Atlas Financial Holdings' (AFH) CEO Scott Wollney
2015 Fourth Quarter and Year End Earnings Call Transcript
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Executives

Scott Wollney
President, Chief Executive Officer, Director

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Operator

Greetings and welcome to the Atlas Financial Holdings 2015 Fourth Quarter Earnings Results. At this time, all participants are in a listen-only mode. And a brief question-and-answer session will follow the presentation. As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Scott Wollney, President and CEO of Atlas Financial. Thank you, Mr. Wollney. You may begin.

Scott Wollney

Thank you very much Rob. And good morning, everyone. With me today is Paul Romano, our Vice President and CFO. We are very pleased to report record 2015 annual operating results and a strong fourth quarter driven by continued premium growth across our nationwide distribution platform, favorable core business underwriting performance highlighted by improved combined ratio. And continued above industry average return equity and book value appreciation.

Today, we'll discuss Atlas' results and share our thoughts regarding the niche within commercial auto on which we focus along with some thoughts on commercial auto generally. Our target market continues to display favorable pricing trends and we feel we have a high level of visibility with respect to expectations for the coming year. We'll also highlight some operating initiatives that we've executed to ensure that our organization continues to improve as we grow.

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

Paul Romano

Thank you, Scott. And good morning, everyone. Yesterday, after market close, Atlas issued its 2015 fourth 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.

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, 2015 which we filed last night.

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.

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. For those of you following along with our presentation, we will begin on Slide 4.

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

Scott Wollney

Thanks, Paul. Throughout 2015 we reiterated the company's expectations in terms of premium growth, expansion within our markets, successful integration of Global Liberty, capital management and ultimately our commitment to deliver above industry average underwriting performance and ROE deliverables.

Before we get into our specific results, I thought it would be helpful to highlight some key facts about the industry in general. Current data indicates that commercial auto insurance represents approximately $29.2 billion of the overall $571 billion annual property and casualty insurance industry premiums in the US. As in past years, we undertook a proprietary market study working with an outside analytics firm to monitor changes in our niche market within the broader commercial auto segment. Based on this information, we believe that Atlas' niche market grow approximately 12% in terms of vehicle count from the last analysis completed in mid-2014. This additional growth readjusts in addressable market of more than $2.25 billion in terms of premium based on current market rate. Data complied by SNL Financial indicates that property and casualty industry combined ratio was approximately 96% in the past year with an average return on equity of 7.9%.

We consistently indicated that based on our hyper focus and specialized business model, Atlas should be well positioned to deliver stronger margin with a goal of always exceeding the industry ROE by 500 to 1,000 bases points. We are pleased to have achieved each of our operating goals during the period while also reinvesting in our business in terms of people and technology to ensure strong and stable growth given the favorable market dynamics in which we are operating.

Our after-tax return on common equity for the full year was 12.3% and for the fourth quarter on an annualized basis was 14.1%. We expect to continue improving this return in 2016 based on margin expansion and operating leverage.

Key elements of our financial results for the year as highlighted on Slide 4 include increased underwriting profit, lower combined ratio and managed growth in gross premium written towards the high end of our stated range of 30% to 50% year-over-year in 2015. We are proud of our results for the year and can confirm that all key metrics are in line with both our expectations and the estimate Atlas provided for the year.

At the end of this call, I'll provide more guidance regarding our expectations for 2016. Our margin improvement during the year was the result of managed expense ratios in line with our expected 24.5% to 26.5% range coupled with an improving loss ratio for the full year. At this time, we are seeing a very favorable pricing environment which we expect to support incremental positive pricing activity. We will take full advantage of this opportunity to grow while continuing to expand margins on a year-over-year basis.

Our 2015 full year combined ratio of 87% is the lowest since the formation of Atlas. From the time Atlas was created, we viewed capital management as a critical core competency. Our commitment to always be a good steward of capital has positioned us well with the clean balance sheet and necessary financial tools to support our specialized infrastructure to sustain the expected current, organic growth trajectory on a self funded basis. The decisions we've made in connection with allocation of our investment portfolio in recent years, protected capital during the tumultuous market activity of past few months.

Ultimately our goals are to properly take advantage of each point in the market cycle. When markets are favorable from a competitive and pricing perspective, we'll grow premiums at healthy underwriting margins. When markets eventually become more prices competitive, our focus will be to maintain margins even if it means that premium shrink. This should then lead to opportunities to redeploy capital into strategic M&A those exceptional valuations as we did early in Atlas' existence when the market was soft.

At this point, the market is favorable in our core taxi, limousine/livery and Paratransit niche and we expect this to continue for at least another year or two. Based on close to consumer approach we take to product distribution which includes active participation in industry events and regular dialogue with agents nationwide, we believe we have visibility of approximately 12 to 18 months and the pricing changes within this niche. And are currently not seeing any signs of disruptive new entrants. As long as the broader commercial auto insurance segment continues to face challenges, we think generalist will stick to their knitting.

As shown on Slide 5, in the quarter our core commercial auto premiums grew by slightly more than 100%. For the full year, growth in our core lines was 73.8% including the addition of Global Liberty insurance company of New York. Atlas has maintained steady operating leverage while still investing in people and technology to ensure that can support growth. We successfully completed and integrated Global Liberty into the Atlas group of companies in 2015 which provided the company with infrastructure that will allow us to grow market share in the East Coast in a profitable way and we believe will serve as a valuable platform to continue to expand in a largest single geographic market for the industry on which we focused.

Firstly, all of our operating metrics are at the highest level seen since the Atlas' inception. Pretax income from operating activities in the quarter was $6 million, or $0.48 per diluted share compared to $4 million, or $0.33 per diluted share. We provided this metric for investors as a measure for the past several quarters as we feel it was helpful in breaking out the tax implications on the company prior to our GAAP results reflecting a full US tax rate this year. As you note in our press release and filings, we also detailed after-tax income from operating activities as well to provide greater transparency and comparison to the industry results.

