Atlas Financial Q2 2015 Results Earnings Call Transcript

Executives

Scott Wollney - President and Chief Executive Officer

Paul Romano - Vice President and Chief Financial Officer

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Analysts

John Barnidge - Sandler O'Neill

Dan Farrell - Piper Jaffray

Ryan Byrnes - Janney Montgomery Scott

Jeremy Hellman - Singular Research

Brian Hollenden - Sidoti & Company

Operator

Greetings and welcome to the Atlas Financial Holdings second quarter conference call. [Operator Instructions] It is now my pleasure to introduce your host Mr. Scott Wollney, President and CEO. Thank you. Sir, you may begin.

Scott Wollney - President and Chief Executive Officer

Thank you very much Donna, and good morning, everyone. With me today is Paul Romano, our Vice President and CFO.

Our second quarter 2015 results were highlighted by continued premium growth in many of our markets, increased overall market share, a smooth transition of our acquisition of Global Liberty and bottomline improvements in every metric.

During today's call, we'll discuss these operating results, provide an update on our management of operating leverage, in light of expected continuing growth and lastly expand upon our goals for the coming quarters ahead, including perspective on market conditions and how we intend to deliver optimal return on equity.

I'll now turn it over to Paul to provide details about our quarterly materials and review our policy regarding forward-looking statements.

Paul Romano - Vice President and Chief Financial Officer
Thank you, Scott, and good morning, everyone. Yesterday after market close, Atlas issued its 2015 second quarter financial results. Copies of this press release are available at the Investor Relations section at the company's website at www.atlas-fin.com.

We will be utilizing a slide show presentation in conjunction with this call. This presentation is available on our website'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 the 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 on 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 10-K for the year ended December 31, 2014.

No forward-looking statement can be guaranteed. Except as required by applicable securities laws, forward-looking statements speak only as of the date on which they are made and the company and its subsidiaries undertake no obligation to publicly 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 U.S. GAAP. In the event of any unintentional difference between the presentation materials and our GAAP results, investors should rely on the financial information in our public filings. All amounts discussed on this call are in U.S. dollars, unless otherwise indicated. For those of you following along with our presentation, we'll begin on Slide 4.

With that, I'd now like to turn the call back over to Scott.

Scott Wollney - President and Chief Executive Officer
Thanks, Paul. In the second quarter, Atlas delivered continued improvement in underwriting performance, both in terms of operating efficiency and loss ratio. We also grew premium and continue to increase market share, while managing operating leverage to support expected future growth. Key metric and milestones are highlighted on Slide 4.

Last quarter we provided a great deal of information about atypical items that affected Q1 of 2015. As expected, Q2 2015 is much more straightforward and provides a clear idea of the earnings potential of our business.

In the second quarter, we delivered tangible growth within each of Atlas' operating subsidiaries, while improving margins, reflecting the combined power of improved pricing within our niche, operating efficiency and strong loss ratio performance. We feel that the company is well-positioned in our current marketplace.

Not including the incremental business from Global Liberty, organic growth in the quarter was 47.9% towards the top of the 30% to 50% guidance range previously provided. And the addition of Global Liberty strengthened our position in New York. The integration of the two companies has progressed to our expectations and we're excited by the prospect of incremental market penetration.

Based on in-force premium, Atlas' overall market share is now approximately 9%. Provided market conditions remain favorable, we continue to feel this can grow to 20% without our having disproportionate share.

Slide 5 details our growth in terms of revenue, margin and book value. Including Global Liberty, our gross premiums written for the period improved by 104.3% to $46.5 million, which included 107.9% improvement in our core target market, namely smaller commercial auto operators.

Notwithstanding the strong growth, as we have noted on several occasions, we are more focused on bottomline improvement and ultimately above-average return on equity. The combination of margin and operating leverage will drive ROE, and that is our priority.

Achieving optimal results overtime on a self-funded basis is of course a balance in terms of managing growth and operating leverage. Our operating income was $6.2 million or $0.49 per diluted common share for the three month period ended June 30, 2015, as compared to $2.6 million in the same quarter last year. This represents a 138% increase.

Despite the fact that our GAAP results reflect the full U.S. tax rate this year, net income for the quarter still rose 50% on a year-over-year basis to $3.9 million or $0.31 per diluted common share. Book value per diluted common share for Atlas at June 30, 2015, is $9.48, a 19.1% increase from $7.96 at June 30, 2014.

As I mentioned, we improved each of our financial ratios in the second quarter, reporting a combined ratio of 86.9%, a 167.4% improvement in our underwriting results. The positive trend in combined ratio, since our U.S. IPO, can be seen on Slide 6.

As discussed in the past, our expectation has been that loss ratio would trend towards our prior year's pricing targets overtime. Some of this can be seen in our second quarter results.

While this ratio can move up or down in any given quarter based on actual loss activity, it should generally continue to trend towards pricing targets following unexpected extraordinary losses. In addition, on a gross basis, before the effective quarter share reinsurance impact, our other underwriting expense ratio was 12.1%, on track with the 10% to 12% range we've been targeting.

