Q4 2013 Earnings Call

Company Participants

- Beth Farrell, VP IR
- Craig Howie, EVP, CFO
- Dom Addesso, President, CEO
- John Doucette, EVP, Chief Underwriting Officer

Other Participants

- Amit Kumar, Analyst
- Greg Locraft, Analyst
- Josh Shanker, Analyst
- Meyer Shields, Analyst
- Michael Nannizzi, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good day, everyone. Welcome to the Fourth Quarter 2013 earnings call of Everest Re Group Limited. Today's conference is being recorded. At this time, for opening remarks and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead ma'am.

Beth Farrell {BIO 19732216 <GO>}

Thank you. Good morning. Welcome to Everest Re Group's Fourth Quarter and full-year 2013 earnings conference call. On the call with me today are Dom Addesso, the company's President and Chief Executive Officer, John Doucette, our Chief Underwriting Officer, and Craig Howie, our Chief Financial Officer.

Before we begin, I will preface our comments by noting that our SEC filings include extensive disclosures with respect to forward-looking statements. In that regard, I note that statements made during today's call which are forward-looking in nature, such as statements about projections, estimates, expectations, and the like, are subject to various risks.

As you know, actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now let me turn the call over to Dom.

Dom Addesso {BIO 1428096 <GO>}

Thanks, Beth. Good morning, everyone, and thank you for joining us this morning. We are very pleased to report record earnings for the Fourth Quarter and the year. There were many elements of our portfolio that performed very well, and others less so. However, with over $1.3 billion in earnings and a 20% ROE, it is a great result overall.

Certainly a factor was the absence of any major catastrophe, but it is worth noting that the year was not without losses. In fact, there were $195 million, or ($178 million) (corrected by company after the call) net, of cat losses during the year.

Growth by diversification, with a 21% or $900 million growth in premium during 2013, enabled the company to absorb a reasonable level of loss events while still expanding margins. New products and growth in many of our traditional lines have all contributed to the margin expansion.

Growth in our core businesses was noted in treaty casualty, treaty property, facultative, and specialty insurance lines. In particular, our property strategy continues to be fluid, meaning that we allocate our capacity to those products offering the best return profile. This translates into more primary insurance and some additional pro rata in the US reinsurance segment.

As cat XOL rates were trending down, we have been shifting to a different product mix. We are moving capacity to the better price layers. The ability to adapt and react quickly to changing market conditions remains a core competency of the Everest team.

The continued management of our portfolio mix resulted in a 4 point improvement in the combined ratio to 81%. All of this improvement came in the reinsurance portfolio.

On the other hand, our insurance business underperformed relative to our expectations. Crop losses and prior-period development overshadowed many underlying improvements in this business.

Excluding crop, the underlying accident year combined ratio improved to 94.6% in 2013. John and Craig will go into further details, but in summary, the crop losses were primarily due to a significant decline in the price of corn. Our estimate at the end of the Third Quarter did not sufficiently take into account yield factors, which were unknown at that time, in our largest states.

The loss development we continued to see was in lines of business that are some of the most difficult to assess, as can be observed generally in the industry. In fact, much of the development we saw emerged on business we had terminated several years ago.

The good news was that our overall reserve position was redundant and, therefore, this specific development had no impact on overall earnings. We continue to feel confident about our overall reserve position, but recognize that any one of our numerous reserve buckets could prove inadequate while at the same time many others will result in savings. That is the nature of the estimation process within our portfolio of reserves. Key is the overall adequacy.

Let me finish up with some commentary on the overall market. As many observers point out, there are many challenges that we face, nothing new, of course, to those of us who have been around a while. Today's headline topics are declining rates and capital markets invasion. Throw on top of that a low investment yield environment, and you have a recipe for lower overall returns to the industry. The key is, of course, not to get your company stuck in the averages. Our performance has been anything but.

Yes, US cat XOL rates were down in 2013 and at 1/1, they were down in the 10% to 15% range. However, this view of the market and how it applies to us is too binary or one-dimensional. These factors are just a slice of the market.

In other parts of the world, particularly in loss affected areas, rates were up, and in many other regions, rates were flat. In addition, primary pricing is still holding, and we access this business through our direct insurance platform, facultative operations, and through pro rata deals in the reinsurance portfolio. Other examples include new products.

