**Atlas Financial Holdings' (AFH) CEO Scott Wollney**

**2016 Second Quarter Transcript**

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Executives

Scott Wollney
President, Chief Executive Officer, Director

Paul Romano
Chief Financial Officer, Vice President

**Operator**

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

It is now pleasure to introduce your host Mr. Scott Wollney, President and CEO of Atlas Financial Holdings. Please go ahead Mr. Wollney.

**Scott Wollney**

Thank you very much Denise and good morning everyone. With me today is Paul Romano, our Vice President and CFO. We are very pleased with our second quarter results, which were highlighted by bottom line improvements, significant sequential rate increases resulting in higher average premium per vehicle, and considerable book value appreciation. This morning, we'll discuss Atlas' results and share our thoughts regarding commercial auto and some of the trends that we're seeing within our niche markets.

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.

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

**Paul Romano**

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

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'll begin on slides 3 and 4.

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

**Scott Wollney**

Thanks Paul. The second quarter of 2016 was a strong period for the company with bottom line results coming in and our expectations in continued improvements in earnings per share, ROE and book value. We're still seeing favorable pricing trends in our markets targeting a better than 60% loss ratio in all areas with an overall expense ratio within the 24.5% to 26.5% range that we've communicated in the past.

In the second quarter, this lead to underwriting income of $6.4 million, almost 30% increase over the same period last year. We delivered return on average common equity of 14.6% consistent with our objective of beating the PNC industry by 500 basis points to 1000 basis points and continue to believe Atlas can further improve upon this result over time provided market conditions remain favorable.

Our focus on bottom line execution has delivered improvements in our operating results most recently resulting in a combined ratio of 84.8%. Year-over-year improvements help drive higher net income along with meaningful growth in book value. From the inception of Atlas, we've consistently communicated our team's commitment to a disciplined approach to growth, always prioritizing long term return on equities to better than average underwriting results to create shareholder value.

As I've mentioned in virtually every investor call from inception to date, top line growth will always be less important that maximizing under writing profit. This quarter is a great example of our commitment. We're continuing to see an overall expansion of the live public auto market while some expect to shifting from the traditional taxi cab business to our other lines of delivery, which we'll detail later in the call.

Market trends continue to remain favorable in both broader commercial auto and our niche segment and we believe that competitors may follow our price leadership, resulting in a return to recent growth rates with an even greater potential future underwriting margin. As has been the case in prior quarters where rates would increase significantly we will monitor key ratios to determine whether these rate levels are sustainable or need to be moderated.

In general, at this point we feel conditions are encouraging for a continuation of favorable pricing and profitable growth in the coming year. We are reiterating our forecast of writing 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.

During the second quarter, we did see gross premium growth in the single digits compared to the higher percentage growth in past quarters, but as we've discussed in the past, our premiums written can fluctuate from period to period and Atlas will maintain strong in force premium growth during the second quarter. We also have a very flexible quarter share program, which is available to help manage our balance sheet appropriately on a quarterly basis and can manage debt through our previously announced facility with their third bank as well.

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 long term return on equity over premium growth on an absolute basis. With this in mind, should market conditions support price levels that we believe will deliver better margins and return on equity in the long term by writing marginally less business we will do so.

Key elements of our financial results for the quarter as highlighted on slide 4 and 5 include increased underwriting profit and growth in our book value of over 11% from December 31, 2015 to $11.27 per common share as of June 30, 2016 and an 18.9% increase, as compared to book value as at June 30, 2015. We've 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 industry ROE by 500 to 1000 basis points.

As I mentioned earlier, on an annualized basis the company reported ROAE of 14.6% during the period. Atlas' second quarter combined ratio of 84.8% was considerably better than the 2015 combined ratio for the overall PNC industry of 98%. As discussed in the past, our expectation has been that future loss ratios should trend towards our prior years pricing targets over time.

We expect that the incremental rate we are able to achieve at this time based on our strong value proposition coupled with the current competitive environment will deliver incrementally more positive results in the future. While our loss ratio can move up or down in any quarter based on actual loss activity, it should generally continue to migrate towards pricing targets borrowing unexpected extraordinary losses.