Backing out the favorable development from Gateway, which was a non-recurring benefit in Q1, the combined ratio improved by 3.6 percentage points. We were pleased to again have the combined ratio moving in the right direction. Each of Atlas' operating subsidiaries are writing new and renewal business to below a 60% loss ratio, which we expect to continue, supporting underwriting margin improvement.

On the next slide, we provide a running tally of our in-force premium through June 30, 2015. As you can see, we achieved considerable year-over-year growth, which was accelerated with the addition of Global Liberty. Further, to the extent uses of this information our forecasting future earned premiums, it's important to understand the impact of purchase accounting on our results this year.

As discussed previously, pursuant to the stock purchase agreement, Atlas' ownership of Global Liberty was effective on January 1, 2015, although the transaction itself was closed on March 20, 2015. As a result, the $11 million of gross written premium that Global Liberty generated during the stub period between January 1 and March 20 was not reflective in Atlas' reported numbers.

However, as this premium earns throughout the year, it will be included in our income statement. To help provide transparency in this regard, we've included premium in-force and unearned premium reserve information in our press release and 10-Q.

Expanding on my earlier comments about managing operating leverage, Slide 8 illustrates the key factors in this regard. At June 30, 2015, our operating leverage, as measured by net written premium to surplus, was approximately 1.5 to 1. As communicated previously, our upward balance for this ratio is 2 to 1.

With the objective of self-funding growth in mind, we have taken actions during the last several months to position Atlas for success over the upcoming quarters and years. We feel strongly that one of the key indicators for a successful insurance organization is the proper stewardship of capital.

This is an area that some companies maybe with secondary, as is evident in the relatively modest results posted industry-wide across market cycles. We view it as one of Atlas' top three core competencies and a mission-critical discipline necessary to deliver expected results.

In our business, we've been very open and we expect a period of considerable growth in the current market, and that we need to ensure that our operating leverage is properly maintained to support this growth. We also need to look ahead and plan for the future, understanding that insurance markets are cyclical.

We conducted a thorough analysis on how to best support this growth in a shareholder friendly, but fiscally responsible manner. We then took important steps in the last six months to ensure that we can continue to capitalize on the current favorable market conditions.

We signed a $35 million credit facility with Fifth Third Bank that will allow us to increase surplus by as much as $30 million at a very attractive cost of capital. The remaining $5 million is available to support other potential non-statutory financing needs.

Additionally and as previously discussed, we signed a two-year quota share reinsurance treaty with Swiss Re in Q3 2014 that provides us with additional flexibility to ensure that incremental capital can be raised at levels that we deem to be attractive, should we elect to do so in the future.

The company's quota share agreement provides a seeding commission to offset expenses, both acquisition cost and other underwriting expenses. However, from an accounting perspective, the seeding commission only reduces acquisition cost in our financial statement and does not offset the other underwriting expense on the P&L.

With this in mind and as mentioned on our last earnings call, our overall expense ratio, which is the combination of acquisition cost and other underwriting expenses, should be looked at collectively to measure operating efficiency. We will also continue to provide pro forma pre-quota share and other underwriting expense ratio for transparency purposes as well.

In our press release issued yesterday, we provided a thorough breakout of the factors that affected our operating ratios for the period, including the increase in quota share reinsurance to 15% and a $15.5 million draw on our line of credit, and subsequently the interest expense related there too. I will talk more about these items as well.

We continue to keep a total expense ratio target of between 24.5% to 26.5% before interest expense and share-based compensation, and expect to progress to this level. This incorporates an expected gross, other underwriting expense ratio in the 10% to 12% range and acquisition cost remaining consistent around 14.5% on an annual basis. So the sum of these two target ratios won't change, but the individual components may vary, depending on our use of quota share any given quarter.

Cash incentive compensation is included in this range target, but the accounting for equity incentive compensation is not. In the second quarter 2015, underwriting expense excluding equity-based compensation was 26.7%, slightly outside of our target range.

Moving to Slide 9, we outlined our geographic diversity. As expected, with the acquisition of Global Liberty, premiums in New York grew significantly as a percentage of the total. Overall, we've seen strong growth and increased market share. In addition to New York, we're seeing strong organic growth in Midwest and West

Coast market, with recent 100%-plus expansion in 12 states. At this point, market share still remains relatively low in numerous high potential areas as well. As I mentioned, we continue to believe that 20% market share is proportionate for Atlas as a leader in our niche.

Earlier in the quarter, we held an Investor Day that many of you attended. Some of the questions, we received had to do with whether the company has the agency relationships and distribution necessary to continue to effectively sell our value proposition in support of incremental growth in newer states.

It's a great question. We're achieving the majority of our organic growth from existing agency channels dispersed across the 40 states plus Washington D.C. in which we write business. This can be seen in the graph at the bottom of Slide 10. These are dedicated retail, commercial, auto agencies that cater to our niche market.

These agents are able to communicate the unique ways in which Atlas as a hyper-focused insurance provider can add quantifiable value to our insurers above and beyond the marginally higher premium we generally charge. We respect our agency network and seek their input regularly, both in terms of market condition, potential and for product development purposes.

