Atlas Financial Holdings' (AFH) CEO Scott Wollney

2016 First Quarter Transcript

May 10, 2016

Executives

Scott Wollney

President, Chief Executive Officer, Director

Paul Romano

Chief Financial Officer, Vice President

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Operator

Greetings and welcome to the Atlas Financial Holdings 2016 First Quarter Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Scott Wollney, Chief Executive Officer of Atlas Financial. Please go ahead.

Scott Wollney

Thank you very much Stacey and good morning everyone. With me today is Paul Romano, our Vice President and CFO. We are very pleased to report a solid start for 2016, with a strong first quarter, driven by continued premium growth across our nationwide distribution platform, profitable underwriting performance highlighted again by an improved combined ratio and continued above average return-on-equity and book value appreciation.

Today, we will discuss Atlas' results and share our thoughts regarding the niche within commercial auto in which we focus, along with some thoughts in 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 will also highlight some operating initiatives that we have executed, to ensure our organization continues to improve as we grown, leveraging technology and analytics.

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

Paul Romano

Thank you, Scott, and good morning everyone. Yesterday, after market closed, Atlas issued its 2016 first quarter financial results. Copies of this press release are available at the Investor Relations section of the company's web site 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.

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 web site'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'd now like to turn the call back to Scott.

Scott Wollney

Thanks Paul. During our last quarterly earnings call, we highlighted the fact that Atlas achieved our goals for 2015 and shared our forecast for certain key metrics in 2016. In summary, from a growth and profitability standpoint, we noted that we believe we can continue to write business at a better than 60% loss ratio, with incremental rate increases, while growing in excess of 30%. We also believe Atlas can produce high teens returns on equity that exceed the industry by 500 to 1000 basis points, provided market conditions remain favorable.

From an operating efficiency standpoint, our goal is to maintain an overall expense ratio within the 24.5% to 26.5% target range we previously communicated. As discussed before, we are likely to remain in the high side of this range, while the company continues to have significant organic growth opportunities.

We expect to write between $260 million and $290 million in gross written premiums 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 will always put a priority in margin and operating leverage over premium growth on an absolute basis.

Our first quarter results demonstrate that we are off to a solid start to the year, and are well positioned to continue growing the business, consistent with the goals we have laid out. Key elements of our financial results for the quarter, as highlighted on slide 4, include increased underwriting profit at approximately double the amount generated in the same quarter last year, and managed growth in gross written premiums.

Before we get into our specific results, I thought it would be helpful to highlight some key facts about the industry in general, especially as they relate to our chosen niche market positioning. Atlas' strategic focus is to always be a leading insurance provider in specialty markets, delivering a true value proposition in an operationally efficient manner, enabling us to outperform the broader property-casualty industry.

Underwriting profit is at the heart of our strategy. We will never try to be everything to everybody. To the contrary, we target a subset of a subset of the market for very specific reasons. This strategy is delivering the intended result. While the broader property-casualty industry and the more general commercial auto segment is facing a variety of challenges, our results continue to be strong and forward-looking trends, about which I will talk later on this call, remain healthy in our sub-segment.

We have consistently indicated that based on our hyper focus and specialized business model, Atlas should be well positioned to deliver stronger margins with the goal of always exceeding the industry return-on-equity.

Current data indicates that the commercial auto insurance segment represents approximately $31.3 billion of the overall $591 billion annual property and casualty insurance industry premiums in the U.S., in 2015. Our market research indicates that the niche in which we focus, represents approximately $2.25 billion of the broader commercial auto premium. To be clear, this figure includes only full time professional taxi, limo/livery and para-transit drivers. Some of these drivers are dispatched either part-time or full time by transportation network companies.

Part-time driver, using personal cars were being dispatched via 'ride-sharing' apps, are incremental to the addressable market we target and are not included in the $2.25 billion market size I mentioned.

As regulations continue to evolve across the country, and if these drivers are required to purchase commercial insurance in the same way traditional operators do, besides with the market for our products, will expand further. Generally speaking, policies or regulations mandating safety and appropriate insurance coverage are positive for our business. There are a number of moving parts in this burgeoning expansion market and new information develops on a weekly basis.

Recently, a number of new specialty-focused transportation network companies have launched. Some are true startups and others were developed by traditional taxi and livery operators. We are working with some and talking with many. Our research confirms that in most cases until regulation and our business policy mandates that appropriate insurance be purchased, the private passenger rideshare market will not support the premium level necessary to generate an underwriting profit. We will be prepared and well positioned to expand into these 10 gentle markets at such time, as we are confident that demand will support adequate pricing and recognize our view of the products and services that Atlas provides. Our commitment to machine learning based analytics and partnership with multiple external technology partners, will also play an important role in this area as well.

In the meantime, we are very optimistic about the prospects in our current target market. Insurance is a cyclical business, with that in mind, our goal is to properly position the business in order to maximize our return to each point in the cycle. We believe we have at least, roughly 12 to 18 months of visibility with respect to pricing, giving us a good idea of where we are in the cycle. At present, the price environment is favorable, and we are not seeing any signs of a new disruptive entrant into our niche market.