As a result of our strategic focus and profitable growth, Atlas has increased book value over each of the past 13 quarters. Moving to the market and Atlas' performance in comparison. While the overall commercial insurance data for Q2 from the counsel of insurance agents and brokers has not yet been released, we are expecting to see incremental hardening.

In general, anecdotal evidence including both feedback from our distribution channel, as well as information shared by other commercial auto insurers indicate an ongoing need for more rate and the broader commercial auto segment. The overall commercial auto insurance market currently represents approximately $31.3 billion of the total $591 billion annual property and casualty insurance industry premiums in the U.S. in the past year.

Our market research indicates that the niche on which Atlas focuses 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 and are commercially licensed and insured. While this has created some shift in the market, we expect the overall market size to continue to grow in terms of total vehicles in operation.

Part time drivers using personal cars would have been 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 that these drivers are required to purchase commercial insurance in the same way traditional operators do, the size of the market for our products will expand further.

On slide 7, we show the impact of seasonality on our premium riding. As denoted in the left, the second quarter of each year represents the smallest amount of gross premium written compared to the full year. Also when looking at comparisons of Q2 versus Q1 over the last five years, historically gross premiums written in Q2 represent around 75% of Q1. Last year, the second quarter represented a higher percentage over first quarter due to the fact that we reported only a portion of Global Liberty's gross written premium for Q1 based on the date of acquisition.

During the first half of this year and in the second quarter in particular, we did see business transition from the taxi segment to delivery segment within our niche markets in terms of percentage of total premiums. On a year-to-date basis, for the ASI pool companies, our limo, livery and paratransit books of business were 79% and 42% respectively while taxi shrunk by 26%.

While we generated a larger percentage of our premium from livery and paratransit than from our traditional taxi service, overall growth remained positive and based on feedback from our distribution channel and insurance, we expect the reduction and available taxies to flatten out. As we've mentioned before, Global Liberty does not currently ride any New York yellow cab business. We also continue to see a reduction in terms of average vehicles per policy across both taxi and limo, livery. This trend is consistent with what we previously communicated as an expectation and it ultimately is a positive for Atlas given our focus on efficiently managing small fleet and owner operator accounts.

Overall, growth from policies in-force were consistent quarter-over-quarter and the vehicles in-force declining predominantly in the taxi service as some accounts to terse out of service. This was more than offset by growth in our livery and paratransit renewals. Our team will continue to closely monitor the overall growth in our market and Atlas should continue to benefit from a greater number of commercially license drivers on an overall basis. While the second quarter has historically been our slowest in terms of premium, we were successful in benefiting from organic growth opportunities in many of our markets despite what we believe is a somewhat temporary headwind in terms of a marginal reduction in taxis.

It seems clear that the owner operator delivery space will experience greater than historically average growth and we continue to maintain the belief that the law impact in the near term, the taxi industry will stabilize as well. The key to insuring that the industry change that I've described can be converted into opportunities as to maintain our niche focus on delivering Atlas the strong value proposition to our distribution channel and policyholders. As a result, we expect to continue achieving underwriting profit the levels considerably better than the overall P&C industry throughout multiple market cycles.

As discussed in detail at our recent Investor Day, we are simultaneously evaluating incremental uses of technology and analytics to ensure that our products and services evolve ahead of market needs as well. We've 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 ROE. The second quarter was clear evidence of our ability to build up around this goal.

On slide 8, we illustrate our consistent growth of in-force premium. Year-over-year this important metric grew 18%. The green portions were bought in 2015 to the premium resulting from the Global Liberty acquisition in the first quarter that year. With that operation fully integrated in 2015, any resulting growth from 2016 and beyond will be considered organic. The second quarter was the first year-over-year comparison on a full quarterly basis since the acquisition of Global Liberty.

On slide 9 our premium by state is summarized for the quarter. We continue to successfully diversify in a geographic basis and saw strong growth in states with relatively lower market share, the largest of which is California with the stated goal of achieving proportionate market share or approximately 20% during favorable market conditions we saw ample room to leverage our current distribution for growth and desired underwriting results.