Net income after-tax for the quarter was $4.3 million, or $0.34 per diluted common share. Tax affecting last year's net income on a pro forma basis and excluding the company's treatment of deferred tax asset this quarter is $0.34 per share compared to $0.19 per share for the same period in 2014. Book value per diluted common share for Atlas at December 31, 2015 is $10.15. Atlas' increased book value for each of the past 13 quarters.

Overall, it was a very successful quarter. That said it's important to keep in mind the fact that we are managing our business for the long term rather than quarter-over-quarter. On Slide 6, you can see the positive year-over-year trends relative to both our loss and expense ratios. As we've discussed previously, our loss ratio can vary quarter-over-quarter. But as you can see on a full year basis, it has been consistently moving in a positive direction. Typically, it takes about 18 months for the effective pricing activity to be seen in our financial results.

On Slide 7, we summarized the pricing target set in recent years and the resulting impact on loss ratio over time. While our full year 2015 loss ratio was 59.2% is consistent with the pricing activities undertaken in 2013 and 2014, it would have been even better but for approximately $2.1 million of loss development recorded in the fourth quarter related primarily to runoff legacy program.

Paul will provide more detail on this regard but in short claims related to these programs are for the most products extinguished and we do not expect material incremental development in the future.

In Slide 8, we displayed our in-force premium to show organic growth coupled with the additional premium as a result of the Global Liberty acquisition. This in-force growth has come through managed market share increases throughout the 40 states plus Washington DC in which Atlas actively writes business.

On Slide 9, premium by state is summarized for the year. Some notes that maybe of interest include the growing portion of New York as a percentage. This is largely due to Global Liberty's acquisition. The growth throughout the country has been strong with several regions such as the west coast growing in excess of 100%. However, in virtually all states Atlas currently has single digit market share. With the stated goal of achieving proportionate market share or approximately 20% during the favorable market condition, we still have ample room to leverage our current distribution for growth with desired underwriting results.

We've increased market share not by adding a large number of new agents but by cultivating the proven relationships that we have and leveraging our strong value proposition and brands within the Atlas group of companies. This is the benefit of our hyper focus business model. We worked closely with our industry specific agents and our policy of holders to ensure that we can outperform our competition in the broader commercial auto industry.

Our agents understand Atlas' value proposition and how to sell it. Our team can also rely on then these partners to provide quality submissions to be underwritten. We also believe that these relationships, coupled with our national scale will allow Atlas to foresee market dynamic changes well in advance of multi line writers. We are also leveraging our national footprint to assist agents in understanding potential areas of industry expansion within light commercial auto.

One aspect of this initiative include expanding brand awareness among the increasing number of owner operators who have been dispatched via mobile apps and ensuring that our agents and customers are properly informed about the opportunity and the impact on their business. We monitor a number of key metrics across our business. On the front end of the production spectrum, we evaluate hit ratio and applications submission both to gauge the efficacy of our distribution channel as well as the strength of our brand in market condition.

As seen on Slide 10 and 11, our pricing and product management have delivered consistent results in connection with these metrics throughout the past three years. In late Q3, we began rolling out a new point-of-sale system. In the short run, this implementation impacted the data seen on slide 10 for Q4. However, overall business remains strong as evidenced by the new business submissions shown on page 11. And we continue to manage to better than 60% target in terms of hit ratio.

The rollout of this system is an example of the kind of strategic investments we've been making in our business with a view towards evolving needs and future success. Development of this interface began almost two years ago incorporating feedback from our business partners and we are now at a point where our agents and ultimately our expense ratio will start to benefit from its deployment. As noted, new business submissions improved considerably year-over-year and while we do not ultimately write every new submission, it is evidenced that we are seeing a larger number and a wider range of opportunities to which we can apply underwriting criteria.

In addition, retention remains consistent and this is a strong indicator that our niche market will continue to be healthy in 2016.

Moving to Slide 12. We know that managing volume, operating margin and financial leverage should result in a maximizing return on common equity and long-term value creation for shareholders. At December 31, 2015, our operating leverage is measured by net written premium to surplus remained approximately 1.5 to 1 similar to the previous quarter. This ratio has been relatively flat as our retain statutory earnings grew by approximately the same percentage as net premium growth. Managing this ratio is important from a regulatory and rating agency perspective. At the same time, our gross premium written to GAAP equity continues to improve quarter-over-quarter moving up from 1.03 to 1 to 1.47 to 1 during 2015.

We reiterate that we regard being a good steward of capital as a critical element of our business and are committed to ensure that this capability is always treated as a core competency. As communicated previously our upward bounce for the company's operating ratio is 2 to 1 and we do expect our leverage to move up in this range during the upcoming year. With the objective of self funding organic growth in mind, we will ensure that our operating leverage is properly maintained. We plan to utilize the reinsurance and debt facilities put in place in 2014 and 2015 to improve our GAAP operating ratio while maintaining healthy statutory ratios.

With that I'll once again turn the call over to Paul for more detailed review of our financials results and then I'll return for a discussion of the market and outlook for 2016.

Paul Romano

Thanks, Scott. Our financial overview in the slide deck begins on Slide 14. As always we encourage each of you to reach out Scott and myself with any questions.

Gross premium written increased 98.9% to $52.4 million compared to $26.4 million for the three month period ended December 31, 2014. This growth included $12.9 million of gross written premium related to the Global Liberty acquisition. Without the addition of premium from Global Liberty, year-over-year organic growth for the quarter would have been 49.8%. The primary driver of this growth was the continued market expansion that Scott has highlighted and the continued pricing improvement across the company's core lines.

