ICC Holdings, Inc. (NASDAQ:ICCH)

Q2 2017 Results Earnings Conference Call

August 15, 2017, 2:30 pm ET

Executives:

Arron Sutherland – President and Chief Executive Officer

Mike Smith – Chief Financial Officer

Julia Suiter – Chief Legal Officer

Ann Riceman

Good afternoon and welcome to the ICC HOLDINGS, INC. second quarter 2017 earnings conference call. Before we get started, I'd like to advise that today's conference call is being recorded, and we have placed all callers on mute for the duration of the presented material. We will un-mute when we open the call for questions.

At this time, I would like to turn the conference over to Ms. Julia Suiter, our Chief Legal Officer. Please go ahead, ma'am.

Julia Suiter

Thank you, Ann. Good afternoon and welcome to ICC HOLDINGS, INC.'s discussion of our second quarter financial results for 2017. By now, hopefully, all of you have seen our earnings release. If not, you may access this document on our website, ir.iccholdingsinc.com.

With us on this afternoon's call are Arron Sutherland, our President and Chief Executive Officer, as well as Mike Smith, our Chief Financial Officer. Following Arron and Mike's remarks about our quarterly results, we will open the call for your questions.

Before turning it over to Arron, however, I would like to advise everyone that during this call there may be forward-looking statements made and references to non-GAAP financial measures. Any forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made during the call. Information concerning those risks is contained in the earnings release and in ICC HOLDINGS, INC.'s most recent 10-Q and 10-K on file with the SEC. In addition, the forward-looking statements speak only as of today, Tuesday, August 15, 2017. ICC HOLDINGS expressly disclaims any obligation to update or revise any forward-looking statements made during this call today.

This call is being recorded. During the next week, the call may be accessed on ICC HOLDINGS, INC.'s website.

With that, I will turn the call over to ICC HOLDINGS, INC.'s President and CEO, Arron Sutherland.

Arron Sutherland

Thank you Julia. Good afternoon everyone. It's a pleasure to share our second quarter results with you this afternoon. The Company faced a variety of challenges in the second quarter, which unfortunately resulted in a net loss for the quarter. Although top line growth was hindered by continuing soft market conditions, ICC successfully began conducting business in both Kansas and Colorado in the second quarter. It is expected that as these markets build momentum, premium growth will improve in the second half of 2017. Additionally, plans continue for expansion into Michigan in early 2018, and continued geographic expansion in future years.

In terms of losses, the Company experienced an atypical influx of property claims, primarily due to increased storm activity throughout the Midwest, as well as more fire peril claims than a typical year. The Company continues to enhance its already robust loss control processes to further reduce this exposure and efforts to return the property line to historical loss levels. The increased property losses have been partially offset by above average profitability in the Workers' Compensation line of business and consistent results from the core Liquor Liability products.

The costs of operational and administrative changes to ensure compliance with the requirements of being publically traded were fully recognized in the second quarter. This regulatory burden negatively impacted the expense ratio. The majority of these costs are fixed, and will not fluctuate with premium. Therefore, one key to improvement of the expense ratio is our ongoing growth initiatives. We expect the continued development of new markets in Ohio, Kansas, and Colorado, combined with increased marketing efforts in established states, will provide this premium growth.

The Company will maintain its focus on underwriting discipline during this soft market. ICC will continue to utilize service, claims expertise and product uniqueness to differentiate itself in the marketplace.

With that, let me make a few high level comments on our second quarter financial results and then Mike will provide additional detail. Net earnings were $614,000 or $0.19 per share for the six months ended June 30, 2017, compared to $891,000 for the same period of 2016. Our combined ratio was 101.7% in the six months ended June 30, 2017 compared to 96.4% for the same period of 2016.

With that, I will turn it over to Mike Smith, Chief Financial Officer to discuss the financials in greater detail.

Mike Smith

Thanks Arron. Good afternoon everybody.