I want to remind everyone that our Excess Taxi program in New York renews in the third quarter. This is a business arrangement providing excess coverage above the levels of risk retained by the insured and only a small number of medallion owners qualified for this program. Those of you familiar with the company know about the seasonal item, we wanted to make sure we explain that to any that may be new to the Atlas story.

Turning to slide 10, our new business hit ratio demonstrates the efficacy of our distribution channel as well as the strength of our brand and market conditions. In late Q3 of 2015, we began rolling out our point-of-sale system. In the short run, this implementation impacted the data seen on Slide 10 for Q4 of last year and again in Q1 and Q2 of this year. We had a change to detail the positive impact of this interface at our Investor Day in May. Our pricing and product management teams have delivered consistent results informed by this metric throughout the past three years and continue to monitor hit ratios closely to ensure that our pricing activity has the desired effect.

Demand for our products is at record levels with that location count up approximately 40% year-over-year and [indiscernible] Atlas in the first half of this year seeking appointments with our insurance companies, 145 of which were in the second quarter alone. As always, we remain very selective in terms of appointing new producers and focused on riding only the best business at price levels we feel reflect our strong value proposition.

On slide 11, we show new business submissions, renewal rates and total vehicles in-force. As noted earlier, while new business submissions are ahead year-over-year we are seeing retention renewals below our target levels as a result of the near-term impact of price increases coupled with the fact that there are fewer vehicles per application particularly in the taxi segment. The number of applications as well as premium per vehicle were in line with or ahead of our expectations.

As I discussed earlier, as mentioned on our previous conference call, lower average vehicle accounts per policy are likely a function of fleet operators reducing the fleet sizes probably as a result of the growth of our insurance services in certain local markets. Importantly as I mentioned at the beginning of the call, our average premium per vehicle in the second quarter was up 10% as compared to the same quarter last year. This was the high end of the rate increase range that I indicated on last quarter's call and we're monitoring the market closely to evaluate price elasticity.

Moving to slide 12, as of June 30, 2016, our operating leverage as measured by net premium written to surplus remained roughly 1.4:1. Managing this ratio is important from a regulatory and rating agency perspective. We know that managing volume, operating margin and financial leverage should result in the maximizing of return on common equity and long term value creation for shareholders. We're planning 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.

Specifically, we have flexibility to the use of increasing or decreasing quota share on a quarterly basis as a measure of maintaining this balance. This ratio has been relatively flat as our retained statutory earnings grew by approximately the same percentage as net premium growth. I will reiterate that we regard being a good suitor of capital as a critical element of our business and are committed to ensure that this capability is always treated as a core competency. With the objective of self-funding organic growth in mind, we will ensure that our operating leverage is properly maintained. Overall, it was a very successful quarter.

With that, I once again turn the call over to Paul for a more detailed review of our financial results, and then I'll return for concluding remarks.

**Paul Romano**

Thanks, Scott. Our financial overview in the slide deck begins on Page 13. I keep the quarterly financial overview relatively brief and as always we encourage you to review our filings and to reach out to Scott or myself with any questions.

Gross premium written increased to $48.4 million in the second quarter, largely as a result of continued organic growth in our core commercial auto business. At June 30, 2016 in-force premium was $219.8 million and the company's gross unearned premium reserve was $112.4 million. As Scott mentioned earlier, we do the flexibility to make changes to our quarter share session rates.

For Q3 2016, we are lowering the amount seeded under our quote share contract for American Country, American Service and Gateway insurance companies from 15% to 5% of subject premiums. The session rate for Global Liberty remains unchanged at 25% subject to written premium. This is a reflection of our continued capital strength and allows us to retain more of the profitable business we write in future periods.

Based on our current trajectory, this change should result in gradual increase to our GAAP operating leverage in future quarters. Net premium earned increased 9.1% in the second quarter of 2016 to $41.8 million as compared to $38.3 million reported in the second quarter of 2015.