As I mentioned previously, we have and will continue to deploy capacity to those areas and others, including new products, that provide the best risk-adjusted returns. Yes, the capital markets is a factor but, frankly, we see it as a tool, not a threat. John will speak to that when he discusses our facility which, for us, is another form of capital that can be used to deliver well-underwritten products.

Nevertheless, capital markets is not a perfect fit for all risks, and this is where company capital can be deployed to new products and risks not well-suited to a capital market structure. The world is changing, as it always has. It is how one adapts that determines if you can beat the averages. Our business plan and strategy anticipates that we can continue to replicate similar returns to what you have seen over the last two years.

Thank you, and now Craig will cover the financial results followed by John Doucette, our Chief Underwriting Officer, for the operations review. Craig?

Craig Howie {BIO 17579923 <GO>}

Thank you, Dom. Good morning, everyone.

We are pleased to report that Everest had a record quarter of earnings with net income of $365 million, or $7.54 per diluted common share. This compares to net income of $59 million or $1.13 per share for the Fourth Quarter of 2012. Net income includes realized capital gains and losses.

For the year, Everest had record net income of $1.3 billion, or $25.44 per share, compared to $829 million, or $15.79 per share, in 2012. The 2013 result represents a return on equity of 19.5%.

Operating income for the year was $1.1 billion, or $21.47 per share. This represents a 58% increase over operating income of $13.62 per share last year. These results were driven by a $480 million increase in underwriting income, representing a 185% increase year-over-year.

As you will hear from John Doucette, there are a number of strategic initiatives that are driving these improved results. This increase in underwriting income was partially offset by higher income taxes and lower net investment income compared to 2012.

The results continue to reflect the improvement in the overall current-year attritional combined ratio, which has declined a full 4 points from 85.0% to 81.0% for the year. This measure excludes the impact of catastrophes, reinstatement premiums, and prior-period loss development.

The total reinsurance attritional combined ratio was 75.5% for the year compared to 80.9% in the prior year. The insurance segment attritional combined ratio was 101.4% for the year compared to 100.9% in the prior year. However, removing the crop results, which show a 94.6% attritional combined ratio for the insurance segment, compared to 97.2% in 2012.

All segments reported increases in premium volume for the year and all reinsurance segments reported underwriting gains for the year. Total reinsurance reported an underwriting gain of $390 million for the quarter compared to a $48 million underwriting loss last year. For the year, total reinsurance reported an underwriting gain of $877 million compared to a $327 million gain last year.

The insurance segment reported an underwriting loss of $156 million for the quarter compared to a loss of $46 million last year. For the year, the insurance segment reported an underwriting loss of $147 million compared to a loss of $68 million in 2012. The 2013 results reflected prior-period reserve development and a crop loss for the year. John will discuss the crop insurance results in more detail.

Mt. Logan Re's financial position and operating results were consolidated into Everest beginning July 1, 2013. These results were included in a separate segment and reflected a $9 million underwriting gain for 2013. Everest retained $3 million of income and $6 million was attributable to the noncontrolling interests of this entity.

The overall underwriting gain for the group was $238 million for the quarter compared to an underwriting loss of $94 million in the same period last year. For 2013, the underwriting gain was $739 million compared to a gain of $259 million in 2012. These results reflect $30 million of current-year catastrophe losses in the Fourth Quarter of 2013 related to Typhoon Fitow, compared to $325 million of cats in the Fourth Quarter of 2012 related to

Sandy. For the year, catastrophe losses were $195 million in 2013 compared to $410 million in 2012.

Our reported combined ratio was 84.5% for the year 2013 compared to 93.8% in 2012.

On reserves, we completed our annual loss reserve studies. The results of the studies indicated that overall reserves remained adequate.

In the Fourth Quarter, we booked prior-year development in the insurance segment, which was more than offset by favorable development in the reinsurance segment. The $125 million of prior-year reserve development in the insurance segment is largely related to workers compensation, construction liability, and umbrella business. The construction liability and umbrella were programs the company discontinued several years ago.

The $142 million of favorable prior-year development in the reinsurance segments mostly related to treaty casualty and treaty property business both in the United States and internationally. These redundancies have developed over time, but we don't react until the position becomes more mature. We continue to hold our estimates for the more recent years.