As at December 31, 2015, in-force premium was $210.6 million and the Company’s gross unearned premium reserve was $108.2 million. We did not make any changes to our quota share reinsurance rates during Q4. We continue to see 50% of our premiums under our quota share contract for American Country, American Service and Gateway. Also during the fourth quarter of 2015, under a separate contract we see the 20% of Global Liberty subject written premium. All reinsurance programs are under review with the objectives of leveraging our increased scale to obtain the best possible terms for 2016.

Managing our operating leverage by proactively utilizing quota share reinsurance is a key element of our self funding strategy. Through this strategy, we've continued benefiting for organic growth within our niche markets during the favorable market environment. Net premium earned increased 53.6% in the three months period end of December 31, 2015 to $41.9 million. Atlas' loss ratio improved to 60.9% in the three months ended December 31, 2015 from 61.7% in the three months period ended December 31, 2014.

The loss ratio improvement in 2015 as compared to 2014 is primarily related to pricing activity on our core lines. We continue to see opportunities to be a price leader in our space. As Scott mentioned the fourth quarter loss ratio included $2.1 million in development related primarily legacy programs which represent 4.7% of our loss ratio in the period. Excluding this development, the loss ratio related to our core business was 56.2%. On a full year basis, excluding development on these non core lines, the loss ratio would have been 58.5%.

At December 31, 2015, open loss reserves related to this legacy lines was less than 1% of the case reserves and we do not expect material future development. As a result, we believe that a full year results are better measure of our operating trends as opposed to quarter-over-quarter changes. Underwriting expense is comprised of the combination of acquisition costs which are agent commission and premium tax expenses, net of seeding commissions received our quota share insurance contract, plus other underwriting expenses.

Excluding the impact from share based compensation expenses, the underwriting expense ratio is 26.3% in the three months period ended December 31, 2015 compared to 25.9% in the prior year quarter. Excluding amortization of intangibles related to Global Liberty acquisition, underwriting expenses were 25.5% in the quarter. We continue to see our underwriting expense ratio falling within our target range of 24.5% to 26.5% of net premium earned.

Overall, Atlas' combined ratio for the three month period ended December 31, 2015 was 88.2% compared to 88.4% for the three month period ended December 31, 2014.

Underwriting profit which is the income produced prior to investment income increased to $5 million from $3.2 million in the prior year period, representing a 56.6% increase. Atlas generated net investment income of $1.1 million and $884,000 for the quarters ended December 31, 2015 and 2014, as well as $183,000 and $228,000 of realized gains, respectively. This resulted in an overall investment yield of 2.2% for the quarter ended December 31, 2015. Atlas reported net income after-tax of $4.3 million during the three months period ended December 31, 2015 compared to net income after-tax of $9.5 million during the three months period ended December 31, 2014.

The fourth quarters of 2014 results were favorably impacted by the adjustments to reverse the valuation allowance against our deferred tax assets in the amount of $7.1 million.

Atlas generated $0.34 per common share diluted for the three month period ended December 31, 2015. This compares to $0.77 per common share diluted as reported for the three month period ended December 31, 2014 which does include $0.58 benefit related to the reversal of the valuation allowance against our deferred tax assets. Excluding this impact, earnings per common share diluted would have been $0.19 for the three months period ended December

31, 2014. For the fourth quarter 2015, the annualized return on average common equity was 14.1%.

On Slide 15, we provide more detail regarding our income from operating activities. The analysis should be helpful in understanding the business side outside of few of the atypical items we've noted in past quarters in light of our tax treatment. This internal non GAAP performance measure is 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.

After-tax income from operating activities which is an indicator of our overall incremental profitability growth for our organization was $3.9 million, or $0.31 per common share diluted in the fourth quarter 2015 as compared to $2.7 million, or $0.22 per common share diluted in the same quarter last year, representing a 46.9% increase.

On Slide 16, we detail the components of book value. We increased book value to $10.15 at December 31, 2015 from $9.08 at December 31, 2014. Towards the bottom of the slide, we step through the key elements that impacted book value year-to-date.

Over the next two slides, we outlined Atlas' balance sheet position. Atlas' cash and invested assets at December 31, 2015 increased to $233.4 million compared to $180 million at December 31, 2014. The increase is primarily attributable to the increased premium written, the addition of Global Liberty and a draw on our line of credit facility. Unearned premium balances which represent premiums corresponding to the time periods remaining on the underlying in-force policies were $108.2 million at December 31, 2015 as compared to $59 million at December 31, 2014. This increase is the result of continued organic growth plus the addition of Global Liberty.

As noted earlier, during the first quarter of 2015, 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 in the $30 million facility and have infused these funds into the ASI pool companies, which include American Country, American Service and Gateway in the form of surplus notes. We also withdrawn $2 million of 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 of 4.1 years remains consistent with the expected liquidity needs and payout patterns and the majority of our holdings are in fixed income securities rated AA or better by S&P.

The high quality of our portfolio is detailed on Slide 18. Because we intend to hold securities and maturity, while any increases in interest rates could create an unrealized loss in the short term, we would not expect such losses to be realized. Working without our outside investment advisor, we monitor these positions in our portfolio closely, especially in light of recent world events.

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

Scott Wollney

Thanks, Paul. I will now highlight some of the market trends we are seeing and provide additional color on our niche within commercial auto. When Atlas was launched five years ago, the broader commercial auto insurance segment had outperformed the P&C industry at large for more than a decade. And more specifically in our niches like commercial auto outperformed commercial auto in general over the same time period. Our firm belief then and now is that a well run, hyper focused operation can successfully manage high frequency lower severity business to provide return in excess of the industry.