In the past year, we were approached by a large number of agents and continue to be extremely diligent in terms of new appointments, with less than 10% of those agents approaching us receiving one. Atlas is committed to the retail agent distribution channel. To be successful in our niche, it is critical to be close to the consumer. As a result, we do not distribute through intermediaries like wholesalers nor managing general agents. The direct contract is the only way an agent can represent our companies. We have a total of more than 250 agents, 40 of whom have more than $1 million of in-force premium with Atlas and we look forward to continuing to grow together.

Before I move on to our new business initiatives, I want to remind everyone that our Excess Taxi program in New York renews in the third quarter. This is a business arrangement providing excess coverage above the levels of risk retained by the insured and only a small number of medallion owners qualified for this program. As a result, we do not expect the premium volume related to the program to vary significantly year-over-year.

Last year, gross written premium in the third quarter attributable to this program was approximately $12 million. Those of you familiar with the company know about this seasonal item and we wanted to make sure that we explained it to any that maybe new to the Atlas story.

As in the past, we've included information on our new business submissions, vehicles in-force, and our percentage of policies bound as well as renewal retention rates in Slides 10 through 12. Notable for this quarter is the considerable uptick in new business submissions, which does not include the incremental volume from Global Liberty. This trend is positive, ahead of last year. All of our other ratios are right in line with our targets.

We monitor a number of key metrics to ensure that we are fully benefiting from the positive rate environment in our niche. Renewal retention continues to remain high, which supports steadily increasing rates in our core markets.

With that, I will once again turn the call over to Paul for a brief review of our financial results.

Paul Romano - Vice President and Chief Financial Officer
Thank you, Scott. Our financial overview in the presentation begins on Slide 14. On Slide 14, we provide a number of financial highlights for the second quarter and welcome each of you to review our press release and filings, should you want more detailed information.

Gross written premium increased to a 104.3% to $46.6 million during the quarter, which included $12.9 million generated by Global Liberty. Specific to our core lines of business, gross premiums written increased by 107.7%. As Scott mentioned, effective July 1, 2014, we entered into a quota share reinsurance contract with an initial cession rate of 5% of subject written premium generated by American Service, American Country and Gateway.

Effective April 1, we increased the cession rate on this contract to 15%. Also, at the time we acquired Global Liberty, they were ceding 20% of their subject written premium under a separate quota share reinsurance program. We do not anticipate making any changes to the Global Liberty cession rate during 2015.

Managing our operating leverage by proactively utilizing quota share reinsurance is a key element of our self-funding strategy, which is to continue benefiting from organic growth within our core lines of business, while favorable market conditions exists. Including the impact of quota share reinsurance, net premium earned increased by 64.4% to $38.3 million for the quarter, which includes $7.6 million of net written premium from Global Liberty compared to $23.3 million in the prior-year period. Our net premiums earn ratably over the term of the policies, which are generally 12 months in length.

Underwriting profit increased by $3.2 million to $5 million, equating to an 86.9% combined ratio for the second quarter of 2015. As a result of growth in net premium earned, we are continuing to recognize benefits associated with our operating scale. As Scott discussed, the use of and accounting for, quota share reinsurance has an impact on acquisition cost ratio, as well as the other underwriting expense ratio, the combination of these two ratios represent underwriting expense ratio.

Our target underwriting expense ratio is in the range of 24.5% to 26.5%, without the impact of debt treatment and share-based compensation expenses. For the second quarter 2015 and adjusting for the impact of the debt treatment and the share-based compensation expenses, our underwriting expense ratio was 26.7% as compared to 28.7% in the prior-year period.

Net income before tax increased to $6.2 million, representing a 132% increase over the prior-year period. After-tax, Atlas generated $0.31 per common share diluted for the three month period ended June 30, 2015. This compares to $0.23 per common share diluted as reported in the three month period ended June 30, 2014. However, from an apples-to-apples perspective, if tax affected, earnings per common share diluted on a pro forma basis would have been $0.15 in the second quarter of 2014. Annualized second quarter 2015 return on average common equity was 13.7%.

On Slide 15, we provide more detail regarding operating income. This analysis should be helpful on understanding the business outside of a few atypical items we've noted in the past few quarters and in light of our tax treatment.

Operating income is an indicator of profit realized by our organization and is an internal non-GAAP performance measure used in the management of the company's operations. It represents operational results excluding, as applicable, net realized gains and losses, net impairment charges recognized in earnings, net tax adjustments and other items. In the second quarter, operating income was $0.49 per diluted common share compared to $0.23 for the prior-year period.

On Slide 16, we detailed the components of book value. We increased book value to $9.48 at June 30, 2015 from $9.08 at December 31, 2014 and $7.96 at June 30, 2014. Further, bottom of the slide, we step through the key elements that impacted book value year-to-date.

On Slides 17 and 18, we include information on our balance sheet and investment portfolio. Atlas' cash and invested assets at June 30, 2015, increased to $227.5 million compared to $180 million at December 31, 2014. The increase is primarily attributable to the addition of Global Liberty and the draw on our line of credit facility.

Unearned premium reserves, which represent premiums corresponding to the time periods remaining on the underlying in-force policies, have increased by 58.6% to $93.6 million. This increase is the result of continued organic growth and the addition of Global Liberty.