Atlas' loss ratio remained consistent at 58.8% for the second quarters of 2016 and 2015. We continue to see our underwriting expense ratio falling within our target range of 24.5% to 26.5% of net premium earned and we reported the 26% underwriting expense ratio during the second quarter of 2016.

Underwriting expense is comprised of a combination of acquisition costs, which are agent commissions and premium tax expenses net of seeding commissions received under our quota share reinsurance contract, plus other underwriting expenses. Excluding the impacts from share-based compensation expenses, the underwriting expense ratio was 25% during the period compared to 27.2% in the prior year period.

Overall Atlas' combined ratio for the second quarter of 2016 was 84.8%, compared to 87% in the second quarter of 2015. Underwriting profit, which is the income produced prior to investment income increased to $6.4 million from $5 million in the prior year period or an increase of 28%. Atlas generates net investment income of $1.1 million and $1.2 million for the quarters ended June 2016 and 2015, as well as $155,000 and $44,000 of realized investment gains, respectively. This resulted in an overall annualized investment yield of 2% for the quarter ended June 30, 2016.

Atlas reported net income after-tax of $4.9 million during the three-month period ended June 30, 2016, compared to $3.9 million during the prior year quarter. Atlas generated $0.38 per common share diluted for the three-month period ended June 30, 2016. This compares to $0.31 per common share diluted as reported for the three-month period ended June 30, 2015.

For the second quarter 2016, the annualized after tax return on average common equity was 14.6%, in comparison for the full year 2015 the overall PNC industry recorded a pre-tax return on average common equity of 8.49%, which if tax adjusted using a normal federal tax rate is 5.5%. On slide 15, we detail the components of book value. We increased book value to $11.27 during the first six months of 2016 from $10.15 at December 31, 2015.

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. Our cash in invested assets at June 30, 2016 increased to $240.3 million, compared to $233.3 million at December 31, 2015. Unearned premium balance, which represents premiums corresponding to the time periods remaining on the underlying in force policies were $112.4 million, compared to $108.2 million at December 31, 2015.

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 using connections with our statutory entities, plus another $5 million at LIBOR plus 275 basis points for other general corporate purposes. We have drawn $15.5 million from the $30 million 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 drew $2.4 million on the $5 million facility that supports the needs of the premium finance company we acquired in the global liberty transaction. As an investment philosophy, we continue to place a priority on preservation of capital that supports future premium growth. Our investment portfolio duration of 3.2 years remain consistent with the expected liquidity needs and claim payoff 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 is detailed on slide 17. Because we intend to hold securities to 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 the 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. The second quarter was a period in which we produced solid improvements in our key operating metrics and feel that our future profitable growth drivers both within our existing niche and specific to Atlas. First, the growth of transportation network companies such as Uber and Lift as well as newer market specific companies. While this development has resulted in some short-term shifting, we do see these emerging technologies ultimately expanding the commercial auto insurance market.

The market growing and more insured's caring people or things for money is ultimately a net positive for Atlas to the extent that these operators increasingly begin to carry commercial auto insurance, either for practical reasons or to satisfy regulatory or compliance requirements. Our underwriting standard in pricing have continued to remain consistent throughout the development of this industry and believe that the use of proper insurance products that safeguard both drivers and passengers to the natural evolution for the ridesharing market.

With this evolution, we see Atlas is well positioned to benefit given our solid track record and experience with the data and the specialty light commercial auto space and overall commitment to the industry. 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 a 20% market share within each market we serve.

We are continuing to cultivate the relationships with our existing agency network. Commercial auto is a high frequency line of insurance and our agents and potential new agents can see the value proposition Atlas provides compared to generous demand to our space. The fleet operators that we work with depend on us to provide timely claim service in order to maximize their uptime for the vehicular assets.

Debt service component allows us some buffer against potential priced competition and our markets down the road. We also look to our distribution partners as a source of valuable market intelligence with the national network of specialized focused agents we're able to gain valuable insight into where our market is headed allowing us to be proactive in our operations.