For investments, pretax investment income was $126 million for the quarter and $549 million for the year on our $16.6 billion investment portfolio. Both the quarter and the year investment income amounts were below last year, as anticipated. This result was primarily driven by the low interest rate environment, a decline in Limited Partnership income, and the amount of cash flow used for share buybacks and the redemption of debt.

However, our investment strategy to diversify into high-yield bonds and dividend paying stocks enabled us to exceed our planned investment income for the year. The increased allocation to equities was also a benefit to net income as the year reflected $197 million of net after-tax realized capital gains compared to $114 million last year. These gains are mainly attributable to fair value adjustments on the equity portfolio.

On income taxes, the effective tax rate is primarily driven by low lower than planned catastrophe losses in the year, resulting in higher than expected tax able income for the year. The 2013 operating income effective tax rate was 14.9%. This 14.9% effective tax rate for the year is in line with our expectations and year with much lower than planned cat losses, as mentioned last quarter.

Strong cash flow continues with operating cash flows of $1.1 billion for the year compared to $695 million in 2012. This is primarily due to our premium growth and lower catastrophe loss payment.

As you previously heard, Mt. Logan Re successfully completed its initial capital raise and now has over $360 million of assets under management. This serves to validate Mt. Logan's business model as investors recognize the value proposition of partnering up with a leading global brand insurer.

Shareholders equity for the group was $7 billion at the end of 2013, up 3.5% compared to the $6.7 billion balance at year-end 2012. This is after taking into account capital return from $622 million of share buybacks and $107 million of dividends paid in 2013. The company announced a 56% increase in its regular quarterly dividend and paid $0.75 per share in the Fourth Quarter.

Additionally, we repurchased another $28 million of stock after the year-end close. These purchases will be reflected in the First Quarter 2014 financial statements.

Book value per share increased 12% to $146.57 from $130.96 at year-end 2012. Our strong capital position leaves us with capacity to maximize our potential business opportunities as well as continued share repurchases.

Thank you. And now John Doucette will provide the operations review.

John Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning.

As Dom highlighted, we had a solid Q4, finishing a successful year. Our group 2013 gross written premium was $5.2 billion, up $908 million from 2012, with growth coming from all segments of reinsurance and insurance.

For our reinsurance segments, total reinsurance gross written premium was up 21% in 2013 with new opportunities globally, and all reinsurance segments had increasing gross written premium led by our US reinsurance segment, up 38%.

We benefited both from a continued flight to quality and Everest being one of the leading US domestic property reinsurers. With over 50% of the global property cat premium emanating from the US, this is an important sustainable competitive advantage for Everest. We write US cat business from the US with the ability to seamlessly provide capacity in any form, excessive loss, pro rata, pro risk, all underwritten by the same underwriting team.

We grew topline on several attractively priced treaties with clients seeking capacity exclusively from domestic traditional reinsurers. In particular, we wrote several large multi-line treaties with US regional companies, a targeted market for us.

Total reinsurance bottom line had a $549 million improvement in underwriting profits for the year to $877 million, benefiting from the successful rollout of new product initiatives such as PURPLE, Everest's pillared product, increased capacity to property pro rata deals where we saw improving original pricing, terms, and conditions, and new credit related opportunities in multiple places.

Globally, we saw the benefit of Mt. Logan Re in 2013 as we chose to deploy larger lines on deals we like and increase our cat capacity for key clients. Logan allowed us to manage our net PMLs while growing our topline. And having additional flexible capital management dials such as Logan gives us more flexibility to manage our PMLs before wind season. As Dom said, we view capital markets more as a tool than a true competitor.

In several cases, providing clients with more property capacity resulted in securing better signings on deals we wanted in other classes. As a leading global multi-class reinsurer, we have the ability and expertise to underwrite all lines of P&C business. This is important to note, as less than 25% of our overall business is property catastrophe related.

We wrote several new crop reinsurance and weather deals globally and in these performed well in 2013. We continue to develop capabilities here and if view weather and agriculture as long-term, strategic core competencies.

In 2013, we also wrote some large quota shares, both internationally and in the US, across various lines. These were strategic transactions with some large global clients. The premium on these deals has not yet been fully reflected in earnings.