As seen on slide 20, over the past few periods as a whole commercial auto has atypically reported worst loss results than P&C at large. Additionally, recent increases and claims severity has start to shift towards loss reserve deficiency. The fact that the broader commercial auto segment has in the past few quarters have been putting up results that are worse than seen historically should allow our model to further differentiate Atlas from the generalists who write the majority of less specialized commercial auto business in the country.

We expect this to be the case for two reasons. First, the longer it takes for generalist to address the challenges they are currently facing, the less likely it is that they will allow intermediaries like managing general agents or wholesaler to attempt, to reenter our niche and second to the extent that broader commercial auto rates continue to increase, overall pricing poignancy from smaller local competitors should be seen in our niche as well.

Looking at Atlas and our niches specifically, we benefited in terms of pricing accuracy and claim discipline. Our laser focused and expertises, coupled with the expected high frequency nature of our niche are key reasons why we have been able to avoid the problems recently challenging other large generalists. Ours is the high touch business and Atlas' subsidiaries have considerable proprietary data points that go back decade. The Predictive Analytics tools that we have implemented both in the area of underwriting and claims will provide further precision and potentially incremental margin going forward to build on the strengths we already possess.

In addition, we've low retain limits on our policies and many other segments within commercial auto which we are further managed through the use of reinsurance. As a result, our exposure to large losses is considerably lower than the commercial auto industry at large. The reason for the market discussion is to express that Atlas truly is operating in a very specific sector within a larger segment. As a result of our specialization, we feel that we can benefit from clear pricing visibility, consistent albeit high claims frequency and lesser risk of unexpected severity claims.

Our trade-off is size in favor of more predictable and potentially better margins supporting higher than average return on equity. Despite the somewhat negative attention that our broader commercial auto is attracted in the past year, is the second fastest growing subset of T&C up 9% year-over-year based on our recent DAV note that places the size of the market at $29.2 billion. It's also highly fragmented with the largest writer under 8% of total share and about 14 companies that make up just over 50% of the market. Like commercial auto is a much smaller subset of that but is growing as well.

We've noted in the past our market size of approximately $2 billion and based on the updated market research study we conducted believe that the segment is now larger based on the aforementioned 12% increase in vehicle count over the past two years. In general, we attribute this market expansion to generational preferences coupled with technology advances making it easier for our customers to attract ride.

We are also seeing a continuing movement of driver into the owner operator model which is our target demographic as evidenced by the fact that our average policy has approximately two vehicles on it. Please note that individuals driving personal automobiles under dispatch via transportation network companies are not included in our estimate of industry size and growth.

Even with this market expansion in mind, it's important to appreciate that Atlas doesn't aspire to be a big in the context of public insurance companies or to grow solely to move to the top line. We continue to believe that proportional market share for Atlas as a market leader will be approximately 20% of our specialized niche. At this stage in our business, the best and highest use of our resources and capital is to organically pursue incremental share in our existing space. That said we are cognizant that expansion in the future across market cycles should also involve strategic M&A that will support horizontal expansion into other specialty commercial auto insurance sub segment with favorable attributes.

Recent industry notes have highlighted the fact that specialty insurance is outperforming the industry overall. As we grow, we will always focus on specialty rather than broader markets. We've a track record of successful acquisitions that were incremental in terms of infrastructure, accretive both to income and book value with attractive valuations. We are cultivating a pipeline to ensure that Atlas is well positioned to build on this capability down the road.

On Slide 21 and 22, we provide recent industry pricing trends. As we anticipated in prior quarterly calls, the commercial auto rate environment in general appears to once again be firming. Data from the council of insurance agents and brokers largely reflect the consistent steady rate increases were seen with broader commercial auto. These increases in the first quarter were flat to moderate 90% of the time, up from earlier quarters in 2015. While one quarter is not a trend, this quantitative information is supplemented by qualitative public information from industry participants suggesting that incremental rate increase should expected in most cases.

Also as it is typically the case, smaller accounts support higher rates than larger ones in general. Our niche traditionally lags broader commercial auto by 12 to 18 months in terms of pricing. As such incremental price increases overall should extend the firmness in our niche market. We've been achieving high single digit rate increases and gaining market share based on our increased marketing activities, strong value proposition and pricing disciplined, coupled with larger carriers exiting our specific market in recent years.

We've not seen any signs of any disruptive new market entrants although there is certainly the possibility and it will come into play at some point notwithstanding the many positives I mentioned earlier. In the meantime, we continue to expect moderate incremental rate increases during the upcoming year and we will be pricing our products to a loss ratio in the 50s. As it has been the case throughout 2015, we will not be providing more granular pricing information for competitive reasons.

Let me conclude with some estimate and additional thoughts on 2016. We believe that we can continue to write business below a 60% loss ratio with incremental rate increases in the mid to high single digits while growing in excess of 30%. We believe Atlas can produce high teens ROEs that exceed the industry provided market conditions remain favorable. Our team is committed to managing our overall expense ratio within the 24.5% to 26.5% target range we previously communicated. As discussed before, we are likely to remain on the high side of this range while the company continues to have significant organic growth opportunities.

Now that our new policy management system has been implemented, we are running off legacy systems and will always look for other incremental opportunities to continuously improve and drive down operating efficiency.

We are also excited about the potential relative to our increase use of Predictive Analytics to add another level of sophistication and efficiency to our operations. And as always it is important to acknowledge the great experience and dedicated members of the Atlas team. We expect to write between $260 million $290 million premium for the full year 2016 and feel very confident that our current capital position will allow us to achieve this growth on a self funded basis.

As always I want to clarify that this premium figure is an estimated range, not a goal. We'll always put a priority on margin and operating leverage over premium growth on an absolute basis.

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

Question-and-Answer Session

Operator

Thank you. Our first question comes from the line of Paul Newsome with Sandler O'Neill. Please go ahead with your questions.