As I had mentioned multiple times, we will always put a priority on margin and operating leverage over premium growth on an absolute basis. This distinguishes Atlas from many other operations insurance operations and we believe it is critical discipline necessary to maximize long term shareholder value over time. We expect to continue growing our book of business organically targeting a better than 60% loss ratio, with incremental rate increases in the mid-to high single digits.

As mentioned earlier, price elasticity will be monitored closely to appropriately balance future margin with operating leverage. Atlas is achieving our stated objective in terms of better than industry ROE and expect to deliver results and the high teens provided market conditions remain favorable. I want to thank our committed and talented team for delivering a great result of which we can be very proud.

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

**Question-and-Answer Session**

**Operator**

Thank you Mr. Wollney. [Operator Instructions] And your first question will come from Ryan Byrnes of Janney. Please go ahead.

**Ryan Byrnes**

Thanks. Good morning everybody. Just obviously, it seems like the top line came in a little bit this quarter, just wanted to see what gives you guys confidence that you can still kind of hit those top line targets for the back half of the year and maybe what steps you need to do to get there, is it a change with the rates, obviously it sounds like you guys push rates pretty hard in the quarter, just wanted to get your thoughts there?

**Scott Wollney**

Sure and I appreciate the question Ryan. I think the first key element is to sort of bring the premium trajectory down in two aspects. The first is the result of rate. Any time we do push rate up we do expect to see a slight pullback in terms of retention ratio and hit ratio. Candidly, if we didn't see that we've probably aren’t testing elasticity sufficiently. So, we did expect that that would happen, but believe that the market is going to continue hardening and as it does we think that the average market rate will rise following our price leadership.

So, we will monitor that closely in the third and fourth quarters to make sure it does happen, but again that is our expectation based on market condition. The second piece of it is that transition of overall vehicles and force where we are seeing a decline in insured taxis, but we’re also seeing an increasing significantly in insurance limo/livery, part of that involves a lack.

So when drivers have been moving away from leasing taxis and going into the owner operator mode within the context of transportation network companies, what we're finding is that they often start approaching it from a ride sharing perspective where they may not commercially plate a vehicle, they may not buy commercial insurance, but if they determine that that is in fact the way they want to go forward, they will typically commercially plate their vehicle and buy commercial insurance.

So they can then be dispatched under the higher priced services from the transportation network companies. It is where they are going to make more money. We are also hearing from a lot of operators that some of those drivers are actually beginning to come back to the taxi segment as well. So, we think we will continue to see expansion in terms of available limo/livery vehicles to ensure.

We also think that we will see some more stability coming into the taxi space. Again, as with the price elasticity we will monitor that closely, but that is a transition that we've seen happening over the last couple of years and of course we are still listening to lots of feedback from our distribution channel and the operators we ensure to make sure that we really do understand what’s going on. And so those are the two things that really give us confidence that we should still be back on track in terms of the full-year goals. In fact, we don't feel like we’re off track at this point, particularly given that Q2 is a relatively small quarter, and so if we were going to see a pullback in terms of growth rates, especially as a result of pricing action, the second quarter is a really good quarter to see that happen.

The final piece and again I just think it’s always important to reiterate this any time we talk about top line is that the ranges that we provide are just that. They are not intended to be goals; they are not targets. Obviously, we are always going to focus on bottom line result over top line growth and on an absolute basis, but we do want to make sure we're providing as much visibility as we can.

**Ryan Byrnes**

Okay great. And then just shifting over to the reinsurance, it sounds like you guys are flexing down the quarter share. Now did that start at the beginning of the quarter or does that happen later in the quarter, just want to figure out how to model that and then it just sounds like you guys want to flexure operating leverage, is that simply what we are looking at?

**Scott Wollney**

Yes, we will take effect for the full third quarter. So, the session will be 5%, obviously that will earn in proportionately. So, all of the premium written in the quarter would be subject to the 5% session, but as you convert that into earned premium of those that will earn ratably over the next four quarters till Q3 of this year through the end of Q2 next year in terms of the earning pattern.

I mean our view was that we've been growing surplus sufficiently to keep the net written premium to surplus ratios relatively flat and by increasing, or rather decreasing the session of course you're increasing the amount of profit we retain. We can achieve marginally better operating leverage and at the pricing levels we are at, we want to keep as much of that profit as we can.

