margins as we go forward, all else being equal. We also believe that the current pricing we're putting in the market should result in improving loss and LAE ratios as well. And that could further accelerate the growth in income.

Mr. Adam Patinkin: Got it. Got it.

And then you've spoken publically in the past about being in this kind of high growth phase for the company, on both the top and the bottom line. Um, and as we kinda try to gauge how much white space there is in front of you, do you think that you're kind of in the eighth inning of the growth phase, where maybe it lasts another quarter or so before leveling off to a more steady growth phase?

Or maybe the fifth inning, where you've got a few quarters to go? Or do you think it's maybe more like the second inning, where you've got a year and a half or a couple years of kind of this high growth and margin expansion before you kinda hit that kinda steady state long-term growth levels for the business?

Mr. Scott Wollney: Sure.

I would say--the first I guess I'd refer you to is, again, on slide seven in the upper right. We've got the slope showing the new cars, essentially reflected on the applications we're receiving. And you can see that there's been a pretty straight line in terms of slope. So, at this point, you know, we aren't seeing the opportunities to write business slowing in a material way.

Um, you know, you do see some seasonality coming in, you know, where it can flatten a little bit and then accelerate again. Um, and what's really behind that is a couple of things. You know, a big part of the growth that we've seen in the last year, and the growth we expect in the next year is recaptured business.

Um, and so, while we are now seeing a significant amount of business coming back to us from agents that had been agents of one or more of our subsidiaries for a number of years, um, it really wasn't until early 2012 that we asked them to begin rolling books of business. You know, essentially we felt that 2011 was a period where we earned the right to ask for that business back.

Um, we also saw the market beginning to harden in 2012, some competitors exiting. And so, you know, we think it's the combination of our earning the business coupled with the fact that there were fewer options in the market, which makes it easier for agents to, um, encourage policy holders to move business back to us, particularly when our pricing may be higher. Um, and so, in terms of that recapture business, I would say we're probably halfway through.

Um, and we expect that recapture business to continue coming back to us in a significant way for the rest of this year and through 2014. We also then expect to continue to see above average growth coming from the organic, um, growth in states that we hadn't been writing in in the past. And I'd expect that above average growth to continue through 2015.

So, if you thought about it as a curve, um, sort of as opposed to innings, or as a way to think about it that way, I would say that we are probably about halfway through the curve. And where the curve will continue out through the end of 2015, before we get to a closer proportionate share, which is when I'd expect our growth rate to slow to a more typical level, would be sort of after we get through 2015. So, hopefully that helps to give you the context you're looking for.

Mr. Adam Patinkin: Got it.

So, like, a very strong growth through 2014 or kind of consistently strong. And then, you know, above average strong in 2015, and then kinda consistent growth after that?

Mr. Scott Wollney: Right.

Mr. Adam Patinkin: Something in that ballpark.

Mr. Scott Wollney: It--correct.

And that assumes that the market continues to be sort of moderately firm the way that it is now. If we saw a dramatic change where the market began to really harden in earnest that could accelerate. Um, and if it began to soften, then obviously it could moderate.

Mr. Adam Patinkin: Got it.

And then, I just have two quick questions on the balance sheet and on the share count figures. So, on the balance sheet, um, you know, the company kinda has this hidden asset on the balance sheet, which is this valuation allowance against net operating loss carry forwards.

And if I look at the valuation allowance against, you know, 9.4 million shares, uh, you know, fully diluted once you get rid of the pref, um, and the, uh, the warrants are all exercised, um, you know, that's something, you know, including the, you know, kind of the modest write down of it from, um, exercising 382. So, that adds another, like, dollar of extra book value to the, um, kinda headline book value.

So, now that you've strung together a few quarters of profitability with a reasonable expectation for continued profit growth, if you will, can you speak to whether you may reassess whether this allowance is still merited, and maybe a timeline for that--when that might reviewed?

Mr. Paul Romano: Yes.

Certainly, um, we reassess our tax assets on a quarterly basis. Um, we evaluate our profitability not only from the current quarter, but from prior quarters. So, considering we're, you know, maybe four quarters into a profitability state, um, it may--you know, we made the determination at Q2 2013 that it may be too early to actually begin to look to, um, reducing those valuation allowances at this point.

However, as we continue the growth that we have that Scott noted and continue profitability trends that we believe will occur in 20--in the Q3 and A4, uh, we may end up going, uh, to take another look at those valuation allowances and make a determination whether or not we can reverse some of those during 2013.