Paul Newsome

Good morning. And thank you for the call. I'd like to start off with maybe a little bit more information about the $2.1 million in reserved development. Can you talk a little bit about what was Gateway, what was American I guess American Service that's right, the only utility business and what happen specifically in the quarter that created the need for an increase in reserve? As I understand those are pretty old reserves at this point. So it's a little bit of surprise that they are called back to sell off?

Scott Wollney

Sure, happy to provide some clarification on that. So in terms of the overall numbers approximately $1.2 million of the development related to the legacy Gateway claims and approximately $700,000 related to the old surety program and the balance of that was the sign risk and some other miscellaneous business. So a key element is that those programs do represent as Paul mentioned a very small percentage of our overall reserve less than 1%. I think at this point we have only about 35 open claims related to that legacy period for Gateway. So you are right and that those are old pretty well developed period. But it is a situation where we need to finalize and put those claims to bed. And as we really focused on getting reserves to where we believe they needed to be to have kind of a final open and loss ratio particularly on the Gateway business as we come to sort of the tail end of the purchase price adjustment on that deal. It made sense to settle out the claims and set the reserves where they were. So that really is the detail around that. All comment that I'll make as we have in the past, we will in the first quarter having adjustment to the outstanding preferred shares related to the Gateway acquisition that ties to development for pre acquisition liabilities for that book of business. And obviously we will report that along with our first quarter results. So at this point we haven't finalized that calculation contractually at the first quarter deliverable. But there will be some adjustment to preferred shares that would be affected by the development on the Gateway side because of that purchase price protection component of the purchase agreement that we talked about in the past. So we do not -- as we mentioned on the formal part of the call expect future incremental development related to those old lines. And as Paul commented too on a full year basis the impact was relatively immaterial I think 0.7% or 0.07% on the total loss ratio.

Paul Newsome

What is that preferred adjustments run through income statement?

Scott Wollney

It will run through the income statement in the underwriting expenses, as a favorable adjustment offsetting the preferred shares. And that will be an after tax adjustment.

Paul Newsome

Great. And then maybe completely switching to the top line guidance. Any more detail about the sources of growth, maybe a breakout in terms of what do you think is going to be customer related growth versus the proportion is related to the price increases and maybe geographic -- through the geographic description where that growth is going to come from?

Scott Wollney

Sure. So in terms of the distinction between increased policy count versus pricing, we are expecting to continue to achieve mid to potentially high single digit rate incremental rate, probably more rate on new business than on renewal. As you know, we've had significant rate increases over the last three years. And certainly for well performing renewal business. Those increases might be moderated relative to what we would attract for new business. So I'd say mid to single digit they are remaining approximate 25% to 30% growth would come from incremental policy of the equal count, all of that would be organic. We did not factor any incremental M&A into that forecast. In terms of geography, we will be able to grow faster in areas like the West Coast where we continue to have relatively lower market share. It's obviously easier to grow from a 3% or 4% market share position to 6% or 7% market share than it is for example to grow from 10% or 12% to the high teen. So while we are focusing on growing organically to write quality business in all of the 40 states plus Washington DC where we distribute. I think our rate of growth will be seen higher in those regions that have a lower overall market share percentage at this point. But we do feel like we have efficient distribution, we got about 260 to 270 independent agents, as I commented we really regard these agents as partners and based on the volume of applications that we are seeing from those agents, we believe that we can achieve those objectives with our current distribution channel. It won't require our adding a significant amount of new agents. And that's an important point because obviously the agents we have we really believe to be experts in the space. They are well connected and we are continuing to see opportunities to write business that they have controlled for many years but perhaps had placed with the competitor earlier on either because of some of the challenges that our subsidiary faced prior to Atlas acquiring them or simply because the market have been softer. If you go back two, three, four, five years.

Operator

Our next question is coming from the line of Dan Farrell of Piper Jaffray. Please proceed with your questions.

Dan Farrell

Hi, good morning. Scott, I was wondering if you could expand a little bit on the Predictive Analytics initiative that you started put in place and how you think over time that benefits the overall operations and results.

Scott Wollney

Sure. I'd be happy to. So we've been utilizing Predictive Analytics in the underwriting area really ever since the inception of Atlas, we continue to evolve that as we press released about a year and half ago. We partnered with the group called EagleEye Analytics to use machine learning tool to sort of further expand on that Predictive Analytics in the areas of underwriting having been impressed with that approach we decided to develop some Predictive Analytics models around our claims process as well. That is now completed and we are deploying here in the first quarter. The claims model essentially includes four sub models. One to predict expected severity early on the claims life. The second to predict likelihood of attorney or representation, another to predict the likelihood of claim that should be fast tracked and then finally average claim life. So the way we are going to apply the model in a nutshell is first to make sure that claims are as quickly as possible routed to the appropriate person within the claims unit, both in terms of experience and expertise. The second is to make sure that from a claimed inventory perspective we always have the right number of people at the right levels within the claim enterprise. And then finally as we scale up in the longer term, potentially at the scale back is the market shifts, it will help us to really balance workload and staffing and expense level. So really the goal initially to make sure that we are always getting the claim in the right place at the right time as quickly as possible. The benefit of that is both operational efficiency which should help reduce our unallocated loss adjustment expense. But probably the biggest benefit is on the indemnity side where although we believe that we have best in class sort of traditional claims capabilities based on all of the experience that we have within our organization. The fact is that this additional layer of sophistication will help us to further leverage that expertise. And so we are expecting that it could result in incremental improvement in terms of indemnity payment as well. So the ultimate benefit of both those things together will be borne out probably over the period of 2016 and 2017 as new claims are routed through the organization using the benefit of the model. But based on some sort of general statistics that we've gotten, our expectation is that could benefit the loss ratio by anywhere from two to as many as five percentage points over time. So we are not going to reflect that expected benefit in our near-term results. But it is obviously our desire that we will achieve those. And to the extent that we do over time it will help both in terms of improving loss result in the near term and simply making us even more competitive in the longer term. So we are very excited about it. I recently saw statistics that indicated that only about 17% of all property causality companies are currently deploying

Predictive Analytics in the claim area, but almost 60% of firms that have not done so have a desire to, so I do feel like this is an area where as in a lot of cases we try to be on the front edge of utilizing our appliance sophisticated tools to layer on top of the strong heritage that our companies have had and really leverage the extensive amount of fine detail and data that we have in the organization.