**Ryan Byrnes**

Okay great for that. And then just quickly, one last one, obviously with the shift may be from taxis to limo over in black car market, does that change, is that different distribution channel at all or is it the same one from an agent in basis?

**Scott Wollney**

No it's basically the same. And again a lot of the drivers that we're seeing transition are going through the same agents that they had worked within the past that they were familiar with from the past. So, as I mentioned we have been approached by a very large number of agents seeking employments and we have a point that some incremental agents where we think that they really add value and be a true partner. And so we do consider their access to sort of the growing aspects of the market as terms of one of the criteria that could make them a beneficial incremental agent for our distribution channel, but for the most part it's the same distribution channel.

**Ryan Byrnes**

Okay great, thanks guys.

**Scott Wollney**

Thanks for the questions.

**Operator**

Our next question will come from Paul Newsome of Sandler O'Neill and Partners LP. Please go ahead.

**Paul Newsome**

Good morning, thanks for the call.

**Paul Romano**

Good morning, Paul.

**Scott Wollney**

Hi Paul.

**Paul Newsome**

I was wondering if you could talk a little bit about your view of what you are getting on rate versus the underlying claims inflation?

**Scott Wollney**

So what we're seeing in terms of claims inflation in general is about 1.5% to 2% year-over-year inflation. It's a little bit higher on the physical damage side, little bit lower on the liability side. The majority of our exposure is liability not physical damage, so from a modeling perspective if you assume kind of a net 1.5% to 2%, I think that would be safe. And so when we see our average premium per vehicle up 10% year-over-year in the second quarter, that should result in a pretty meaningful impact in underwriting margin down the road. As we mentioned before, obviously we expect about 18-month lag between priced activity and when we reflected in our financial results, but we definitely feel that we are capturing incremental underwriting margin at the current rate levels, but frequency and severity are obviously things that we monitor very closely.

We are continuing to see frequency moderate. I think some of that has to do with the fact that many of the vehicles we are insuring we are ensuring are in fact on the road slightly less, coupled with the fact that we are also increasingly seeing some better witness technologies, some aftermarket some becoming part of fleets as our operators are using vehicles that have OEM technology that help in that regard. And on the severity side, we have not seen a significance increase in severity particularly on the third party liability side and now that we've implemented the predictive models on the claim side in the first quarter believe that we are going to be well positioned to actually manage it as even more tightly than we've been able to in the past. So, obviously it’s too early to be able to articulate what the specific benefit has been, but that is an area that we believe will provide opportunity for us as well.

**Paul Newsome**

Great thank, you.

**Scott Wollney**

Thanks for the question.

**Operator**

[Operator Instructions] Your next question will come from Brian Hollenden of Sidoti. Please go ahead.

**Brian Hollenden**

Good morning guys and thanks for taking my call.

**Scott Wollney**

Good morning Brain

**Brian Hollenden**

Since increasing rate in the second quarter have you seen competitors try to push through accelerated pricing since the quarter ended and if not when do they follow and if they don't follow do you take your rate down?

**Scott Wollney**

Great questions. I mean, at this point it’s hard to say specifically when we might see competitors follow. Generally speaking, when we’ve raised rate in the past what we've found is that our competitors, most of whom at this point are local privately owned companies, many of them non-standard, often relying pretty heavily on quarter shares. So, they do generally benefit by increasing rate than increasing market share and so that is part of why we feel confident that we will see them follow price leadership. So, already we are starting to see our hit ratios stabilize in the phase of the rate increases that we put through in the second quarter. If we continue to see that obviously, we will feel comfortable that we hit the right target. If we don't see that happening or if we see entities like state funds beginning to clear more of the renewals we would consider moderating rate increase that would be very regional and targeted in nature, but if we ended up pulling back in certain areas, I think it would still be too sequential mid-single digit rate increases year-over-year, you know we wouldn't have to go back to flat just based on the data that we've been able to observe so far, but as I mentioned it’s something we're going to watch very carefully, and obviously we wouldn't have taken the rate that we did, if we didn’t believe the market was well positioned to absorb it, you know both based on our competitive environment and also our belief in terms of the strength of our value propositions.