Mr. Scott Wollney: And then that's an issue too, where we seek guidance from our outside tax advisors and also our auditors. Um, so, I think it's premature to be able to predict when we might reduce those allowances.

Um, but it is something that Paul and I should look at each quarter, um, and do wanna be fairly conservative in terms of, you know, when we make the decision about actually writing those up. Um, obviously, the real value is--are the economics behind them, you know, we are--we will actually have, you know, the $204 million of tax-free income each year for, you know, the next 20 years.

Mr. Paul Romano: And keep in mind too that we've taken the position to offset our tax expense on the current quarter basis with, uh, a comparable reduction of that valuation allowance. So, we are eating into that valuation allowance on a quarterly basis. Um, you know, and we are aware that it's still out there. And we need to, you know, continue to reevaluate that as we move forward.

Mr. Adam Patinkin: Got it. Got it.

That makes sense. And then kind of a final question. So, um, as I'm sitting here this morning, I've noticed that several self-side [sp] shops have come out with, um, you know, you guys. I guess they've been, uh, using a 12 cents earning per share number for you guys this quarter.

And I think the way that they're getting there is that they've been including the pref in the share count and then backing in the warrants as well, um, whereas I'm kinda using a 9.4 million share count, fully diluted. Just, you know, all the shares, uh, plus all the warrants being exercised by year end, which I assume will happen.

Maybe can you--and so, using my numbers, I guess I get to 16 cents rather than the 12 cents. So, I'm wondering maybe can you comment on how you look at the share count and what you expect to happen with those preferred shares that are in there right now and where those might go away over time?

Mr. Paul Romano: Yes.

So, you know, as we discussed, um, during our, uh, presentation, um, we did redeem, um, 18 million of the preferred shares from, uh, our prior [unintelligible], um, which equated to about $2.3

million of shares, had they been converted. So, those shares will not enter into our dilution calculations on a go-forward basis. However, they did enter into our dilution calculations during Q3.

Mr. Adam Patinkin: Got it.

So, you expect those to be removed on a go-forward basis?

Mr. Paul Romano: Correct.

Mr. Adam Patinkin: Okay.

So, the appropriate share count then to use on a fully diluted basis, assuming all the warrants are exercised, and all the options are exercised, is something in the ballpark of 9.4 million. Is that about right?

Mr. Paul Romano: Correct.

It's also worth noting that in Q1 of this year and for every prior quarter, the potential impact of the preferred shares were not considered in the net income calculation, um, because of the way GAAP wants you--or requires you to treat those. Um, so, because our basic earnings per share on a quarterly basis were less than the preferred dividend, um, those amounts actually were not factored in.

And so, if you want to look at an apples to apples comparison to see where Q2 income was, for example, relative to Q1, um, you know, you could basically use that 9.4 million in both instances. And that would give you a better view as to what the gross and net income actually has been. Um, so, that's--I think that's, uh, an important note since that's, uh, a sort of unique situation that we've just transitioned through.

Mr. Adam Patinkin: Got it. Got it.

So, I think then--just as I'm looking at this quarter, then I'm kinda using 16 cents, uh, you know, not pro forma. And then pro forma and exact the benefits of not having to pay the dividends on the prefs, um, you know, it adds another two or three cents to that page, you know, 19 cents. And then, uh, you know, kinda looking forward then, it's all about the base business and how it grows.

Mr. Paul Romano: Correct.

Mr. Adam Patinkin: Okay. Great. Thank you, guys, very much. I appreciate it.

Mr. Paul Romano: Thank you, Adam.

Mr. Scott Wollney: Thank you, Adam.

Operator: Thank you. Our next question comes from the line of Matthew Berry with Lane Five Capital. Please proceed with your question.

Mr. Matthew Berry: Hello, gentlemen.

Mr. Scott Wollney: Hi, Matthew.

Mr. Paul Romano: Hi, Matthew.

Mr. Matthew Berry: Um, okay.

So, I don't want to harp on this one too much. But I just want to, uh, to go back and, uh, look at the size of some of the opportunities that you're seeing again. Um, we spoke that, uh, going through the end of 2014, um--well, you're about halfway through winning back the prior share with your existing agents, um, and that you expect that to continue through 2014.

So, if I understand correctly, um, when you have, uh, completed that, that would get you back to this sort of 90 to 100 million of premium that you had before. Is that correct?

Mr. Scott Wollney: Um, related to the recapture of the business--.

Mr. Matthew Berry: --Yeah--.