The decrease in our net earnings from $891,000 to $614,000 for the six months ended June 30, 2016 and 2017, was a result of increase in expenses for the year. Losses and settlement expenses increased 7.2% primarily due to an increase in fire losses and higher retention on the property line of business in comparison to 2016. Other operating expenses also contributed to the decline in net earnings. The Company completed its initial public offering in March 2017, and those additional costs associated with operating as a public company are included in other operating expenses.

Direct premiums written grew by $20,000 and $532,000 for the second quarter and first six months of 2017 compared to the same periods of 2016. Net premiums earned grew by 1.5% and 3.4% for second quarter and the first six months of this year, respectively.

Net investment income increased $391,000, or 50.8%, to $1,161,000 from $770,000 for the six months ended June 30, 2017 compared to the same period of 2016. Net investment income grew by $267,000, or 63.3% for the second quarter of 2017 compared to the same period of 2016. The increases are primarily due to average invested asset increases as a result of the funds received from the IPO (initial public offering).

Losses and settlement expenses increased 7.2% to $13.46 million for the six months ended June 30, 2017. Loss and settlement expenses increased by 11.1% to $6,864,000 for the second quarter of 2017.

Policy acquisitions costs and other operating expenses increased by 12.1%, to $8,455,000 for the first six months of 2017. Policy acquisitions costs and other operating expenses increased by 17.7%, to $4,720,000 for the second quarter of 2017. The increases in policy acquisition costs and other operating expenses during the three and six months ended June 30, 2017 are primarily driven by increases in the other operating expenses. And as previously mentioned, those increases are due to result of additional costs being incurred for operating as a public company.

Total assets increased by 22.1% from $122,160,000 at December 31, 2016 to $149,172,000 at June 30, 2017, primarily as a result of our initial public offering completed during the first quarter of 2017. Our investment portfolio, which consists of fixed maturity securities, common stocks, preferred stocks, and property held for investment, increased by 31.7% from $76,122,000 at December 31, 2016 to $100,231,000 at June 30, 2017, as a result of deploying the net proceeds from our completed initial public offering.

At June 30, 2017, shareholders' equity was $64,065,000 and book value per share was $20.28 a share.

With that, I will turn it back to Arron.

Arron Sutherland

Thank you Mike. Before we move to the question-and-answer portion of the call, let me leave you with some summary points.

Despite the current soft market conditions, the Company believes that it has the right strategy and underwriting methodology necessary to grow profitably long-term. ICC expects to maintain a strong commitment to the food and beverage niche.

The Company expects that our expansion into the states of Kansas and Colorado, continued plans to enter Michigan, as well as increased marketing efforts in our established states, will further improve premium growth.

Overall, experience in the core liquor liability line of business continues to be consistent and profitable, as well as strong performance from the Workers' Compensation segment.

The Company continues to maintain a strong balance sheet, including reserve adequacy. As the operation becomes better leveraged, and certain efficiencies are realized the Company expects that it will see improvement in the expense ratio.

With that, we will unmute our callers and would be glad to take your questions. 9:21

Henchy

Hello,

Arron Sutherland

Yes

Henchy

Arron this is Henchy how are you?

Arron Sutherland

Good Henchy how are you?

Henchy

OK I have a question on the share count, I am a little confused there, and I am hoping you can help me. So, the increase in shares the 3,158,680 from 3.150 last quarter, so last quarter when you first did the offering there were 3 and a half million shares issued but 350,000 were taken back for the ESOP. Okay, now you are showing 3,158,680. The 8,680 increase in share counts, is that because some of the ESOP shares have been distributed or that is because some of the MRP Stock in the option have been….can you help me understand this?

Mike Smith

Sure, this is Mike. So, with weighted average shares, we we've designed the ESOP so that each month a portion amount of shares are released. So, at March 31 - and we assume those shares are released on the last day of the month - so at March 31 there was really no weighted average share impact from the March release of the ESOP shares, but, for the three months ended March you know there were shares released April 30, May 31 and June 30. So, that increase the total number of shares issued and then the weighted average shares increase by some small proportion of that because they are pro-rated for the period that is under consideration.