Dan Farrell

That was helpful detail. Thank you. And then just your comments on your niche the industry addressable market that you target seems to continue be showing strong growth, maybe a little bit slower than have been but they are pretty solid. Can you comment on current drivers there and how you maybe think about that as we go forward?

Scott Wollney

Sure. You recall when we revised our outlook based on the analysis we've done mid to late 2014, the two year period leading up to that point vehicle count was about 19% obviously in the most recent two years period it's more like 12%. And we have commented that earlier adjustment we thought was -- had been impacted by the introduction of transportation network companies among other things. And that we did see that would be somewhat of correction potentially have a couple more years of benefit and then ultimately the industry growth rate would probably revert back to what it's historically been which is typically somewhere between 3% and 5% year-over-year. So the 12% we saw over the last two years is still a faster rate of growth than what has been historically the case, but as you point out not as significant as it was from 2012 to 2014. So I think as we look forward we do continue to think that the industry growth rate has been -- niche growth rate is going to probably revert back to 3% to 5% year-over-year and sort of a must of bit of bell curve so. In terms of the drivers of that growth I think we continue to see benefit of incremental ridership I think demographic trends, people are moving away from car ownership, increased number of people moving into metropolitan areas, obviously access via mobile apps and online handling tools are increasing people's reliance on the kind of people we insure across the board. And you are seeing that not only in the context of T&C companies but also traditional taxi, limousine operators with an increasing number of mobile apps and web based handling applications that are designed for all aspects of the industry. So we do think that trend will continue and as I pointed out is also causing an increased overall percentage of drivers to operate as owner operators which fall squarely within our target demographic. So in addition to seeing a bit of market expansion overall in terms of direct opportunity for Atlas. That shift or continuing shift towards owner operators is a positive in terms of more vehicles and drivers falling within kind of our underwriting sweet spot.

Operator

Our next question is from the line of Ryan Byrnes with Janney Montgomery Scott. Please go ahead with your question.

Ryan Byrnes

Thanks. Good morning, everybody. The loss ratio is improved a couple of points in each of the last couple years. And again it's a very attractive loss ratio right now. Is it at a point now where you are willing to sacrifice some rate to get more volume at these current levels or I guess can you continue to grow at these levels and continue to show a couple of point of loss ratio improvement?

Scott Wollney

We do feel that we can continue to improve the loss ratio both due to pricing activity as well as the expected benefit of some of the initiatives we talked about particularly in the area of Predictive Analytics. In terms of the trade off, the two things that deliver return on equity in the insurance business from an underwriting perspective really is margin coupled with operating leverage and so if we can expand margin by or at a level that will continue to allow us to maximize operating leverage within the range that we are comfortable. Balancing those two things together is what will optimize return on equity. So that is ultimately going to be the analysis we go through and all of the different territories where we write. And different geographies are going to be different. There are some local markets where we will have the opportunity to both grow and expand margin and others where we may tamper one or the other but across our overall business, the goal is going to be to maximize our return on equity which is going to be the combination of those two things together. But we do feel like the market is very healthy from a competitive standpoint. We continue to strengthen the Atlas brand and the brand of our operating companies across the country. And continue to deliver that strong value proposition to policyholders with the expectation that it should allow us to charge a premium price for the products that we underwrite. So I think it's -- the short answer to your question would be combination of both with the ultimate objective of maximizing return on equity.

Ryan Byrnes

Okay, great. And then again I hate to blabber I guess the non core reserve but I just trying to figure out what gives you guys confidence that there some other company outstanding claims but just trying to figure out what gives you guys confidence that they won't have more I guess material on say development.

Scott Wollney

Yes. I mean the real key in particular if you focus on the non -core commercial auto business, I mean that we are now in the third year or 2015 was the third year where we were managing the runoff of those claims. The typical lifecycle of those types of claims is to three to four years. So from a pure duration standpoint at the end of that tail you are really dealing with somebody oldest, potentially most challenged claim and so as I touched on I think we have approximately 35 of those claims open. It is a very, very small percentage of overall inventories. Those claims throughout the year but especially in the fourth quarter where we added at a very granular level by our senior claim staff to ensure that they were comfortable with where our reserves were held. A number of those claims were also settled out in 2015 which again you would expect given the typical duration of the claim pattern for that type of business. And finally a number of those claims because they are older, larger claims, some maybe in litigation, they are reserved at the policy limit in many cases. So they simply can't develop further. So we do feel very comfortable with that. I think both because we are at the tail end of the runoff period coupled with the fact that we know that our senior claim staff looked very specifically at each of those claims individually to make sure that they were comfortable and finally because we are very ultimately getting them resolved, which is part of why we recognized the development in the fourth quarter. But it's also why we feel comfortable that we shouldn't see it going forward. I guess the final piece is to the extent that there is any development of favorable or unfavorable we still have the protection related to the original purchase price agreement as well. So while that didn't come into play in the fourth quarter, it will ultimately offset development whether it's a positive or a negative. So hopefully that helps to explain our counter level.

Ryan Byrnes

Sure. It does. And again just quickly just from a numbers questions. I just want to make sure I understand the mechanism with the preferred so essentially that will offset to expenses in the first quarter and I guess on just a tax affected basis of $1.2 million, is that the right way to think about?