As noted earlier, during the first quarter, we established a credit facility with Fifth Third Bank, which allows us to draw up to $30 million at LIBOR, plus 450 basis points for the use in connection with our statutory entities. Plus another $5 million at LIBOR, plus 275 basis points for other general corporate purposes.

We have drawn $15.5 million from the $30 million credit facility and have used these funds into the ASI Pool companies, which include American Country, American Service and Gateway in the form of surplus notes. We also drew $2.5 million on the $5 million facility to support the needs of the Premium Finance Company we acquired in the Global Liberty transaction.

As an investment philosophy, we continue to place priority on preservation of capital to support future premium growth. Our investment duration remained consistent with expected liquidity needs and claim payout patterns at 3.6 years and the majority of our holdings are in fixed income securities rated AA or better by S&P.

The high quality of our investment portfolio is detailed on Slide 18, but we intend to hold securities to maturity. While any increase in interest rates could create an unrealized loss in the short-term, we would not expect such losses to be realized. Working with our outside investment advisor, we monitor the positions in our portfolio closely, especially in light of recent world events.

With that, let me turn the call back to Scott for his concluding remarks.

Scott Wollney - President and Chief Executive Officer
Thanks, Paul. On Slide 20, we provided sensitivity analysis around improved margins and operating leverage. As you can see, we continue to move in the right direction in terms of factors that will support our target of exceeding industry ROE by 500 to a 1,000 basis points at any given point in the insurance market cycle. We believe that continuing to drive margin improvement with a managed increase in operating leverage will deliver the result we expect.

Our in-force premium was $186.2 million as of June 30, 2015. We previously shared a forecast of between $200 million to $240 million in gross premiums written, as collectively generated by our four operating subsidiaries from January 1 through December 31, 2015. This remains a reasonable range based on our expectations for the balance of the year.

We continue to see favorable market conditions ahead, enabling us to continue pricing better than commercial auto in general, with target loss ratios below 60%. As before, for commercial reasons, we will not be providing more detail in terms of pricing targets by geography.

We are committed to maintaining expense control, while investing in the infrastructure necessary to support continued growth and the delivery of our strong value proposition to agents and policyholders. We will also manage our net written premium to surplus to leverage operating margins, maximize ROE without creating a near-term need to raise additional equity capital to support organic growth.

Naturally, a material M&A opportunity or a meaningful change in the market condition could always impact our capital planning strategy. That said, managed self-funded growth will deliver the highest-quality sustainable income stream and ROE.

To conclude, our expectations for the coming months are to continue to take advantage of the market, where we're seeing margin expanding and premium writings continuing to accelerate. We typically provide updated quarterly data about the commercial insurance market as provided by the Council of Insurance Agents and Brokers.

Unfortunately, incremental data was not available at the time our debt was published. However, we expect that when released it will show the commercial auto segment, in general, continues to fight a bit of a battle, where large generalist continue to see great increases and where larger accounts are putting pressure on those initiatives.

Overall, we continue to feel that the broader commercial auto segment may move more or less sideways for a number of quarters, while commercial insurance across all lines may show continuing signs of softness.

As discussed previously, our niche generally lags broader commercial auto by approximately 12 to 18 months, both in terms of hardening and softening. We continue to benefit from generalist who exited the market in recent years. As seen in statistical data over numerous quarters, our target demographic of owner operators and small fleets also tends to be less price elastic to the cycle.

Our retention remains at target levels and our priority will always be to generate an underwriting profit based on the experience and expertise we have in the specialty insurance lines we write. The opportunities we've generated have improved underwriting results and our niche, and are consistent with the gradually increasing average rate levels seen in the past few quarters.

These continuing positive trends are expected to improve operating results and margin. Our goal will continue to be to remain diligent with respect to capital planning and increasing our operating leverage in a responsible manner to fully benefit from these trends.

While the best and highest use of our time and resources is currently vertical growth in Atlas' current niche market segment, we continue to evaluate ideas for opportunistic M&A to leverage our proven experience, finding, diligencing and fixing challenged insurance businesses.

Generally speaking, our favorable market M&A will focus on bolt-on deals to accelerate our reaching proportionate share in the current market cycle. In softer markets, we will be well-positioned to pursue horizontal expansion transactions at very attractive valuations, by leveraging our competencies in the area of reorganization and reimplementation.

As we discussed, all trends are moving in the right direction. We recognized that our growth needs to be stable and sustainable, and we feel very encouraged with where we're headed.

I also want to thank the great team that we have at Atlas, across the country, for their excellent work in all areas last quarter. Without the expertise and commitment our staff brings there, we wouldn't be able to deliver the results discussed today.

With that Donna, let's turn it over for any questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is coming from John Barnidge of Sandler O'Neill.

John Barnidge - Sandler O'Neill

I just have a few questions, if I may. There was a large sequential and year-over-year increase in net investment income. As you grow your premiums, how should we think of this kind of for modeling purposes as a run rate going forward?

Scott Wollney - President and Chief Executive Officer

Our new money yield is 1.9%. There were a few $100,000 of gain in the second quarter that was part of an annualized review relative to one of our real estate related holdings. So I think if you back that out, it would get you to about that 1.9%.