Henchy

Okay so, again I am looking at the balance sheet and you have foot note 2. So again, 8,680 shares were released from the ESOP? Is that correct?

Mike Smith

Yes,

Henchy

Ok so then how come if the ESOP right was 350,000 shares, if you look at footnote 3 it goes down to 348,000. It goes down by less than 2,000.

Mike Smith

Because not all of them are counted in weighted average shares.

Henchy

Thank you

Mike Smith

Yes, so the actual weighted average is from the financial statement.

Henchy

Again this is not weighted average. I don’t think this is weighted average. I think this is actual numbers

Mike Smith

let me…

Henchy

I am looking at a balance sheet, which is a snapshot at a point in time, not the income statement.

Mike Smith

Right so are you in the footnotes?

Henchy

I am in the footnotes. It’s on the balance sheet, page 3 of your….

Mike Smith

Okay, Note 2. Okay so you are looking at the 3,158,000? What number are you -?

Henchy

Yes

Mike Smith

Okay

Henchy

It looks like it increased 8,680 quarter over quarter from 3,150,000 to 3,158,680. And I think if I …if I understood you correctly the 8,680 was a release of some ESOP shares, Right?

Mike Smith

Correct.

Henchy

Okay so then in footnote 3, it says there are 348,054 shares right? Of ESOP.

That have unearned ESOP shares, Right?

So that's less than 2,000.

Mike Smith

Right. So I think what we are counting in that note 3 is just the weighted average shares that are released. Although it doesn't say. It does say 348,000 shares, but the shares released are, I mean, I can tell you there are about 79 shares a day is what we are releasing. So, you would see 90 for the quarter…for the quarter you would see 90 days at close to 80 shares a day. That get released so I think…

Henchy

(Muffled statement)

Mike Smith

Go ahead

Henchy

None of the MRP shares, Right? None of the stock of the 490,000 shares.

Mike Smith

There has been nothing issued. There has been nothing issued on equity comp, stock options, none of that. Anything that's changed on share count strictly has to do with ESOP shares.

Henchy

Okay. And when you release the equity comps, are you going to be buying those shares on the market? Or are you going to be issuing a new shares?

Mike Smith

Yeah, I am going to have to let Arron answer that one.

Arron Sutherland

Yeah, at this point, the board has not indicated either way, because they have not initiated that, so I can't say right now how they would do that. I'd have to wait until the board gives direction.

Henchy

Okay. Okay, thank you. I will let someone else ask a question now.

Arron Sutherland

Any questions?

Mike O'Brien

This is Mike O'Brien just following up on shares. Just ...do you have a period end number? For shares outstanding at this point?

Mike Smith

How many shares are actually outstanding in the market place?

Mike O'Brien

Yeah, yeah I am just trying to figure out current book value, roughly.

Mike Smith

Yeah there is 3,150,000 shares actually issued, and then at the end. The ESOP shares won't get officially issued until sometime after year end.

Mike O'Brien

Okay, thank you. And could you just say a little bit about the problems that hit you this quarter and how you are trying to tighten that up as you were saying.

Arron Sutherland

…in the quarter was increase in both frequency and severity with the property line. And so the increase in frequency was driven by an influx of storm claims. So our number of property claims are up 24% over this same period last year. So, that can range from very small to some a decent size claim of a couple hundred thousand dollars with a roof removed. That sort of thing. There was a frequency issue and at the same time we have had more fire losses than we normally experience in the first six months of the year.

We have had, and so with those two things it's sort of two different mitigation efforts. On the storm claims, you main mitigation effort is to monitor concentration of risk. Just look at the overall book of business, and we don't see any issues there. So we are somewhat dependent on the weather patterns which is a little harder to mitigate. But we more evaluate the book for the storm.