Furthermore, as broader commercial auto continues to pursue rate increases, it seems unlikely, that larger general ones will outsource underwriting to intermediaries like managing general agents. Both of these things give us confidence that our market will not soften in the near term. Obviously, this is something that we monitor carefully, and intend to be very transparent, should we see even early signs of the market shift. We will also be prepared to take full advantage of attractive M&A opportunities as we did early in Atlas' lifecycle, when the market was soft.

As shown on slide 5, in the quarter, our core commercial auto premiums grew by over 42%. To support this growth in a managed and healthy fashion, Atlas has maintained steady statutory operating leverage and invested in people and technology. Year-over-year growth was achieved in the majority of markets in which we write across the country in the first quarter. Additionally, after successfully integrating Global Liberty into the Atlas Group of Companies in 2015, we are focused on leveraging that platform in order to continue our growth in the large and important New York market.

From a net-written premium to a GAAP equity standpoint, we are comfortable that using the capital management tools we have put in place in the form of our debt facility and quota share reinsurance program will allow us to manage operating leverage to increase throughout 2016 without creating pressure on our ratings. Virtually all of our operating metrics are at the best level seen, since Atlas' inception, enabling us to drive strong bottom line results and return on equity.

Net income after-tax for the quarter was $4.8 million or $0.38 per diluted common share. This compares with $2.1 million or $0.17 in last year's first quarter. Please note that for the last several quarters, we have been providing non-GAAP operating income comparisons, as we transition to a normalized corporate tax rate in 2015. With that now behind us, our tax rate should be comparable period-to-period at the normal U.S. Federal tax rate, and thus, we will not be providing this non-GAAP comparison going forward, unless there is a special situation where it may be helpful to provide additional clarity for investors.

Book value per diluted common share for Atlas in March 31, 2016 is $10.73. Atlas' increased book value over each of the past 14 quarters, with a 5.7 increase over Q4 2015 and a 16.3% increase over Q1 of 2015.

Overall, it was a very successful result. We like to make a point of emphasizing the fact that, while we are proud of our results in the period, 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 have discussed previously, our loss ratio can vary quarter-over-quarter, but as you can see, our result was very good and continue to trend, that has been several years in the making.

Typically, it takes approximately 18 months for the effective pricing activity to be seen in our financial results. Our first quarter loss ratio of 59.7% was roughly in line with our full year 2015 loss ratio of 59.2%, both of which are consistent with the pricing activities undertaken in 2013 and 2014. As noted earlier, it is our expectation that the impact of more recent pricing activity in 2015, coupled with the implementation of new analytics tools, will result in further improvements in this area.

On slide 7, we have displayed our in-force premium which was $220.6 million as of March 31, 2016. The green portions of the bar in 2015 show the premium resulting from the Global Liberty acquisition. With that fully integrated in 2015, and a resulting growth in 2016 and beyond, we will be organic. So on a go forward basis, we will focus only on overall growth, until such time as another potential acquisition is made.

On slide 8, our premium by state is summarized for the quarter. As we have noted before, the Global Liberty acquisition resulted in New York being our largest state on a percentage basis. With the stated goal of achieving proportionate market share across the country or approximately 20% of the $2.25 billion in addressable premiums in our niche during favorable market conditions, we still have ample room to leverage our current distribution for growth, with desired underwriting results.

A key theme we'd like to reiterate, is the role that our agency partners play in our successful growth. As a [indiscernible] between Atlas and its policyholders, agents play an important role in communicating our value to the marketplace, while at the same time, evaluating accounts to bring us quality underwriting opportunities. We are selective in the agency partners we work with, seeking those that are finally attune to the needs of our marketplace and with the value we bring to bring to it.

It is worth noting, that while we elected not to appoint a meaningful of new agents in the first quarter, based on the fact that we feel confident our current channel is efficient and represents us effectively on a nation-wide basis, we were approached by a record number of agent seeking contracts with Atlas. This is another good indication that market conditions remain favorable from our perspective. It is also demonstrative of the fact, that we will never compromise underwriting profit for top line growth.

We look to our agency partners as a source of valuable market intelligence. With the national network of specialized focused agents, we were able to gain valuable insight into where our market is headed, allowing us to be proactive in our operations. We are also leveraging our national footprint, to assist agents in understanding potential areas of industry expansion [indiscernible] commercial auto. One aspect of this innovative approach, includes expanding brand awareness among the increasing number of owner-operators were being dispatched via mobile apps, and ensuring that our agents and customers are properly informed of both the opportunity and the impact on their business.

As this market continues to expand and develop, we are committed to ensuring that our internal research and development, as well as technology and analytics partnership, position us effectively to generate profitable business in new areas, as opportunities materialize. That said, we continue to remain committed to the traditional operators who represent the bulk of our business and the addressable market overall, as well.