We continue to execute on several large one-off transactions from new and existing clients, which require significant reinsurance structuring and capabilities; the ability to combine underwriting skill sets across multiple lines of business; manuscript policy wording expertise; and global capabilities with multiple jurisdictional expertise and paper. We can bring all of this to bear and our ability to execute nimbly and in size with a highly rated balance sheet has been a key differentiator in this competitive market.

Globally, we deployed more fac capacity, increasing shares on well rated program and enhancing our product offering to our fac and treaty clients.

To summarize, we are a leading, global, multi-line reinsurer, and we have the culture and organizational structure to react quickly to changing market dynamics and identify strategic opportunities that can enhance the long-term franchise of the Group.

Now, turning to insurance operation, our premium grew by $195 million in 2013, primarily driven by crop, workers' comp, nonstandard auto, property E&S, and casualty. However, insurance calendar year results underperformed, as Craig indicated, driven by prior-year loss development and a difficult US crop season. The result was an underwriting loss of $147 million.

Our crop insurance had an underwriting loss of $57 million in Q4, resulting in an underwriting loss of $68 million in 2013. This was driven by falling commodity prices, particularly corn, as well as final crop yields that were lower than we originally expected and even what we expected a quarter ago.

We saw crop yields all below average in some areas where we have a large footprint, such as southern Minnesota due to excess moisture, and in Texas, due to abnormally dry conditions in the areas we write in.

We anticipate improved underwriting results in our crop book in 2014 as we continue to build out a more diversified geographic footprint, increase operating efficiencies, and roll out new systems. As I stated earlier, ag and weather are long-term strategic focuses for us and the crop business we write through this platform complements that well.

We have a great team at Heartland. We believe that, under more normalized circumstances, our crop insurance book will achieve profitable growth along with our ag and weather reinsurance products.

Our California Workers' Comp book saw 13% rate increases in 2013, continuing the double-digit rate increases for the last several years, providing a compound rate change of over 60% since 2009. Workers' comp writings increased $50 million, mostly from rate increases. Our current accident year workers' comp combined ratio was in the mid-90s%.

Our nonstandard auto book grew nicely, giving broader geographic mix and economies of scale. And our property E&S book continued to see rate increases, growing over $30 million in 2013 with additional geographic diversification.

Our financial institutions book remains talk book profitable, but growth was flat, as we remain cautious in light of increased competition. Our casualty and environmental facilities achieved rate increases throughout 2013, and we grew these books.

Other recent insurance initiatives, including our primary A&H, Canadian insurance, and contingency business, all continued to enhance their capabilities with new hires, new products, and new distribution channels, and are poised for profitable growth in 2014 and beyond.

Finally, some color on January 1 reinsurance renewals, which represents approximately 45% of our annual reinsurance premiums.

Some key themes we saw at 1/1. First, it has become a stratified reinsurance market of haves and have-nots. Everest is solidly in the haves, and we have bound new business opportunities, had strong signings on existing treaties, and, in some cases, differential pricing.

Second, there has been a globalization in consolidation of treaties by several global insurers seeking to both narrow their reinsurance panel to improve security, but also diversify their credit exposure with a broader panel of high quality reinsurers. This has generally been positive for companies such as Everest with strong ratings and high quality balance sheet.

Third, we are successfully competing with and winning against nontraditional capacity everywhere. In many instances, Everest won placements despite offering higher prices, due to our ratings and diversified 40-year-plus franchise, the breadth of our trading relationships with clients globally, and our ability to tailor solutions to meet the clients' needs and to design products that benefit from structural advantages we have over competitors, which have all proven to be significant competitive advantages.

Furthermore, unlike the nontraditional markets, Everest's promise to pay does not expire, nor do we force a collateral release mechanism into products earlier than the natural expiry of the liabilities being reinsured.

Specifically, on 1/1 renewals, casualty was challenging, especially pro rata, due to demands for expanded terms and conditions. As a result, we did withdraw from some contracts and deployed capacity at higher layers on others.

On the other hand, despite headlines on property conditions, we had a successful renewal of our property portfolio globally. Net written premium for property grew by $150 million this January 1. Over all territories and all products, our property book combined ratio increased by a couple of points at 1/1, but we still saw margin expansion across the whole book at this renewal as we continue to grow at what we consider to be -- to still be attractive returns.