Mr. Scott Wollney: --Um, so, we don't expect to get all of it back. But we do expect to get about 80 percent back. Um, so, that would be approximately 80 to 85 million, uh, possibly a little bit more.

Mr. Matthew Berry: Okay.

Mr. Scott Wollney: And that's in about a dozen states, which is where American Country & American Service were very active in the past. Um, but then add to that the incremental business that we'll be getting in the additional states that get us to the total 40 plus D.C. that we're writing in now.

Um, you know, keeping in mind that one of the three components we looked at when we expanded into those states was the expectation that we write between $1 and $5 million, um, in every state in which we're active.

Um, and so, all in, what we expect to be moving towards is that 20 percent proportional market share of the $1.5 billion total space, which should get us into a total premium range of about 200 to 300 million. Um, and so--.

Mr. Matthew Berry: --And that's based on the existing network of agents that you had already. So, just working through your existing agent relationships?

Mr. Scott Wollney: It's the combination of both. So, if you look at the deck, um, on slide eight, the bottom chart actually shows the volume of business we're getting from existing agents. And those were essentially agents of American Country & American Service prior to Atlas's acquisition of the company. Um, and then the green line shows activity that's incremental from new agents.

Those are essentially agents that have been signed up subsequent to our acquisition of the companies. Um, and then we are now adding to that the 60 or so agents that we were able to add having acquired Gateway earlier this year. So, right now about 70 percent of our applications are coming from existing agents. And 30 percent are coming from new agents.

But what we're beginning to see is a marginally higher amount of additional applications beginning to come from new agents as those agents are becoming more and more comfortable selling our product and as those agents who in the past were working with competitors of ours, in some case are finding that those competitors, whether they were generalists or companies working through managing general agents, are now exiting.

Um, so, what we're seeing is incremental volume from existing agents--that's the business we expect to grow to that $80 to $85 million portion--and then an increasing volume of new applications coming from new agents as well.

Mr. Matthew Berry: Okay.

So, you've managed to answer all my subsequent questions. So, in the description, um, one of the other things I wanted to ask about was that with, uh, Gateway, you brought in some trucking, uh, premium. Is that right?

Mr. Scott Wollney: They had a trucking program, um, that in 2011, uh, generated about $10 million in premium. Um, Gateway prior to selling to us had put that program into runoff, um, in April or May of 2012. Um, and so, when we acquired the company on January 1st of 2013, there was still some unearned truck premium, about $1 million worth.

Um, but the program was in runoff. We're continuing to run that off. Um, and so, you'll see some truck premiums showing up, um, through the end of this year. But after this year the earned premium from that program should be fully run off the books. And then we'll continue to handle the claims, obviously, until, you know, they're fully adjudicated.

Mr. Paul Romano: And just so you know, Matthew, we only had $44,000 worth of truck premium, net earned premium, in the quarter.

Mr. Matthew Berry: Okay.

It's--it--.

Mr. Paul Romano: --Yeah.

It's very insignificant.

Mr. Matthew Berry: Okay.

Um, and then I just wanted to, um--as you know, I have some other questions. So, I'll take those, uh, offline after I've gone through the queue. So, thank you.

Mr. Scott Wollney: Okay. Great. Thanks, Matthew.

Mr. Paul Romano: Thanks, Matthew.

Operator: Thank you.

Our next question comes from the line of Brian Hollanden [sp] with Sidoti. Please proceed with your question.

Mr. Brian Hollanden: Morning.

Mr. Scott Wollney: Hi, Brian.

Mr. Brian Hollanden: Thanks for taking my call.

Mr. Paul Romano: Hi, Brian.

Mr. Brian Hollanden: Hi.

I think a lot of my questions were answered also. But I just wanted to ask are you still writing to a, uh, you know, a sub, uh, 60 percent loss ratio now? And what, you know, and what would that number be? Is--could it be at 55 percent?

Mr. Scott Wollney: So, our profit target and our underwriting models right now is 60 percent for loss and LAE. Um, there are certain areas where as a result of more limited competition, um, we are able to price to a slightly higher target, um, 57.5 percent approximately.

Um, and so, you know, that's the pricing that we're putting into the market today. Um, as the proportion amount of earned premium on our books related to business written at those target levels, you would expect to see the loss and LAE ratio that we're actually booking trending towards that target. But we're taking a perspective that we want to see how losses actually develop before we fully give ourselves credit for the pricing that we're putting into the market.