Turning to slide 9, we show metrics that help us monitor and evaluate the efficacy of our distribution channel, as well as the strength of our brand and market conditions. Our pricing and product management have delivered consistent results in connections with these metrics throughout the past three years. In late Q3 of 2015, we began rolling out a new point-of-sale system. As noted last quarter, the implementation impact of the format of the data seen on slide 10 for Q4 of last year, and again in Q1.

In the new system, we are tracking all submissions, not just those that we quote. As a result, the numerator on our hit ratio has increased and the results and target level is 52%. At our Investor Day next week, we will highlight some of the positive trends that this innovation has had in our operations, along with other key analytics and technology partnerships.

On slide 10, we show new business submissions, renewal rates and total vehicles in-force. Renewal retention remains strong, and we are managing to an 85% target. New business submissions are tracking ahead of last year, which is generally a positive indicator of future business. The proportionate number of owner-operators as a percentage of all applications, continues to increase as well. As we have discussed before, this trend was anticipated and is positive from Atlas' perspective, given our focus on smaller accounts.

Moving to slide 11, we know that managing volume, operating margin, and financial leverage should result in a maximizing of return on common equity and long term value creation for shareholders. At March 31, 2016, our operating leverage is measured by net written premiums as statutory surplus remain roughly 1.5 to 1. This ratio has been relatively flat, as our retained statutory earnings growth, and we utilized our quota share in that facilities. Managing this ratio was important from a regulatory and rating agency perspective.

At the same time, our gross written premium to GAAP equity dropped slightly to 1.38 to 1 during Q1, as a result of retained earnings growing marginally faster as a percentage than premium, and there is room for this leverage to increase without creating any need to raise external capital.

I will reiterate, that we regard being a good suitor [ph] 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 outward bounce for the company's operating ratio is two to one, 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 continue 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 this growth may require.

With that, I will once again turn the call over to Paul, for a more detailed review of our financial results, and then I will 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 13. As always, we encourage you to reach out to Scott or myself with any follow-up questions.

Gross premiums written increased 42.4% to $64 million compared to $45 million for the three month period ended March 31, 2015. The primary driver of this growth was the continued market expansion that Scott has highlighted and continued pricing improvement across the company's core lines.

At March 31, 2016, in-force premium was $220.6 million, and the gross unearned premium reserve was $180.8 million. We continue to see 50% of gross premiums written under quote share contract for American Country, American Service and Gateway, which began in Q2 of 2015. Also, during the first quarter of 2016, we renewed Global Liberty's reinsurance program with similar terms to those utilized by our other subsidiaries, which ultimately reduce the effective cost of the program. For 2016, Global Liberty's reinsurance session level was increased at 25% versus the 2015 session rate of 20% of subject written premium.

Net premium earned increased by 38.4% in the three month period ended March 31, 2016 to $41.9 million. Atlas' loss ratio increased to 59.7% in the three month period ended March 31, 2016 from 56.1% in the three month period ended March 31, 2015. The loss ratio increased relative to the prior period was primarily due to unfavorable development on mandatory signed risk programs, which represented 0.7% of this ratio in the quarter. Also, for the three month period ended March 31, 2015 favorable development on Gateway's commercial program created a 6.2% decrease in a loss ratio for this prior period.

Underwriting expenses, is comprised of a combination of acquisition costs, which are agent commissions and premium tax expenses, net of seeding commissions received our quota share reinsurance contracts, plus other underwriting expenses.

Excluding the impact from share based compensation expenses and the impacts related to acquisitions and stock-based purchase agreements, the underwriting expense ratio was 24.7% in the three months period ended March 31, 2016 compared to 26.9% in the prior year 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 March 31, 2016 was 84.4% compared to 89.8% for the three month period ended March 31, 2015. Underwriting profits, which is the income produced prior to investment income, increased to $6.5 million from $3.1 million in the prior year period, representing 110.9% increase.

Atlas generated net investment income of $653,000 and $520,000 for the quarters ended March 31, 2016 and 2015 respectively, as well as $239,000 and $137,000 of realized gains for the same periods respectively. The gross annualized investment yield on our fixed income portfolio was 2.1% for the quarter ended March 31, 2016. In the quarter, there were approximately $327,000 of losses related to private placement investments; ILS Funds and private placement investments backed by real estate, which are accounted for, under the equity method.

These investments represent less than 5% of our cash and invested assets and we expect them to return to a gain position in future quarters. Typically, gains from these investments have offset our investment expenses, which have been approximately $200,000 per quarter.

Atlas reported net income of $4.8 million during the three month period ended March 31, 2016, compared to net income of $2.1 million during the three month period ended March 31, 2015, representing 125.1% increase. Atlas generated $0.38 per common share diluted for the three month period ended March 31, 2016. This compares to $0.17 per common share diluted as reported for the three month period ended March 31, 2015. For the first quarter of 2016, annualized return on common equity was 15%.

On slide 14, we provide more detail regarding the income from operating activities. This analysis should be helpful in understanding the business outside of a few atypical items we have voted in the past quarters. This internal non-GAAP performance measure is used in the management of the company's operations, that represents operational results, excluding as applicable, net realized gains or losses, net impairment charges recognized in earnings, and other items.