The first quarter was unusually low, because of the fact that at the beginning of the quarter we had a large amount of cash set aside to fund the Global Liberty transaction. And then we had the stub period issue that we've touched on in terms of written premium that also factored into the calculation of yield in the first quarter.

So I would sort of ignore the first quarter in terms of that yield and think more about our current yield, again at about 1.9% or 2% is being a reasonable expectation going forward.

John Barnidge - Sandler O'Neill

On a point basis, how much was the expense ratio impacted by Global Liberty?

Scott Wollney - President and Chief Executive Officer

It was about $200,000 in the quarter. In terms of direct expense, there was a little bit of primarily audit-related costs that came in after we closed the first quarter. At this point, we expect all of those to be done. So that was about $0.02 a share. And then going forward, we do not anticipate any incremental non-recurring cost related to that acquisition.

John Barnidge - Sandler O'Neill

Where do you think you're going to have the expense ratio to overtime? Not like next quarter, but overtime.

Paul Romano - Vice President and Chief Financial Officer

On a gross basis, and again we're using that because we want to back out the effect of reinsurance, quota share reinsurance benefit, but on a gross basis that 10% to 12% range continues to be our target. As we are growing in a favorable market, we will generally be towards the upper end of that range. And that's principally because it takes more time and resource to quote new business, relative to every earned premium dollar than it does to support renewal business.

And a lot of that really comes down to the fact that we aren't going to quote every opportunity that an agent submits to us. And as you've seen in the information we've provided, the hit ratio on new business maybe 55%, 60% in the current market environment, whereas renewal retention is much higher at 85% or even 90%. And so it's much more operationally efficient to support a flatter or even shrinking book of business in a softer market environment, because most of that business will be renewal.

So as we continue to grow in the favorable market, I'd expect this to be on the higher end of that 10% to 12% range. And then in a softer market down the road, you can expect us to drive that expense down closely to 10%.

John Barnidge - Sandler O'Neill
And last question here, it's more kind of a big picture. What impact demand are you seeing from transport network company, such as Uber in west, directly and then also from the taxis?

Paul Romano - Vice President and Chief Financial Officer
So on a direct basis in states or municipalities, where a commercial insurance requirement has been implemented, like New York. For example, we are seeing direct demand, because those drivers do need to buy full-time commercial insurance policies. And provided they're commercially licensed and driving commercially plated vehicles and fit our underwriting criteria, that is incremental market opportunity for us.

In other areas, where the legislation is less specific or still in the process of being evolved, there may not be that incremental direct demand. But obviously we're watching all of the markets, where we do business, very carefully in that regard.

In terms of the effect it's having on our traditional customers, I think the headlines are a little overblown in terms of cannibalism of rides. Obviously, it is creating a disruption in the industry.

I think our traditional clients, traditional taxi and livery operators are responding in a couple of different ways, as a group and as members of associations, like the Taxi Limo Paratransit Association. They are definitely sharing ideas in best practices in terms of thinking about ways to evolve their business to take advantage of the consumer's increased appetite for our mobile app dispatch, for example, and other customer service related services.

So I think we want to work with them to make sure that we are sharing risk management and driver training best practices as part of our relationship. Those things are good from a competitive standpoint for them. They're also positive for us in a sense that generally those things correlate positively with improved risk or relationship to risk.

And there is some loss of business. Obviously, I think the statistics that we're hearing directly from our account in urban areas is that revenues maybe off 10% to 15%. I think in less urban or more suburban areas, there is probably a bigger impact. But our assessment is that the majority of rides that the TNC companies are generating may actually be incremental.

In other words, it's people who may actually be choosing to use TNC companies and even traditional taxi and livery operators, instead of buying a car. And so we think that's where a lot of these incremental rides are actually coming from. And so overtime as that industry develops and as the insurance need becomes more formalized, it could create incremental demand for our product as well.

Operator
Our next question is coming from Dan Farrell of Piper Jaffray.

Dan Farrell - Piper Jaffray
I was wondering, given where the current operating leverage is, I was wondering, if you could talk a little bit about how you think about the piece of improvement in ROE towards some of the stated goals that you've talked about working towards?

Scott Wollney - President and Chief Executive Officer
We've obviously referenced the long-term goal of always being 500 basis points or 1,000 basis points ahead. We talked about high-teens for this year. Those continue to be consistent goals of ours. And really to get there, we need to continue to maintain either existing better margin and see incremental operating leverage as well.

So as I mentioned, we saw that leverage come down by design to about 1.5 to 1 in the quarter, and that was the result of our borrowing against the Fifth Third line and putting that into surplus, coupled with a moderate increase at the quota share reinsurance program. Having set those levels, we think that it puts us at a sufficient surplus level to continue to grow through certainly the end of this year and into next year.

And so that growth on the consistent surplus basis will increase operating leverage. And so our upward constraint on that is 2x in terms of net written premium to surplus. And so that would be essentially a 50% increase in ROE at the same operating margin. So part of the current leverage is really planning for the future. It's showing regulators and rating agencies that we are being physically responsible, and also giving us some dry powder, so we can take advantage of what we continue to see as favorable market environments.