Across all classes, we grew gross reinsurance premium by $300 million, or 18% on our 1/1 reinsurance renewal book. And, our net reinsurance premium grew by 6%. We accomplished this growth by expanding shares with existing clients on desirable treaties or layers, writing new quotas shares at attractive terms and conditions, and increasing our marketing of new products and deploying capacity to them.

For example, our PURPLE premium was up significantly at 1/1/2014 as our long-term clients clearly prefer to buy this product from Everest's highly rated traditional balance sheet. The ability to flexibly move between products has been critical to our 1/1 success. We trade with our clients in many different products in every P&C line of business around the world. We are not beholden to excess of loss or pro rata, nor to reinsurance, retro, or insurance. And we will dynamically reallocate capacity to where the best risk-adjusted returns exist. We are not restricted to any product, class, premium size, or minimum rate online. And, we continue to roll out many new insurance and reinsurance products in 2014.

Thank you, and now back to Beth for Q&A.

Beth Farrell {BIO 19732216 <GO>}

Shannon, we will open for questions now.

Questions And Answers

Operator

[Operator Instructions] Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

In the insurance segment, I am just wondering if we could talk about what book specifically, what year is that related to, and can you tell us, in the case of the affected books, what is total case in IB&R that you are currently holding? Thanks.

A - Dom Addesso {BIO 1428096 <GO>}

Michael, the first part of your question kind of cut out. Could you just again restate it?

Q - Michael Nannizzi {BIO 15198493 <GO>}

Oh, I'm sorry. Yes. So I was just saying the reserve development in your insurance segment, I was just wondering. You mentioned work comp, construction, umbrella, so could you give us some color on what accident year is that related to and, just from a magnitude perspective, what is the total case in IB&R that you are currently holding after development for those books?

A - Dom Addesso {BIO 1428096 <GO>}

Well, in the insurance segment, we have about -- we have approximately $45 million of development in work comp, a little over $40 million in construction liability, and $17 million in umbrella.

In the construction liability and the umbrella, those are programs that we discontinued several years ago, so that should not be something that we see in our future results.

In the workers' comp, part of the development related back to some earlier years -- the early part of the 2000 time period when we first got into the program. And it is just a matter of some severity and a handful of claims that we saw from the early part of the decade.

We also, though, did see some increase in frequency of some smaller claims in the later years, primarily in 2009, 2010, and 2011, I believe. And, in that particular case, what we have seen in that increased frequency has been contemplated in the more recent accident years, so our more recent accident years do reflect that increased frequency. And, might I point out those recent most accident years are profitable. Just a second.

A - Craig Howie {BIO 17579923 <GO>}

I just wanted to add that the majority of the workers' compensation adverse development came from years before our rate increases started to kick in four years ago, and we have been getting double-digit rate increases since then as well.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. So has that been related to case reserves, or do you still hold IBNR for those older years?

A - Dom Addesso {BIO 1428096 <GO>}

We still hold IBNR for those years, yes. I don't know that we have our disposal right this minute, but it is split between case and IBNR, so you have to (multiple speakers).

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Great. And then have you had any adverse development -- you mentioned, Dom, recent years. Was that comp or -- I'm just curious if you have heard some commentary about recent professional liability years. Have you seen any adverse development, either in recent comp or recent professional liability, just to be clear?

A - Dom Addesso {BIO 1428096 <GO>}

No, we have not seen any development in the recent years for professional liability. In particular and as I mentioned, the comp where we saw the development on the insurance side was really in the more recent years. It was 2009, 2010, and 2011.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Great. Thanks. And then just on the renewal comment -- this is for John. You seem pretty optimistic about opportunities in property cat. I'm just curious. How are you thinking about opportunities heading into midyear renewals? And, I mean, do you think that your structure or your market position or some other differentiator is allowing you to achieve terms and pricing that are materially better than the market? Thanks.

A - John Doucette {BIO 7178336 <GO>}

You are welcome. Michael, as we talked about, I think each of us talked about in a different way in our drafted response, we do believe that we have, given our balance sheet, given our market position, given how we access US catastrophe business, and the ability to dynamically move between different structures around the globe, that we do have an opportunity to get better-than-market results.

We wrote, as you may recall, we increased our quota share writings in June and July, and we also increased quota share writings at 1/1, as well as moving -- repositioning the book to better lines that we like at more attractive prices.