Adjusted operating income after-tax, which is an indicator of the overall incremental profitability, growth of our organization, is $4.4 million or $0.34 per common share diluted in the first quarter of 2016, as compared to $3.5 million or $0.27 per common share diluted in the same quarter last year, representing a 25.7% increase.

On slide 15, we detail the components of book value. We increased book value to $10.73 during the first quarter of 2016 from $10.15 at December 31, 2015. For the bottom of the slide, we step through the key elements that impacted book value year-to-date.

Over the next two slides, we outline Atlas' balance sheet position. Atlas' cash and invested assets at March 31, 2016 increased to $238.4 million compared to $233.4 million at December 31, 2015. The increase is primarily attributable to the increase in premium writings.

Unearned premium balances, which represent premiums corresponding to the time periods remaining on the underlying in-force policies were $118.8 million compared to $108.2 million at December 31, 2015. This increase is a result of continued organic growth.

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 of LIBOR plus 450 points for the use in connection with our statutory entities, plus another $5 million of LIBOR plus 275 basis points for other general corporate purposes.

As confirmed via 8-K this morning, the terms of our credit facility with Fifth Third Bank were enhanced. The initial one year revolver was extended by two additional years and a draw period related to the five year credit facility was extended through the end of this calendar year. Flexibility was also added to allow the redemption of certain preferred shares, which may be utilized in connection with exclusion of the post-closing components and the stock purchase agreement related to Gateway. The interest rates, as previously communicated, along with the other terms of the facility, remain unchanged.

To-date, we have drawn $15.5 million from the $30 million credit facility and infused these funds to the ASI pool companies, which include American Country, American Service and Gateway, in the form of surplus notes. We also drew $2.4 million on the $5 million credit facility to support the needs of the premium finance company we acquired in the global liberty transaction. Interest expense related to this facility was $233,000 in the current quarter.

As an investment philosophy, we continue to place a priority on preservation of capital to support future premium growth. Our investment duration of 3.2 years remains consistent with the expected liquidity needs and client 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 investment portfolio was detailed on slide 17; because we intend to hold securities in maturity, while any increases in interest rates could create an unrealized loss in the short term, we do not expect such losses to be realized.

Working with our outside investment advisor, we monitor positions in our portfolio closely, especially in light of any recent world events.

With that, let me turn the call back 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 Atlas' niche within commercial auto. We have been consistent in communicating several key themes, that provide a positive macro backdrop for our business.

First, despite our recent growth, we have still only captured a single digit market share in most of the states in which we operate. This provides us with ample runway to grow, as we pursue our target of the 20% market share in each of the markets we serve.

Second, commercial auto is a high frequency line of insurance. This allows us to distinguish ourselves in the market, especially, relative to generalists that may enter our space The operators with whom we work, depend on us to provide timely and effective claim service, in order to maximize the uptime of their vehicular assets and protect from them non-meritorious liabilities. That service component creates real value to our customers, and allows us to charge a premium price for the products we write.

We also expect that it will allow us some buffer against aggressive price competition in our markets, when softening is ultimately observed down the road. A third element that has been getting more attention recently, is the growth of ridesharing services such as Uber and Lift, as well as mobile phone and internet-based dispatching technologies, designed for more traditional operators.

Overall, we see these emerging technologies creating an overall increase in the usage of on-demand writership, whether it occurs in the traditional taxi, livery vehicle, or in a rideshare vehicle.

As the ridesharing market evolves, we support the inclusion of proper insurance products that safeguard both drivers and passengers. With this evolution, we see Atlas as well positioned to benefit, given our solid track record, expertise and significant data in the specialty commercial auto space, coupled with our commitment regarding technology and analytics. While our research and development in this area is ongoing, we are committed to exercising the appropriate level of discipline and patience necessary, to ensure that we achieve the same expected underwriting profit from any expansion line, as we do in our current core business.

Recapping the trend we have seen over the last several years, slide 19 detects loss performance for the commercial auto sector, versus the broader PNC Group. Beginning in 2012, the commercial auto group began to experience greater loss performance, due primarily to increased severity. We have not experienced these issues, primarily based on our narrow focus, expertise as a specialist and a relatively lower limit profile of our business. While ours is a high frequency segment, severity is generally much lower than broader commercial auto.

We actually look at this with a [indiscernible] perspective; a high frequency marketplace demands a heightened level of service, when it comes to claims processing, so that asset downtime can be minimized. The independent agents that we work with know this, and that this is an area where we excel, and are thus further motivate to direct their customers to Atlas. This, coupled with overall increases in commercial auto pricing, should create future blends [ph] in our space.

On slides 20 and 21, we provide recent industry pricing trends. In recent quarters, we've begun to see some retranching of pricing, which is a positive for Atlas, as generalist competitors are less likely to attempt to disrupt our market. Additionally, weaker players find challenged markets to be a more significant headwind than we do, thus creating more incremental opportunities for us to pursue targeted horizontal M&A.