On the fire loss side of things we look to mitigate that through loss control efforts. And so a couple of the loss control efforts that we have been putting in place:

One is, we have been seeing an increase in spontaneous combustion type claims, i.e. greasy linens or rags will just catch on fire in restaurants. We are now, anyone who keeps those rags on site, we are requiring that they be stored in a fire safe metal container.

And we are also investigating ways to try and better loss control and inspect the electrical aspect of some of our older buildings. As you can imagine, some restaurants are in older buildings, so we are looking at ways to try to identify hotspots in the wiring. That is a research effort undergoing, but that is one of the things we have identified.

And then the third from a property perspective not a fire related is we are working to….We have had a pilot program going to utilize drones to basically see some of the unseen property risks up on some roofs, A/C units, roofs in disrepair that sort of thing. Again, trying to attack it on the front ends so that we can better underwrite versus having to…once the claim... You have the claim, now you are just in a cost control standpoint you are not avoiding. So, does that answer your question on some of the things that went on to hurt the quarter's results and what we are doing?

Mike O'Brien

Yes, thank you, that is helpful and on the litigation side? Anything to speak of there on terms of trends or what you are saying?

Arron Sutherland

No, litigation side has been fairly quiet in 2017. June 30 only had two trials and they were both losses but the grand total of the two losses was less than half million dollars. So, we haven't seen anything from a legislative. The one thing I would point to is in Missouri. There have been some positive legislative changes regarding what is called an O-65 Rule. And I can let Julia give you a little bit more background on that and why we think long term that is going to help on the liability side of the business.

Julia Suiter

Without boring everybody to tears with too much legal analysis on this, it was an opportunity for the state legislature and the governor to level the playing field in litigation. There was a very unfriendly environment that allowed a plaintiff's attorney to basically insert himself to… the company to have to make some hard decisions and would give some very unreasonable timeframes for responding to demands was just again just allow these plaintiff's attorneys to insert themselves into the relationship and put insurance companies in some very unfavorable positions.

Through a series of new bills and laws that have gone through we have gotten a great new set of laws in that completely curtail the ability for the plaintiffs' attorney to do this Just imposed a series of what would be very reasonable requirements for pre-suit settlement discussions. And it is just absolutely was a red letter day across the state across all the law firms and all the insurance companies of the state. So, something we have been hoping for, for a long time came to fruition in August and we're very excited about it.

Mike O’Brien

Good news, Thank you

Henchy

This is Henchy again, can I ask one more question?

Arron Sutherland

Absolutely, you can ask as many questions as you want to Henchy. We have the afternoon free for you.

Henchy

Okay, don’t worry. I only have one more. Are we going to see the percentage of premiums needed? I mean it still at 15, 14%? Is that going to go down this year or is that really a 2018 event when you are able to sign on less reinsurance?

Aaron Sutherland

Yes that is going to be 2018. When we entered those agreements that is a yearlong obligation so, that is where the timing of the IPO really prevented us from being able to make those changes for 2017. So you will see that more in 2018 as we start re-negotiating the reinsurance later this year.

Henchy

Thank you so much

Arron Sutherland

Thank you

James Ingles

This is James Ingles from Philo Smith and Company. Can you tell us a little bit more about the expansion plans you have been referencing. These new states in terms of books of business types, where you are writing? Is it the same kind of business sort of etcetera.

Arron Sutherland

Everything we are doing in all the states that we are expanding we are staying in the food and beverage niche, at this point so we are not... So none of these efforts are to go outside of that wheelhouse of the type of business that we’re used to. There is a little bit of a unique situation with each one of the expansion efforts, and I’m going to talk really about the foremost most recent one of those not yet on the books but licensing is in place. So, the first was Ohio in 2016. And that has been one that the growth has been a little slower than we would like, but is starting to gain momentum in 2017 and obviously it is a very high population state. It doesn't have… it has a state run Worker's Comp fund, so it is really going to just be our BOP and Liquor product in Ohio. And I would say here mid 2017 we are seeing that really start to mature out. We have some key agents in place, marketing efforts taking hold. So, somewhat early in the life cycle but there is a little traction there and with premium dollars.