Scott Wollney

No. So the ultimate adjust -- so the adjustment itself was going to be tax affected off of the development. It would be --if for example if you tax affected the $1.2 million, we would call back preferred shares in the amount of that tax affected number which is Paul mentioned will have roll through the income statement but it also then reduces the number of outstanding preferred which would then going forward reduce the amount of accrued interest that tax forward and it is also is going to have a very small positive effect on outstanding dilutive common share account as well. But again we will do the actual calculation in the first quarter and articulate on our first quarter call what that adjustment is, the same way that we did last year and the prior year in connection with that aspect of the deal. It is premature for us I think to communicate the exact detail of the analysis because candidly it's something that gets completed in the first quarter after the full year results are done.

Operator

Thank you. The next question is from the line of Brian Hollenden with Sidoti & Company. Please go ahead with your questions.

Brian Hollenden

Good morning. And thanks for taking my call. With your strong organic growth can you talk about how you gain market shares specifically how does your value proposition differ from your niche competitors?

Scott Wollney

So the real key is being able to deliver a level of service that is truly valuable to the end users of our products as well as to our distribution channel. So in the case of the end users the policyholders it has to do with getting their vehicles back on the road quickly when they have physical damage claims, it's being able to appropriately respond and protect them when third party claims are brought against them, which in nutshell really means quickly being able to valid versus invalid claims resulting valid claims quickly and making them hard target in the context of claims that are not valid or not meritorious. And we are able to do that through a combination of sophisticated resources and experience. And so that's the key area and also on a day-to-day basis helping operators who have multiple drivers, evaluate drivers, providing risk management guidance. We are working with a number of in-vehicle technology providers to make sure that we can help drivers understand how they could benefit by implementing some of these new technologies in an after market basis. So there is a whole range of things that we do. And it really all emanates out being close to the consumer and have -- the companies we own having a very long heritage in the specialty need. So it's understanding what's important in their business and making sure that we are able to provide direct value to improve that customer experience. At the agency level is doing things like one making sure that we can quickly turn court around which we can do because our underwriters specialize in this business, we understand what we are looking at the -- agents don't have to reeducate them the way that they might, if they are dealing with the generalists committing to best in class turnaround time and then finally the deployment at the point-of-sale interface that I mentioned is going to move us forward significantly in terms of giving our agents the capability to interact directly with the company in real time basis. And get access to lots of information that previously might have to been obtained manually. So we are still retaining control over underwriting and claims handling but this does give our agents the ability to have real time access in a way that they indicated would be valuable and important to them. So those are some key areas. And then it really comes down to making sure that value proposition is understood by the market. And so we have since the inception of Atlas been very active in terms of local industry advertising being very involved in industry groups like the Limousine association and taxi and Paratransit association both nationwide and regionally. Partnering with our agents to go out and visit their large customers. So there is a lot of different initiatives that we've undertaken to make sure that not only do we have that strong brand and value proposition but that it's well known to the marketplace. And in those states where we have relatively lower market share, the incremental benefit of that is going to continue to become more and more significant. So we do still see a lot of opportunity and lot of runway ahead. And that something we really committed to continuing to cultivate.

Brian Hollenden

Thanks for that color. And then just one follows up question on modeling. Just noticed your tax rate I guess is a little bit lighter than what would have estimated in the fourth quarter. How should we think about the tax rate in 2016 if you give general rate guidance on that?

Scott Wollney

So the tax rate in 2016 should be model at 35%. We did have an incremental benefit as a result of going from a 34% taxpayer in Q3 and prior to 35% taxpayer in Q4.

Operator

The next question is coming from the line of Ron Bobman with Capital Returns.

Ron Bobman

Hi, Scott. Good morning. I had a question about a niche doesn't really have -- so your correct answer now but sort of trying to get some insight as to how long this favorable commercial auto pricing trend continues, and I would stress if you could provide some color about as it relates to of course your specialties and your core opportunities with core more business and convert some portion of that to --business, could you talk about sort of the trend there maybe early 2016 compared to late fourth quarter 2015 or at least late fourth quarter 2015 versus the third quarter of 2015 as far as the sort of the quantity of flow whether it's picking up, whether it is continuing at the same rate, whether it's flat and then also talk about sort of their -- what I call sort of rate of conversion and any -- what the rate there has been and is it improving maintaining itself or declining. Thanks a lot.

Scott Wollney

Sure. Those are great questions. So I guess to address the first part of the question our niche tends to lag broader commercial auto by about a year and half in terms of general rate activity. So when commercial auto generally begins to harden it typically takes a year to two years for our niche to follow similarly when commercial auto generally begins to soft and it will typically be a year to two years before our market follows. And lot of that dynamic is fundamentally driven by the trends towards and away from managing general agents that generalist will tend to follow at those points in the market cycle. So as markets become soft it's typically the case that generalist will allow managing general agent as you know to represent them. When markets turn it is often the case that those programs get terminated generalists kind of redeploy their capital within their core spaces. And it is that exodus of general agents and wholesalers that really helped to create incremental opportunities for us to capture more business at higher rates beginning in 2012 and continuing through 2013, 2014 and 2015. As we had mentioned on previous calls the momentum of that exodus of capital is slowing down where most of those programs were in fact probably terminated in 2012, 2013, it took a year to two years for those terminations to result in non renewals of business which means that we really saw those non renewals hit the market place probably mid -2014 to 2015 and to some extent in 2016. But again I think we won't see as much of that non-renewal activity. That said we are not seeing any signs of disruptive new entrants. So that we do expect the continued opportunities to exist. If you look at slide 10 and 11 of our deck, we do provide details around our bound to application ratio; we expect to be at around 60% for 2016. Our application count is up significantly. As we noted and some of that is our new point-of-sale system captures a more granular amount of detail. So the denominator in that equation is a little bit higher. But overall the number of vehicle is still up significantly as you can see on the upper left chart on slide 11. So while one quarter is definitely not a trend, we are definitely seeing a healthy increase in terms of opportunities to quota new businesses and we are not seeing a significant amount of competitive pricing pressure. So I think we look forward and expect that 2016 will be favorable. We are going to manage price increases around the idea that we want to maintain about 60% bind to quota ratio. We want to maintain a renewal retention rate at about 85%. So those are going to be some of the key metrics that we look at in terms of managing the amount of rate we are able to take versus the amount of business we are able to incrementally write. And again it really comes back down to balancing margin and operating leverage because as we grow, we are ultimately a user of capital and since we want to self fund that growth and maximize the return on the capital that we have and can we return to common shareholders, that balance is key and critical.