Data from the Council of Insurance Agents and Brokers, shown on slide 20, illustrates commercial auto pricing in general, increasing again in Q1. Notably, as seen on slide 21, the smaller the account size, the more insulated the account was, with respect to pricing declines in the broader market. With most of Atlas' target market consisting of small fleet markets and individual entrepreneurs, we are well positioned relative to generalists, who focus on larger accounts.

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 niche markets. We have a track record of successful acquisitions, that were incremental in terms of infrastructure, accretive to both the income and book value, and with attractive valuations. We are cultivating a pipeline to ensure that Atlas is well positioned to build on this capability down the road.

Let me conclude by reiterating our estimates and thoughts on 2016, which are much the same as when we spoke with you in March. We believe that we can continue to write business below a 60% loss ratio, with incremental rate increases in the mid-single digits, while organically growing in excess of 30% on a full year-over-year basis. Provided market conditions remain favorable, we believe Atlas can produce high teens return on equity, that exceed the industry by 500 to 1000 basis points. Our management 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 in the high side of this range for the full year 2015, while the company continues to have significant organic growth opportunities.

Now that our new policy management systems 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 in the future.

We are also excited about the potential relative to our increased use of predictive analytics and in-vehicle technologies to add another level of sophistication and efficiency to our operations. And as always, it's important to acknowledge the great experience and dedicated members of the Atlas team. None of these achievements will be possible without their commitment and expertise.

As I noted at the beginning of the call, we expect to write between $260 million and $290 million in premiums 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 will always put a priority on margin and operating leverage over premium growth on an absolute basis. It is also important to note, that as observed in prior years, there is seasonality in our business and the rate of growth in any given quarter can vary, as a result.

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

Question-and-Answer Session

Our first question comes from Paul Newsome with Sandler O'Neill and Partners. Please proceed.

Paul Newsome

Good morning. Congratulations on the quarter. I was hoping if you could talk a little bit more about how you see the level of price increases relative to underlying claim cost inflation?

Scott Wollney

Sure. So we are observing claim cost inflation at about 1% to 2%. In terms of new business, we are pursuing high single digits so 7% to 9% in most geographies. Some more, some less, depending on the competitive environment locally, and for renewal business, consistent with what we communicated on last quarter's call, we are seeing more moderate rate increases of kind of mid-single digits, I'd say 3% to 5% depending on the profitability of the renewal accounts, and sequentially, the amount of rate increases that they have experienced over the last couple of years, depending on how long they have been insured with us. So most of the activity, is a good sense for kind of the spectrum of increase, but also the net benefit to us, based on the expected loss contemplation.

Paul Newsome

So how mechanically should that translate into loss ratio above --

Scott Wollney

Really, that is the way that we like to think about it. So we have indicated that we are pricing to below 60% in all areas. I think if you use the past activity as a guide, we have mentioned that it takes about 12 to 18 months for price activity to kind of flow into the financial results. If you look at the year-over-year change, 2013 to 2014, we saw about 1.6% improvement in the loss ratio on a full year basis. 2014 to 2015 was about a 3.1% increase on a full year basis. So 2015 to 2016 for the full year, I think we, at this point, expect the improvement to be somewhere in between those two amounts, so call it somewhere between 1.5% to 3% full year, and again, as we always comment on a quarter-to-quarter basis, there can be some variation in the actual carried loss ratio.

Paul Newsome

Thank you very much.

Scott Wollney

Thanks for the questions Paul.

Operator

Our next question comes from Ryan Byrnes with Janney. Please proceed.

Ryan Byrnes

Hi, great. Thanks. Good morning everybody. I just had a clarification on the other income, which it sounds like some of the real estate, and I guess, capacity bond investments. Do those investments run on any sort of lag or are those reported on a real time basis?

Paul Romano

There may be a quarter lag in some of those valuation reports that we get, or even a month's lag in some of the valuation reports. So there is not much of a lag between the actual results and when we record it.

Ryan Byrnes

Okay, great. So I just have to figure it -- so most of the pain of -- obviously the January and February markets are showing up in the current results?

Scott Wollney

Correct.

Paul Romano

Correct.

Ryan Byrnes

Great. Thanks for that. And then secondly, on the revolver, I know you guys noted that you may look at some of the preferred issuance. Are there any prepayment penalties on the preferreds or any one time costs that we should think about?

Scott Wollney

No. There is n prepayment penalties on the revolver, nor is there any penalty, if we were to redeem preferred shares in connection with -- in this case, the Gateway transaction. We are in that window. The terms of the stock purchase agreement allow us to begin redeeming preferred shares that were issued as consideration of partial consideration for that acquisition, after the third anniversary. But we are not obligated to do so, and they are not convertible by the holder, until the fifth anniversary. So we are basically in a two year window, that gives us some flexibility in terms of timing, and what we might do there.

You might recall, we had a similar structure when we acquired American Country and American Service, and once we were in the elected [ph] window to redeem, we did ultimately negotiate a discounted redemption, and so we did that early in the window. But obviously, we look at every situation independently and do what we think is going to be most accretive in terms of book values.