In other words, if we're pricing to a 60, we aren't immediately gonna book to a 60, with the idea that we want to make sure that the actual claims activity reinforces what we expect based on the pricing targets we have in place. Um, and, you know, we're seeing that as those pricing targets, those profitability targets, um, our hit ratios are holding up.

Um, if we begin to see the hit ratios going up higher as a result of either the limited--or more limited competition I mentioned, or just general market hardening, um, we will obviously revisit those, you know, opportunistically and look for areas where there may be a ability to price, you know, to a slightly higher target, or slighting more profitable target.

Mr. Brian Hollanden: Excellent. Thank you very much.

Mr. Scott Wollney: Great.

Thanks for the question, Brian.

Mr. Paul Romano: Thanks, Brian.

Operator: Thank you.

Our next question comes from the line of Fang Li with Baleen Capital. Please proceed with your question.

Mr. Fang Li: Hey, Scott, Paul. How are you guys?

Mr. Scott Wollney: Good, Fang. How are you?

Mr. Paul Romano: Excellent, Fang.

Mr. Fang Li: I'm great. Awesome, awesome, job.

Mr. Scott Wollney: Thank you.

Mr. Fang Li: Um, I had a question actually on the very, very small, uh, follow-up to Adam's point about, um, kind of what the recurring [unintelligible] power of the business [unintelligible] as of Q2. Um, Paul, you mentioned that your other underwriting expense, um, had some one-time items in it. So, being the--some one-time Gateway integrations costs and the worker's comp surety, I guess, are the stuff that gets, um, gets reinsured away.

Mr. Paul Romano: Right.

Mr. Fang Li: Um, so, I'm just doing the math. That's kind of--it sounds like, kind of like $300,000 to protect [unintelligible] change?

Mr. Paul Romano: I'm sorry?

Mr. Fang Li: Uh, just the dollar amount of that kind of one-time adjustment, is that--is my math right? That's kind of like $300,000?

Mr. Paul Romano: Correct.

Mr. Fang Li: And so, that's a one-time kind of cost that won't occur in Q3 or going forward?

Mr. Paul Romano: Well, there's a portion of it. Um, so, there's two elements of that, uh, differential. One is the integration costs and kind of the short-terms costs for the Gateway transaction. Um, so, for example, um, you know, we've integrated all the accounting services here in our corporate office in Elk Grove.

Um, and there's no longer any accounting at Gateway facility in St. Louis. Um, so, those costs go away in terms of salaries and benefits and those other sorts of costs you'll see with employees. Um, and there's some other smaller integration costs that actually do go away starting in Q3. So, that's one portion of it. It's, like, half of it.

Uh, the other half relates to the discontinued work comp program. And we'll--we're gonna continue to see some, um--a little bit higher OUE expenses, but they are gonna be offset with the seating commission that we're receiving on that work comp business.

So, we'll see--you know, into Q3 and into Q4, we'll see lower acquisition costs, but a little bit higher OUE. But when you look at a combination basis of total underwriting expenses, they should flatten out. There's a offset going against--.

Mr. Fang Li: --All right. I gotcha.

Mr. Paul Romano: --Acquisition costs and OUE.

Mr. Fang Li: Gotcha.

So, really the one-time stuff is kind of half of the $300,000, which is, like, $150,000--.

Mr. Paul Romano: --Right--.

Mr. Fang Li: --Uh, which comes out to two cents a share. So, like, on a runway basis, just, you know, at least you're at 16 cents before adding back preferred dividends, say 18 to 19 after adding back preferred dividends. Um, if you then add back the one-time expenses, it'll be, like, uh, 20 to 21 cents per share, uh, that you are, you know, on a runway basis, [unintelligible] of the base, um, for this quarter?

Mr. Paul Romano: Correct.

Mr. Fang Li: Awesome. That's actually clarification.

Mr. Paul Romano: All right. Thanks for the question, Fang.

Mr. Scott Wollney: Thank you.

Operator: Thank you.

Ladies and gentlemen, as a reminder, it is star-one to ask a question at this time. We'll pause here for a moment to allow for any other questions to come in. Mr. Wollney, there are no further questions at this time. I'd like to turn the floor back over to you for closing comments.

Mr. Scott Wollney: Great. Thanks, Melissa.

And thank you to everyone for joining us. We are available to answer any additional questions you might have and look forward to speaking with you again during Atlas's Third Quarter Financial Results Conference Call.

Operator: Thank you.

This concludes today's teleconference. You may disconnect your lines and have a wonderful day.