The Kansas expansion is really to write the Kansas City side, or the Kansas side of Kansas City. We've been on the Missouri side, we have seen that with not having the ability to write both sides of the city… we are just not getting the same penetrations we do as in St. Louis and we think a lot of it has to do with when they see a carrier that can't write both sides of state line highway they just sort of put us out of mind. So, that will be more growth of the Kansas City agents then anything where I watch the actual Kansas state premium.

Then the third, Colorado, just got really. They just got started June 25th, so there wasn't much opportunity for there to be very much premium in the second quarter. But we have a relationship with an agent that we have done business with for a long time. He was an agent in Missouri who has moved on to Colorado and so we think that he will be able to some, a good healthy book of business on here in 2017. Again, really bolstering that premium growth from what we saw in the first quarter.

And then the final state of the expansion, where we have got licensing in place, is Michigan. And right now, we are targeting early 2018. We will be starting our marketing efforts in 4th quarter of this year, and what we are hoping to do is go with a more aggressive marketing approach before we are actually writing in the state, to get a little bit more of a jump start and see the premium come in from Michigan faster in 2018 then Ohio did in 2016.

But just to wrap that all up. These are all state expansions. So far a minimal increase to the expense structure to add these states. We haven't ....we may need to expand marketing staff by one body. But systems wise we can write all these states with no changes. In the short term, we won't need to add underwriting possibly one member of claim staff because unfortunately as you write premium eventually claims are there. And from a loss control stand point we're not adding staff initially we are going to cover it with basically our existing staff taking some road trips , for a lack of a better way to put it. So, I am hoping that there won't be much impact in the expense structure here in the short term. We'll get the states up and running, see the premium growth, and then go from there, but no change in the core business that we are looking at.

Does that give you what you want on the expansion?

James Ingles

Yes, also along the same line: who are you taking this business from? I assume it is being written by another carrier at the present time.

Arron Sutherland

It is a little different in each state. In Colorado we are really targeting Excess Surplus Writers. Whereas in Kansas and Ohio, it is a little bit more traditional markets. Obviously Ohio has some big in state and even there excess surplus lines, a lot of that is with Cincinnati in Ohio So, that is a big company that we are looking to take that away from there. And then Michigan is going to be a mix. It will be a mix of Excess Surplus Lines there are some Michigan based companies that write quite a bit in our niche. As we get further down the marketing cycle I can give you more information on who we are going to take the business from there.

Our most successful, when we first enter states is usually taking the business from Excess Surplus lines where our coverage is far superior, and the agents need a market to better protect their customers. As we mature out, then we start to take more of the traditional restaurant lower alcohol sale business from what I would call generalist writers, the Travelers, the Cincinnati's of the world.

James Ingles

Okay, do you have sense how big you, I guess, can be in these states and or one?

Arron Sutherland

It is very pre-spective to be speculating on, so I don't get too specific in terms of the ceiling on premium dollars in a given state, but I would tell you that we have been very consistently able to get to a 10% market share in the states we operate. So, for example in a state like Michigan where the population is in excess of nine million people, that is going to be a pretty good market share. If we can get 10% market share in Ohio, that is going to be healthy premium.

Again, I doubt in Kansas because I am not working on westward in the state that would [not] be as big a penetration. And I have seen us get market shares as high as 25% in a state. We're up in that 20-25% market share area in Iowa. So what I would tell you is I tend to think I can get 10-25% of the market in a given state, that can be anywhere from 5 to 15 million depending on the size of the state.

James Ingles

How are your products superior to competition, not talking about anybody specifically, but is there generally, how is product different than theirs? I mean is it lended? How does it differ?