Dan Farrell - Piper Jaffray
And then can you give us any update on the current environment for M&A in your statement?

Scott Wollney - President and Chief Executive Officer

Sure. So we are focusing more on the West Coast at this point than the East Coast having just completed the Global Liberty transaction. Although, we are open to being opportunistic, depending on the circumstances. Our primary objective at this point would be transactions that would help accelerate our ability to get to the 20% proportion of market share that we think is reasonable for Atlas as a market leader, while the market is still favorable, but only at reasonable valuations. And in longer term, we are going to be more focused on M&A that would be opportunities to horizontally expand.

So I think in terms of opportunities we are definitely seeing a number of things. We are being approached more often than we used to be, but are still being very selective. We are certainly not going to do deals just to do them. We also recognize that the best and highest use of our resources right now is vertical growth in our core niche and we don't want to create distraction in that regard, and so we are being very diligent about focusing those efforts.

But I think there are going to be opportunities. I would not expect us to be perusing in earnest a large number of those. Again, we'll be very selective and only focus on things that are truly strategic, giving us incremental opportunity that we don't think that we could generate as beneficially or with this much accretion organically in the near term.

And then longer term is where I think you'll see us focusing on higher amount of M&A activity, and again that would, as we talked about before, generally would be something we'd think about more in the soft market when the other opportunities to use the core competencies we have in terms of finding and fixing challenge companies to really identify projects that could be strategically interesting, but also give us really attractive valuations.

The other sort of ancillary aspect of the question I think you asked is kind of the impact of some of these very large deals that have been announced recently in the insurance space, well, that is sort of outside of our sandbox?

I think it does create an interesting thing to think about, which is as big companies get even bigger, market segments that may have traditionally been focused on by generalists may become more niche-like. Because the bigger companies get, the bigger a target market has to be to move their needle.

And so down the road, it could create opportunities for us to find specialty areas that are going to look and feel more like a niche than they do today. So again, that's more of a longer term thought, but something that we are considering and obviously as a specialty writer something that could be of interest to us down the road.

Operator

Our next question is coming from Ryan Byrnes of Janney Montgomery Scott.

Ryan Byrnes - Janney Montgomery Scott

Just had a question on kind of loss cost, especially on the frequency side, we had a large personal lines underwriter notice a pretty big spike in loss frequency. Just wanted to see what you guys are seeing apparently, doesn't look like you are. It looks like your underlying loss ratio obviously was in high 50s for the first time. Just wanted to see if you guys are seeing anything out there?

Scott Wollney - President and Chief Executive Officer

No, we have not seen a significant increase in frequency following storm activity, like Sandy, for example. We have provided good information in terms of really the relative lack of impact that those things tend to have on our customers and its predominantly because they are not operating in the eye of the storm as it were, so from that perspective we generally don't see frequency change much based on weather patterns. In a long and very snowier icy winter in certain cities you might see a slight uptick in frequency, but obviously that wouldn't come into play right now.

So we really haven't seen a dramatic increase in the frequency. If anything, we've probably seen some bit of a decrease in frequency in terms of the taxi utilization, because of the fact that we touched on answering the earlier question, there is some activity from the TNC companies that maybe cannibalizing to a small extent, 10% or 15% from the traditional operators.

So because of that taxi utilization maybe down slightly, not enough to take the vehicles off the road, not enough to start buying insurance for those vehicles, but enough to improve frequency a little bit, that could be a bit of a positive factor, but I would say, assume frequency stays relatively flat, understanding that there could be some positives in there.

And then on the severity side, we are continuing to see some benefit from severity. And we touched on this to a great extent at our Investor Day. A lot of that we think has to do with the fact that the average age of our vehicles is relatively old, seven to nine years, and so if you look back at personal auto data what you see is that frequency came down dramatically, seven, eight, nine, 10 years ago.

And the benefit of the newer bumpers, airbags other technologies that significantly reduce fatalities and severity claims in the personal auto space is now flowing into the fleets that we're currently insuring. So that is a more notable trend I think and one that is probably a bit more of a correction, than it would be a continuing positive trend, but we're definitely comfortable with where frequency and severity are.

Ryan Byrnes - Janney Montgomery Scott

And then just quickly my last one. We saw some favorable development obviously from Gateway in the first quarter. It looks like there was a little noise there -- I'm sorry, there wasn't a noise. But should we expect similar adjustments for Global Liberty or how often do you guys look at those types of adjustments?

Scott Wollney - President and Chief Executive Officer

So both the Gateway and the Global Liberty deal do have purchase price components to them that tie to loss development in the years following the acquisition. And so on an annual basis, we will be looking at the carried reserves plus IBNR after we complete our outside actuarial reserve analysis each year to determine whether the pre-acquisition reserve developed favorably or adversely or stayed neutral. And depending on what the outcome is, there could be a positive or negative development.

And in both of those cases, if there is favorable development, we would issue more preferred shares correlated with the amount of that development. And if there were adverse development, we would callback preferred shares that were issued at closing in order to essentially keep the multiple of book value that was the basis for the purchase price constant, so that would be an annual analysis and again always focusing on pre-close reserves.