Ryan Byrnes

Okay, great. Thanks. That's all I had.

Scott Wollney

Thanks for the questions.

Operator

Thank you. Our next question comes from Brian Hollenden with Sidoti. Please proceed.

Brian Hollenden

Good morning guys. And thanks for taking my call.

Scott Wollney

Good morning.

Paul Romano

Hi Brian.

Brian Hollenden

Can you talk about how much of your premiums were renewal business versus new business?

Scott Wollney

So overall, our renewal retention was about 85% in the quarter, and for the majority of the business that we have in force, is actually renewal business. I don't have the exact number off the top of my head, but we certainly can drive it and provide it to you Brian, as a follow-up for modeling purposes. But we are looking for the full year for an organic growth rate of about 30%, and so that's probably a good number to use, in terms of extrapolating what full year new business would be, as opposed to renewal. Obviously, the balance of the book of business would be renewal in the second through fourth quarters.

Brian Hollenden

Thank you. And then gross premiums written in growth occurred in 26 of the 41 states you write premiums. Has competition picked up in those other states? Can you talk about that dynamic?

Scott Wollney

It's not really so much of an issue of competition as when we implement incremental rate increases. Sometimes it does take time for the market to catch-up. And so certain instances, where we put significant rate into the market, we do see a bit of a lag in terms of when the new business is able to start coming online at those higher rates. Obviously, that is something we monitor very closely, to make sure that we are not being too opportunistic.

The second thing really is that, in some areas, prices are at a level where sort of the market tolerance for incremental rate increases may start flattening out. And so again, we want to manage that. And that is part of why I commented earlier, in response to the first question that, the amount of benefit on the bottom line in terms of rate activity in 2016 is probably going to be somewhere in between, what we saw in the last two years. So we are still expecting marginal benefit and we are not seeing a significant impact from new competitors, but the reality of it is, we do have a premium product we charge a premium price for. But there is only so much incremental rate that we are going to be able to get and maintain the hit ratios that we target.

So it's all really a balance, and we try to balance all of those things to maximize that combination of margin and operating leverage. And so that's really, what we are using in terms of valuating the information and making decisions.

Brian Hollenden

Thanks. I will jump back in the queue.

Scott Wollney

Okay. Thanks for the questions.

Paul Romano

Thanks Brian.

Operator

Thank you. Our next question comes from Dan Farrell with Piper Jaffray. Please proceed.

Dan Farrell

Hi Scott. Good morning.

Paul Romano

Hi Dan.

Dan Farrell

Just a question on growth and seasonality. If I look at the -- [indiscernible] your organic contribution in the first quarter seems a little lower than sort of 30% you are talking about. And now that we have sort of passed comparisons on [indiscernible] that has been done, can you just remind us again of some of the seasonality that impacts your business quarter-to-quarter, and what we should be thinking about?

Scott Wollney

So I think the two key issues with seasonality, in the first quarter, Chicago has a common renewal date of January 1st for taxi business, and New York has a common renewal date of March 1, for most of its taxi and livery business. And so as a result, it has been the case that, seasonality or growth -- due to [ph] seasonality in the first quarter has always been relatively lower than other quarters. It's also the case that the companies we own, have their most mature market positions in those two student states. Although as I commented earlier, we still expect that there is meaningful opportunities for growth, in particular in New York. The second seasonality impact that we see in our book, is in the third quarter. Our Excess Taxi program, which is also written to the New York market, has a renewal date in the third quarter. And so, that will, to some extent, impact the amount of percentage year-over-year growth we see there.

Outside of that, I would expect that the second and fourth quarters probably would see seasonality similar to what you'd see if you looked at those quarters, relative to the other quarters in prior years. But again, we are really trying to look at things on a full year basis, and give good guidance in terms of what we think the overall expectation is going to be; because it is difficult to really predict quarter-over-quarter, given the dynamics of the market that we are in.

So hopefully that's helpful, just in terms of providing some perspective.

Dan Farrell

It is. And then just a question around the expenses? I know you have given the guidance range, total expense ratio; how are you thinking about pacing of investments? I know you have talked a lot about also increased use of analytics, predictive model etcetera. I am just wondering, how you are thinking about pacing those investments through growth and sort of how you see the trend of expense ratio? Thanks.

Scott Wollney

Sure. So we do want to manage the expense ratio within the 24.5% to 26.5% range. we have commented before, that as we are growing at the healthy growth rates that we currently are, we do want to make sure we are investing in people and infrastructure to keep up with that growth. So that is a near term, but relatively variable expense.

The second piece is, as we over time, get to a more mature market position, we do expect to drive the expense ratio down in the lower end of that range. And as we are doing that, we will probably be following back more dollars into future horizontal expansion, research, development etcetera, into new opportunities down the roads. But right now, the real focus is making sure that we are delivering that strong value proposition, that allows us to charge a premium price for premium products, really maximize the opportunity in the current market environment, but still maintaining an expense ratio within the range, albeit probably on the high end that we have described.