Arron Sutherland

Like many companies we start out ISO-based with the product. So, when you are talking about Excess Surplus Line carrier that already is superior coverage because the excess surplus writers will have warranty coverages, etc. We then take that ISO based policy and we have a lot of coverages that are very unique to the industry because and what we tout our agents and what we tout with the customers and what we feel is true about the product, is that a lot of the coverages for example, there is a utility time service element coverage that is, we feel, is better than most products they will get because we recognize that power loss type claim is a very big exposure to a restaurant. We have superior business income coverage to most of the business interruption coverage to most of the competition. But it really comes to having several coverages that we can point to that are uniquely designed for restaurants and taverns and then we get into the fact that we have a separate liquor liability policy instead of it being part of a BOP. And that is a whole host of advantages having a separate liquor policy versus it all being in one.

James Ingles

Okay, great Thanks.

Arron Sutherland

Any other questions?

Unknown caller

So, if you are to project out, just how do you think about your target combined ratio? Maybe a year or two years out?

Arron Sutherland

Well, it’s a little hard to project a specific combined ratio because, if you can tell me when the market is going to harden, I can tell you how the combined ratio is going to go. I can tell you that historically we feel like our combined ratio will fall between 95 and 101. Somewhere in there. Again, right now we are in a little bit of a unique position compared to our history because we are more over-capitalized then we have been. I think that the next 2-3 years will be comparable historically to the previous years. But, I don’t know how the market conditions are going to soften or harden. Right now we are in a soft market and…

The reality of this business is the conditions from 2 years ago start dictating what goes on today and what goes on today will flow through results in 18 months, it’s the nature of the business.

I know that is not a specific, pencil-this-combined-ratio-in for you answer, but that is about the best I can do for insurance.

Unknown caller

I guess maybe the follow up, you know if the market stays soft for the next couple years, I guess your investment income is higher right? So you will be profitable but just not as profitable? Or how do you think about it?

Arron Sutherland

That is what we expect. That is how we would expect it to play out. That right now being in an overcapitalized position will increase the investment income to hopefully offset the impact the soft market is having on the underwriting result. Again, subject to weather patterns, significant fires, all the things people do after midnight in a bar, these are all the things we deal with in this business.

Unknown caller

Is marijuana playing into the picture as it gets more acceptable and popular?

Arron Sutherland

I want to make sure I clarify on the question: do you mean marijuana as it impacts our existing book of business and our existing lines of business?

Unknown caller

Yeah. Yeah.

Arron Sutherland

Honestly, well, one: we have put coverage exclusions in place in Colorado, where it is legalized that we are doing business. We thought we needed to do that. Marijuana, even before, I often joke even before it was legal believe it or not we would see it in our claims, and marijuana is not the only drug we see in people's systems on liquor liability claims. we haven't seen any increased impact of it and for the most part when we go to court, it gets, it's a non-factor, we can't really point to it, if it was in their system it doesn't really impact the case one way or another. They courts view it that it could confuse the jury in terms of how much of the intoxication was from alcohol. So it's not a big factor in what we do, but we did put an exclusion in Colorado where it is legal and it is a little bit unique. So, For example, if you have a bar selling marijuana, and claim arises out of that, there is an exclusion.

Unknown caller

Okay. Do you think it increases your risk overall? Or how do you think about it? I mean I understand legally what talking about but, from a risk perspective?

Arron Sutherland

I would say, I haven't seen anything to tell me, to tell me it would so, I don't have anything. I haven't seen a claim pattern, I haven't seen anything in my results to show me that is impacting it. Again I think for the most part there is enough drugs available legally and illegally that it is not going to move the needle. They are just as likely to have 10 oxy-cottons in their system as they are to smoke marijuana and have it impact the claim.

Unknown caller

Okay I got you. Thank you.

Arron Sutherland

Any other questions?

[Pause]

Well at this time I will say thank you for participating in the call. We appreciate it and just wish everyone to have happy day.

Thank you.