**Brian Hollenden**

I appreciate the color of. Just if I can ask one follow-up, the loss ratio was flat or year-over-year when pricing has been sort of increasing mid-single digits over that same time period, can you kind of talk to help us better understand why that was?

**Scott Wollney**

Sure. I think a couple of things first, the loss ratio does move around quarter-to-quarter, so it isn't always going to be an apples to apples comparison. You know you we do want to try and be fairly conservative in terms of how quickly we recognize the benefit of priced activity, particularly when our loss ratio is in the 50s. So that's part of it. And the second piece of it is having put the claims predictive model in place in the first quarter we do want to allow that to flow through, you know more and more of our inventory has been scored by the model to estimate severity, so that we have good baseline in order to evaluate the efficacy of that.

So, in the end, we expect that to further improve the loss ratio in terms of the average value of claims paid. So it should have a positive impact, but that is also part of why we are wanting to maintain a relatively stable perspective, but again the key issue mostly is, we were taking great, we do expect the loss ratio to trend in a positive direction, but we want to be fairly conservative before we take advantage of that and reflect it in the financial results.

**Brian Hollenden**

Thank you.

**Scott Wollney**

Thanks for the questions.

**Operator**

Our next question will come from Sameer Kher of Capital Returns Management. Please go ahead.

**Sameer Kher**

Good morning and thanks for taking the question. I just want to ask that you made reference to the reduction against utilization of cars, of your insured's in the road, which led to kind of improving frequency, what you think that this?

**Scott Wollney**

Well so in particular, in the traditional taxi space and even to some extent in the more delivery space when competition for rides or even drivers results in vehicles being taken out of service there is a period before that where the revenue is down, but not down enough that you would essentially take the asset of the road. So, what we found is that particularly taxi operators are seeing revenues down anywhere from 10% to 30% depending on geography and so within that range there are definitely vehicles that are being insured full time, but aren't being used as often as they were in the past.

And so again, while we think that there ultimately will be a stabilization, particularly in the taxi space in terms of the vehicles coming out of service overall the vehicles are in service and more likely to be used slightly less than they were say two or three years ago before there was many alternatives to provide rides.

And so that really is the general reason why we think that that's the case and what we know specifically is that we have in fact seen frequency trending down. And so when we look at that, we obviously want to drill down into it and understand why that might be the case, particularly given that personal auto had actually seen some increases in frequency last year, you know which ultimately I think were attributed to distracted driving and lower fuel costs by a lot of the personal auto insurers.

So, anytime we see something happening differently on our segment then in our broader segment in the auto insurance industry we always want to sort of look at it with a skeptical eye as it were, but ultimately – and we've covered this often in prior calls, but we got comfortable as to why what we are seeing in our data makes sense and part of it is active those vehicles are just being utilized less on average than they were in the past, but still kept in service.

**Sameer Kher**

Got it, okay. And then as far as market conditions go, as the market has continued to burn in commercial auto liability, is the firming seen purely in price or on the margin does it also help in terms of conditions and claims metrics like the frequency and severity as well?

**Scott Wollney**

I would say it's predominantly priced in terms of what we are seeing. I think most commercial auto underwriters utilize ISO forms, so I don't think you're seeing a lot of changes in terms of the scope of coverage, I do think it is predominantly underwriters in the broader sense trying to figure out what the right prices for the product they sell it. But again where that's helpful for us is, if there the overall price increases in broader commercial auto that will generally create overall buoyancy for us. It will tend to result in ISO making recommendations that price be increased across the board and commercial auto and so to the extent that our local competitors are following ISO it will ultimately follow those recommended rate increases, which again is part of why we think the market will observe the rate increases we put through in the second quarter.

**Sameer Kher**

All right, great. And on lowering the quarter share, what's the amount of unearned premium that's coming back to you?