The second thing that I think is worth noting, and I touched on this, and we will talk a lot more about it at our Investor Day next week; we have established a number of key partnerships with analytics, partners, as well as technology partners. And so that gives us the opportunity to really work with them on innovative forward thinking applications that, to a great extent, and even in some cases, are not used at all in the commercial auto space. But, they are making the capital investment and technologies and we are really providing the intellectual capital, to help them think about how their technologies can be deployed in the insurance space, and obviously help make sure that are able to be a first mover in terms of doing that.

So when it comes to some of those types of investments, it should not be a capital intensive investment on our part. In other words, we won't have a significant amount of fixed costs related to those, because we are partnering with technology companies, who are already going down that path. We are really working with them, to make sure that we can benefit mutually from working together, but without having to make a significant investment at our end, in terms of the technology development itself.

Dan Farrell

That's helpful stuff. Thank you very much.

Scott Wollney

Thanks for the questions.

Paul Romano

Thanks Dan.

Operator

Thank you. Our next question comes from Chris Brown with Aristides Capital. Please proceed.

Chris Brown

Good morning guys. Just had a question on the guidance for the high teens return on equity. So I think as that you intend to be exiting the year at a high teens return on average, that could reach the fourth quarter or is that more intended to say, that you expect a full year 2016 high teens return on average equity?

Scott Wollney

Well, so the first quarter annualized was 15%. Obviously, we would like to improve it from there. And so, certainly we'd expect to exit the year higher. But for the full year, it should also be greater than the 15% that we saw in the first quarter. So our plan for this year, barring an incremental acquisition or something like that, would be to continue to improve quarter-over-quarter, in terms of return on equity, both, because we do expect our GAAP operating margin to migrate up in a managed way, for the reasons I touched on and also, because we do expect to continue to improve our operating margin.

Chris Brown

Okay, great. And in terms of being self-funded for the year, is there a certain stock price at which, as a two times book or 2.5 times book, somewhere, where you would -- the calculation between ceding versus issuing new equity kind of changes, and you would be more accretive as opposed to [ph] issuing new stock?

Scott Wollney

Well I think our view has always been that, we would not raise equity capital just because we could; and so, our expectation is that, if we were to raise equity capital using incremental equity, it would generally be, because it's in connection with a specific significant transaction and acquisition, not simply to raise capital for the sake of doing that. Again, we have internal tools that we feel comfortable, allow us not only to be flexibly, but also, it gives us the ability to take pressure off the balance sheet from a statutory leverage standpoint, in a very frictionless way.

So borrowing against the line or utilizing incremental quota share, had relatively low cost of capital and allow us to utilize them and then unwind them, again, in a relatively frictionless way. And so for all those reasons, that would be our primary way of managing our capital leverage, as opposed to just thinking about some stock, simply because we could.

Chris Brown

Okay. Great. Thank you very much.

Scott Wollney

Thanks for the questions.

Paul Romano

Thanks Chris.

Operator

[Operator Instructions]. Our next question comes from Ron Bobman with Capital Returns. Please proceed.

Ron Bobman

Hi. Thanks and good morning.

Scott Wollney

Good morning Ron.

Ron Bobman

I had a couple of questions; Scott, you mentioned a couple of times, and I sort of -- you roughly used the words, we target a retention ratio of -- I want to say, 85. But in essence, you highlighted the point that you target a retention ratio. And I don't hear that too often, and I am wondering why you, in essence have a target ratio? I can obviously understand sort of an underwriting level of profitability or pricing adequacy, but having explicit retention rate is noteworthy to me.

Scott Wollney

Yeah. The reason that we are -- first, it's important to put it in the context of where we are in the market cycle in our niche. So we are in a favorable side of the cycle, and so the business we are riding obviously, is that a combined ratio in the mid-80s right now. And so, we look at that margin as being beneficial, and so, as we continue to increase rate, when I say we are targeting a retention ratio; if we increase rate on renewals to a point where the retention ratio starts to drop, we may rethink whether or not we want to be more moderate. And the reason that that's valuable, is at the current margin, if we can maximize the combination of margin and operating leverage, because of the fact that we do still have, for the lack of a better description, some dry-powder, in terms of our capital base. That is going to be return on equity maximizing for us.

If we were in a softer market cycle, I think we would look at that retention ratio differently. We would be focused almost exclusively on preserving underwriting margin, and not thinking about it so much as the way to moderate increasing price. So some of it is specific to where we are in the market cycle, and it also is coupled with the fact that, again, we do have the opportunity to increase operating leverage, without needing to go out and raise equity capital and we want to take advantage of that, at the kind of margins we are currently generating or better.

Ron Bobman

Okay. Thank you. Had a question about -- and I clearly recognize that you are a specialty commercial auto writer. But obviously, there are other segments for the wheels business, the standard auto, and even I guess the non-standard auto business, is seeing some dynamics in the area of frequency and severity. And I am wondering if you have any evidence of those developments in your -- again, specialty areas of commercial auto?