So in both cases, we went through a lot of diligence to get us comfortable as we could get with the pre-close reserve levels, but feel it's important to have that protection in there given that in insurance obviously there can be development positive or negative down the road. And so it really protects the Atlas as the buyer and is also equitable for the seller. And in both cases, the tail on the claims is generally going to be three to four years. And so we set the threshold for those adjustments with that in mind.

Operator

Our next question is coming from Jeremy Hellman of Singular Research.

Jeremy Hellman - Singular Research

And forgive kind of a long-winded question here. I wanted to build on two questions to go, and your answer around M&A, and what's happening at the higher rungs of the commercial auto market and some potential burgeoning niche markets similar to your market? And playing that against the success you're having and the runway you have ahead, I thought it might be good just to have you guys kind of review the mote around your business and how you expect that to have some durability?

Scott Wollney - President and Chief Executive Officer

It's a great question. I mean the things that we feel make our niche attractive really boil down to a couple of key areas. The first is it is a very specialized high touch business. And so in order to understand the risks that you're ensuring that how to price them and how to appropriately handle claims, you really have to have a lot of expertise, which requires a significant commitment and investment over time. So that was one of the reasons why we were motivated to buy subsidiary companies that had been in this niche literally for decades and have demonstrated success in that regard.

The second aspect of it is the overall size of the addressable market. And so in the case of our current niche markets, we believe the addressable market is about $2 billion. We've talked on the call on previously about

20% of that being proportionate for the market leader, and so that would be, call it, $400 million to $500 million. Most generalists even in today's world would not regard that as being big enough to be willing to deploy capital across market cycles, especially given the first point I made, which is how specialized and high touch the business is.

So then the third aspect really is where does capacity come from? So because you don't have large generalists staying in the segment across market cycles, you tend to see capacity coming in and out and so that is what creates what we refer to as the hyper elasticity of the market cycle.

So in the soft market, our niche will generally perform about the same as commercial auto, because we do see some generalists coming in typically through intermediaries like managing general agents and wholesalers. They will probably not understand the niche as well. They will generally be more price-aggressive and they won't be able to handle the claims in the disciplined way that we do.

And so for all those reasons, their result will not be as good. And typically after a couple of years, we see those programs start non-renewing or exiting. And so as that capacity comes out, not only do you see the benefit of general rate increases in a hardening market, but you also see a lack of competition and the absence of the lowest rate in the market. So really those three things I think are the reasons why our niche had been initially fairly fragmented and why there is so much opportunity from Atlas' perspective.

So thinking ahead, if some of these large mergers or megamergers ultimately cause a $3 billion to $5 billion segment, which today we might not consider to be niche to be perceived more like a niche, because this move the needle issue just keeps getting bigger, that could cause more fragmentation in segments that today are not as fragmented. And provided that it's a non-commoditized segment where you can truly specialize and deliver a real value proposition by being committed to a niche like that over time, as I said, it could create longer-term opportunity for us.

So it's something obviously we're keeping an eye on. I think its well off in the future, because a lot of these deals are just happening now. But depending on how many more of them we see, it could really dramatically change the landscape in the insurance environment.

Jeremy Hellman - Singular Research
One, I guess, kind of follow-on to that. And that make sense when you kind of look at the competitive threat, or a lack thereof, if you want to call it that from, quote unquote, above. If you look at it from the other perspective, how long would it take for someone just if they wanted to build it from scratch, so to speak?

And the background of that, being every dollar that's out there, when someone sees you're doing well it's going to perk up someone's interest, how much of a wee do you have on someone who might have insurance industry experience, and say, well, hi, these guys have something here, I want to go build this and compete, how long would it take them to get into the market effectively?

Scott Wollney - President and Chief Executive Officer
It's a great question. I don't know that I could put a specific timeframe around it. But what I would say is it's definitely hard to replicate in the sense that you have to start having a great deal of data and data that is specific to our niche. That data is not available publicly. So sources like ISO don't aggregate data and break it down into the fine segments that are necessary to really understand our niche.

So they have a lots of aggregated commercial auto data, but it's not going to be a specific to the business that we're writing, as evidenced by the difference between our effective rates and ISO rates, for example. So it's starts with the data, which you really need years, if not decades, of data to really understand it.

The second thing is that knowing what to do with that data. And so that requires a level of sophistication that very large companies will certainly have, so then it becomes a question of are they going to be willing to deploy that resource into the market. And that kind of takes us back to the market size issue that I touched on in response to your competitive mote question.

So I think there is two segments, which is the possibility of doing it and then a willingness. And then on top of that, you really have the issue of the relationships with agents. So our niche is a very agent-centric environment. Our clients put a lot of value on their agent relationships. These are local agents who really understand the niche market.

And so in order to distribute the product effectively, if you've created one, you then would have to cultivate a relationship with a large number of local agents, which again can be challenging. There are royalty issues. And that really comes down to, are the agents going to be confident that a new entrant would be able to deliver the same kind of value proposition that we are currently creating.

And that's going to be important to them, because retaining existing account is the most valuable thing for most agencies. And the thing that we'll put an account at risk is if they move the account to an insurer who then doesn't handle claims or doesn't handle other aspects of customer service effectively.