**Paul Romano**

Well it's a go forward measurement Sameer. So, it will be 5% of subject written premium starting effective July 1, going forward. So, all the premiums that were seated under the contracts through June 30 were at 15%.

**Sameer Kher**

Got it. Okay. That helps. And just in general philosophically on capital structure, how do you guys think about using your debt facility versus keeping your preferred out there or ratcheting the quarter share up or down?

**Scott Wollney**

So, I think we think about the quarter share is probably being the first mover in the sense that it is most flexible, obviously we can electively increase or decrease it quarter-over-quarter or at a minimum of 5% session, which is where we're going to be in the third quarter up to a maximum of 50%, but we look at it as less permanent and so the debt facility it would certainly be the next tier where it's a five-year facility. We've got about 3.5 years left on it. So, while it's not prominent capital, I mean it is more permanent, right.

The reinsurance market today is very soft, we believe the terms we have on the quarter share program are extremely competitive, but if we saw a series of large storms for example, you might see overall reinsurance firm up, in which case we don't want to rely entirely on quarter share, which is why we put the debt facility in place, but both of those are nonpermanent and relatively short term tools. And then obviously equity capital would be the last thing we would want to use in terms of raising money to support organic growth.

And as we've said, we believe we can self-fund growth with the quarter share and debt facility we currently have in place, coupled with the significant retained income that we've been ploughing back into surplus. So, I think the quarter share obviously, which is the first tool, the first lever we pulled, but now it is at the minimum 5%. So, if we did decide over time that we were able to without creating a regulatory rating agency concern further reduce or capture more of a profit reducing reliance on the quarter share of the debt, the debt would be the next level we would probably pull, but at this point we don't see any anticipated changes in terms of drawing on that facility.

**Sameer Kher**

Okay, and how about the preferred, I mean did you guys intend to keep them out there?

**Paul Romano**

Yes the preferred shares were always issued in connection with acquisitions. So, right now we have tranche of preferred shares related to the Gateway acquisition. We have a second tranche of shares related to the Global Liberty acquisition. The terms of both of those are that we can redeem the preferred shares for face value plus any accrued interest after the third anniversary of the issuance, and then they would convert into common after the fifth anniversary.

So, we have a two-year window, we are in that window for Gateway. We are two years away from that window or 1.5 years away from that window for Global Liberty. So for Gateway, our expectation is that we would redeem those preferred shares prior to a point where they can convert because they would be very meaningfully in the money. And that was always our intent and the sellers of Gateway understand that. And same thing with Global Liberty, you know when those ultimately are available for redemption it would be our goal to redeem them.

And this is a point of reference, we bought American country, American service we actually issued a very large tranche of $80 million of preferred shares and did redeem those when we got into to the window and in fact we were able to redeem them by making an offer to redeem early at about 90% of face value. So, it is definitely a tool that we've consistently used in connection with acquisitions and have always intended to redeem those rather than let them convert into common.

**Sameer Kher**

Okay. And then just given all the storm activity in second quarter and you guys have some taxis exposures it looks like as well, was there any I guess increased loss activity that you guys have in your results?

**Scott Wollney**

No not really, I mean our exposure is predominantly really into the vehicles and so while we do some physical damage exposure to the vehicles themselves, we aren't ensuring garages or other infrastructure from a physical damage perspective. So, we really don't see a significant uptick in claims activity when there’s been storms. We've seen significant storms like Sandy in New York for example, we didn't see a significant uptick and similarly we have not seen a significant uptick in terms of claims presented.

In fact in some respect when there is heavy storm activity the kind of vehicles we are insuring tend not to be on the road because people are staying inside. So from that perspective in a way it’s probably a neutral impact if not in some cases even potentially a little bit positive, but in any case we have not seen a specific uptick in taxes.

**Sameer Kher**

All right, great. Thanks guys.

**Scott Wollney**

Thanks for the questions.

**Operator**

And Mr. Wollney at this time I am showing no further questions, I would like to hand the floor back to you for your closing comments.

**Scott Wollney**

Thanks again Denise and thanks to everyone for joining us. We look forward to speaking with you again in the future.