Scott Wollney

Sure. That's a great question. It is something we watch very carefully, and in fact, we like to look at that from a very skeptical point of view. In other words, if something is affecting lots of other people in the industry, we start with a perspective, it should affect us or why shouldn't it affect us. We are not thinking about it. We don't want to fit the data to our conclusion in other words. But so with that perspective in mind, we do look at it very carefully, and we have not seen any significant upticks. I think in the area of frequency, what we have heard from a lot of the larger, especially personal lines writers, is that frequency is up because of low gas prices, and which is resulting in increased amounts driven, and also distracted driving.

So in the case of our niche market, our clients generally will use their vehicles, to the extent they can to fully deploy them in the market. In other words, if there is demand for rides, the vehicle is going to be out on the road, picking up rides. And so the price of gas, does not create much elasticity in terms of miles driven in our niche. So I think, that's the first reason we haven't really seen a change in frequency.

The second thing is, just being blunt, I think our drivers have always had a tendency to be somewhat distracted. There is a passenger in the back. They are using navigation tools, they are dealing with dispatch. And so, in fact, most of our drivers and the operators that dispatch our drivers, have been really aggressive about discouraging texting and some of the other things that are creating distracted driving on the personal lines side. So I think, the fact that some of that distraction, just because of the niche, where the driver is already based into the results that we use for underwriting purposes, and we have obviously got a lot of that data across the nationwide market, where we write, because of the heritage of all the companies we own. Coupled with the fact that, again, these are professionals, so I think are really, being managed or trying to manage that experience. So you don't see as much arbitrary texting and driving and that sort of thing.

So again, it's something we are monitoring. We are obviously wanting to make sure we are increasing, looking at ways to underwrite on a behavior based sort of basis. But I think that's our current conclusion on frequency.

And then in terms of severity, that's really a little bit different, and primarily the fact that most of our accidents are relatively low speed, low impact. And so it's more fender benders than kind of [indiscernible] highway accidents that a truck might have.

Second thing is the limited profile is just a lot lower. The typical limit we have is going to be less than $1 million for virtually all of our segments, especially taxi, which is our largest segment. And so you don't see the kind of significant multi-million claims of these settlements that you are going to see in the heavy commercial side. And again, I think that's a lot of what's been driving severity, in terms of the broader commercial market.

Ron Bobman

Okay. And then, I believe you have a very small book in Texas. And obviously, there has been some nasty weather in the first quarter, which is presumably reflected in your numbers. But I was curious to know about April, I think there was incredibly flooding in Houston and then monster-size hail in San Antonio; anything noteworthy sort of beyond the otherwise expected level of weather losses that you could mention or --?

Scott Wollney

Sure, it's a good question. Our business has a rule, it's not very catastrophe exposed. We do not ensure physical damage on garages or other physical infrastructure, and we are only writing physical damage, probably on about 20% to 30% of the fleets we insure. Most of our exposure is for the third party liability. And so, the third liability doesn't really increase when you have storm activity, sometimes it can decrease, because you don't have a lot of people out in the street, hailing cars. And as we saw for example, with Sandy, back in New York; there just wasn't a significant pickup, because the vehicles that we are insuring, are typically being moved kind of out of harm's way.

So as I say, we haven't seen a significant increase, as a result, that I wouldn't expect it, based on historical experience, other severe storms. But again, a lot of it just has to do with the fact that the thing that we are insuring -- or the things that we are insuring, aren't the assets that tend to get damaged, in the case of flooding and storms.

Ron Bobman

And my last item is really a comment or a request; can you endeavor to report your results earlier in the season, so to speak, sort of closer to the quarters in -- for which you are reporting, and less close to the current quarter that you are operating within? You're really sort of in the last 5% of companies reporting, and I think for -- if I think, sort of best practices or even average practices would have several days, if not weeks earlier?

Scott Wollney

Sure Ron. Appreciate the feedback. I think, some of what has informed our timing, has been the fact that, we have over the last five years made four acquisitions that were all relatively meaningful for the size of the business and wanted to make sure that we were managing the integration of that into the financial reporting, because all companies or at least, most recent two companies we bought were private, and so there was a bit of a transition, in terms of continuing to do statutory reporting, but then also layering on to it, the GAAP reporting. But I think that is a fair point, and certainly something we can take into consideration.

Ron Bobman

Thanks. I think also what transpired yesterday, is you'd also reduced the risk of that. So thanks and good luck and hope it continues.

Scott Wollney

Appreciate that. Thank you for the questions and suggestions Ron.

Operator

Thank you. I'd like to turn the floor back over to management for closing comments.

Scott Wollney

Great. Thanks to everyone for joining us. We look forward to seeing many of you at our Annual Investor Day next Monday, May 16th at our headquarters location, that's west of Chicago. We have received favorable feedback from investors and analysts on the event we held last year, and are expecting a great turnout this year as well. If you're interested in attending and have not yet RSVPed, further information is available at the end of our conference call presentation materials. And as always, we look forward to speaking with each of you again in the future. Thanks very much.

Operator

This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.