And as you know, in our niche, there is a relatively high frequency generally because our clients are on the road all the time and so they're going to crash a lot. And so I think there is this issue of the value of the distribution channel, which is we touched on earlier on the call, we've cultivated over time, are very selective and disciplined about who we appoint.

And so could a new entrant set up a distribution channel quickly, yes, but they would do it by under-pricing the business. And so again, it's one of these issues where could it be done? Yes. Could it be done effectively, quickly? Not really. And so those would be some of the key things that I think would be important to consider.

So while there will be a new entrant, at some point we will see naïve capacity coming to this space, they will probably come in, in the same way that we've seen it coming in the past, which is too cheap, that will put pricing pressure into the market, but as a result it will not be very long lived.

Operator
Our next question is coming from Brian Hollenden of Sidoti & Company.

Brian Hollenden - Sidoti & Company
What were the net premiums earned from Global Liberty in the quarter and is that number a seasonal number?

Paul Romano - Vice President and Chief Financial Officer
I think it was $7.9 million for the quarter. And their premiums have been pretty consistent over time. So I would imagine $7.9 million to $8.2 million would be a consistent number that you can model in.

Scott Wollney - President and Chief Executive Officer
Their written premiums tend to be more seasonal where it's weighted in the first quarter, because there is a common renewal date for a lot of business in New York on March 1. But because their book had been relatively flat over the last couple of years, their earned premium, it is going to be flatter, but the written will tend to be more seasonal.

Brian Hollenden - Sidoti & Company
And that $7.9 million that was the net premiums earned?

Paul Romano - Vice President and Chief Financial Officer
Correct.

Brian Hollenden - Sidoti & Company
I mean, you mentioned the agent count in the quarter at about 250, how does that compare year-over-year?

Paul Romano - Vice President and Chief Financial Officer
So on a year-over-year basis it is up by about 80 agents. And again, those are principally the Global Liberty agents that were added as a result of the acquisition. Every year we look carefully at our distribution channel and essentially call out agents who are not either delivering on a commitment and/or are simply not as engaged as our more active agents are.

If you refer back on our website, we have the presentation from our Investor Day. It is actually a series of slides in there that show the year-over-year change in agent count and average premium per agent, since the inception of Atlas. That will actually give you some very good information, if you're wanting to see, not only the agent count, but the amount of premium volume that we've gotten on average from those agents.

So you'll actually see the number of agents relative to premium written going down, but the average premium volume per agent going up. And as I touched on earlier, we now have 40 agents who generate more than $1 million of premium each. So our goal really is to cultivate strong relationships with committed agency partners, and I think the historic results are consistent with that goal.

Brian Hollenden - Sidoti & Company
So after the Global Liberty agents, the 250 that you have now, I guess the way for us to think about it going forward is about 10% growth in that number?

Scott Wollney - President and Chief Executive Officer
We don't have a target for agent count. We do feel comfortable we've got good efficient distribution. We were approached last year by more than a 100 agents who had books of business, and appointed less than 10 of them. So from that perspective, 10 agents into 250 would be less than 10%.

So any appointment of agent is really going to be selective and based on their bringing something very specific to the table. Either they have distribution in an area that perhaps is slightly underserved at this point or we may cease consolidation. It could be that one of our agents merges with or hires producers from another agent. So we feel comfortable that we have efficient distribution.

It will probably grow a little, but I wouldn't put a specific number on it, because we don't have a specific agent count target. Again, it really comes down to wanting to have strong efficient distribution from committed partners, who are going to help us grow today. But then also down the road are going to be as committed to us, when the market eventually turns, because that's what's going to help us preserve share at appropriate premium levels.

Brian Hollenden - Sidoti & Company
And then just one final question. Any new regional competitors, I know we talk a lot about the national ties maybe not coming in through MGA's recently, but any new regional competition?

Scott Wollney - President and Chief Executive Officer
We haven't really seen new regional players. But what we do see is that local non-standard companies in particular are tending to write more of this business than they did, because some of the accounts that are non-renewing with the generalist were exiting, are going to go somewhere, right. They are not all coming to Atlas.

Some of them won't be an underwriting fit for us. And others, we may not be price competitive in the eyes of the customers.

So I think there are a number of incumbent generally privately owned non-standard companies who are benefiting from that shift in the market dynamics as well. But I'm not aware of any new local company that started up to really focus on this business.

The other thing I would comment on, there are certain jurisdictions where the current rate levels are now starting to go above the state pool levels, which is essentially sort of the market a last resort level. And so in those cases some of the state pools are even picking up some of the more challenge risks, because there just isn't anybody locally to clear the market on those.

So we are starting to feel like a harder market in that respect. That is generally kind of a hallmark of a hard market is when you start to see more risks going into the pool.

Operator

Thank you. This brings us to the end of our question-and-answer session. I would like to turn the floor back over to management for any additional or closing comments.

End of Q&A

Scott Wollney - President and Chief Executive Officer

Thank you, Donna, and thanks to everyone for joining us. We look forward to speaking with each of you again in the future.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines at this time. And have a wonderful day.