Operator

The next question is from the line of Ali Mogharabi with Singular Research. Please proceed with your question.

Ali Mogharabi

Good morning. You touched on the growing P&C and they are impacting the overall market now and in the future. Wanted to know specific and more specifically, seemed to success of your Predictive Analytics in terms of lower loss ratio, will that be impacted by less taxies out there and possibly more owned and operated in P&C vehicles and drivers more that in the short to medium term.

Scott Wollney

Yes. Interestingly when we look at the market expansion, we are continuing to see nationwide that the taxi space in terms of vehicles on the road is actually still healthy. When you look at overall number of ride in the New York Taxi Limo Commission publishes some really good data on the subject what you actually see is that although P&C companies have been growing significantly, they still represent a relatively small percentage of the total number of rides where most are still clear through traditional taxi operators. What we are also seeing is that there are a number of new technologies that have been launched that are actually aimed at providing a similar kind of experience for -- to connect consumers with traditional operators. And so while we definitely see mobile app dispatch and web based dispatch and potentially other technologies continuing to be the way that people hail ride and it isn't necessarily funneling ride over the long term away from the traditional operator so much is it's expanding the overall market. So I think in 2014 and 2015 you definitely some migration away from traditional operators in terms of drivers and vehicles but we are starting to see that in some cases kind of comeback. But most importantly they are really is just an overall expansion. Our perspective is that we want to continue to leverage the data that we have and utilize the Predictive Analytics that we have to be able to have an underwriting model that allows us to successfully underwrite full commercial auto insurance for people who move people around for money. And so as long as we are talking about people that are commercially licenses, driving commercially plated vehicles, risks that we feel comfortable that we can understand from a loss expectation standpoint. Those are all opportunities for us. And then we are going to continue to leverage the data and technology we have to evaluate whether or not we want to expand even into more part time drivers but as we've commented before as an expert in market leader in the space, it is very likely that in the short term while we understand those risks and we have the capability to write that business, we are going to be cautious because to some extent we are seeing especially personal line riders under pricing some of those part time sort of P&C related risks. And so we need to see the market mature of it I think before you will see us really jumping into that area, which is why as I commented we exclude individuals driving their own personal vehicles from the overall addressable market numbers that we gave. So the numbers that we are highlighting are solely commercially plated commercially licensed vehicles being utilized within the taxi, limousine/livery and Paratransit. So many of those might rely on some web based or mobile app based channel to get some or all of their ride. But we are not in our market size our market share figures contemplating individual using their own private cars.

Ali Mogharabi

I see. That's helpful. But at the same time I am assuming that you are pursuing to have access to data related to those types of drivers that you talked about?

Scott Wollney

Absolutely. Yes, from a research and development standpoint, we absolutely want to make sure that we understand the risks and are able to apply our analytics and leverage the data that we have but in the insurance business often times understanding the risk supports the decision to wait rather than to jump into a new market. So our goal is to make sure we always understand it. As the industry leader as well are better than anybody. But I just want to caution people not to necessarily expect to see us jumping until we feel confident that the risk is going to be have an appropriate amount of volatility and at the same time we want that we can achieve the appropriate level of premium in order to deliver the kind of margins that we expect.

Operator

The next question is from the line of Sang Lee with The Link Capital [ph] Please proceed with your question

Sang Lee

Good morning, guys. I had a question on the $2.1 million reserved development. Does that all reflected into Q4 results?

Scott Wollney

Was it all reflected in the Q4 results, yes.

Sang Lee

So meaning that the $2.1 million was surely negative to Q4?

Scott Wollney

Correct. So it's essentially on an after-tax basis. It had approximately $0.10 a share impact on income per share in the quarter.

Sang Lee

And so with that -- I mean so was that a one time reserve development on your core ongoing business then your loss ratio would have been or was 56%.

Scott Wollney

For the quarter, correct.

Sang Lee

Is that a fair starting point to kind of think about using from period using by 2016 and into 2017?

Scott Wollney

Because we really think it's better to look at full year numbers as opposed to quarter-over-quarter because business mix and payment of the occasion larger claim in a quarter can skew the quarter-over-quarter. I suggest using a starting point that is the full year number adjusted for the adverse which is 58% in change, 58.5% that's probably a better starting point rather than starting at the 56%.

Operator

Thank you. At this time, I'd like to turn the floor back to management for closing remarks.

Scott Wollney

Great. Well, thanks everyone for joining us. I'd like to close with an invitation to each of you to attend our Annual Investor Day on May 16 here at our headquarters outside of Chicago. We receive very favorable feedback from our investors and analysts on the event we held last year in New York. And are hopeful to see many of you here in May. Further information on the event is available at the end of our conference call presentation. So thanks again for joining us. And we look forward to speaking with each of you again in the future.

Operator

Thank you. This concludes today's conference call. Thank you for your participation. You may now disconnect your lines at this time.