A - Dom Addesso {BIO 1428096 <GO>}

Michael, let me add to that. In many cases, we are not necessarily going to get different terms and conditions in market pricing, but there are unique circumstances where, with certain clients, where we have had long-standing relationships. The terms that we do get may be different than the market. So I wouldn't say that it is universally in every particular offering that we get terms different than the market.

But, as John is pointing out, were those terms -- if those terms come to us and it doesn't hit our pricing targets, then we begin to allocate our capacity into other places, whether that be pro rata, facultative, or into the primary space. So even if terms and conditions are at the market, we still have the ability to not take those terms and conditions and we can move our capacity into different lines or segments.

Operator

Amit Kumar, Macquarie Capital.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning. I guess two quick follow-ups to the previous question. You had mentioned that some of the piece was from the runoff -- some of the runoff lines. Can you expand on that piece, or is that also related to the comp piece?

A - Dom Addesso {BIO 1428096 <GO>}

It is not related to the comp piece. These are separate programs. As I mentioned, part of it was construction liability, in particular one program where it was a landscapers program. And because of the additional insured endorsement that we have on many of those policies, what we are seeing is an increase in expense, even though you wouldn't normally expect landscapers to be brought into a construction liability claim. But because of the additional insured endorsement, they are being drug into those matters and it is mostly an expense or a defense issue.

The umbrella program, again, is one that we canceled a while ago and, again, the umbrella, as you probably know, is a very volatile class of business. And we got hit this year with several large claims which caused us to increase our estimates in some of the older years.

Q - Amit Kumar {BIO 15025799 <GO>}

That's helpful. I guess what should give us comfort that this might be -- hopefully, this is the last time that this noise sort of resurfaces. What would you say to that?

A - Dom Addesso {BIO 1428096 <GO>}

Well, I guess I would say that it is not really noise at all. We have $10 billion of reserves. We actually reported an overall reserve redundancy coming through the numbers. And, as I have mentioned on previous calls, we manage some 200 different reserve buckets, and there are pluses and minuses in all of those buckets each and every year. These estimates on these particular lines are well within the actuarial ranges. It is not anything unusual to those of us that have been around the reserving process for a long, long time, as I have been. But I think we are proud to point out that our overall reserve position as a group is positive.

And our accident year development, if you go back in time for the entity, has been a pretty stellar record relative to how each accident year is ultimately developed at the group level. But here again, you're managing a portfolio and you have individual buckets or lines of business that sometimes develop poorly. And, on the other hand, offsetting that, would be lines of business that develop redundantly. That is the nature of the beast.

Q - Amit Kumar {BIO 15025799 <GO>}

That's helpful. I guess the one other question, and I will reach you after this, is the discussion on the increase in cat premiums, I guess growth on 18% and net 6%. Do you have corresponding PML numbers which might have been updated post renewals?

A - Dom Addesso {BIO 1428096 <GO>}

Well, we can get into that detail later, but just generally, our net PMLs are up about consistently with those premium increases we cited. It is in different regions. It doesn't mean that is where we will end the year. As John pointed out in his comments, opening comments, we have the ability to go into the market before wind season and change that if we so desire.

But, right now, given our capital position, we are quite comfortable with where our PMLs are at. And, as you probably have noted, through the years that what we carry as our net PML for 1 in 100 and 1 in 250 are pretty conservative relative to the industry.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. I will stop here. Thanks for all the answers.

Operator

Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Yes, going back a little bit on the reserving issue, I just want to understand the process that you go through. Is there an annual reserve review that comes in the Fourth Quarter and this is sort of how it came to be? What is the process right now at Everest Re?

A - Dom Addesso {BIO 1428096 <GO>}

We review reserves throughout the year. Starting at the beginning of the year, though, the reserve buckets that we review tend to be the less material buckets. And then, as we get into the Fourth Quarter, we are evaluating our largest lines of business or largest classes of business, beginning with the most recent data, meaning as of September timeframe. In other words, all the claims data up through September is accumulated in order to do our year-end reserve review. And that is the process that we have been under, at least since I have been here in 2009.

And, if there is anything, for example, during the year that comes up with some of those smaller classes of business, we would certainly book that into our numbers, but generally, given the size of it, it is generally not an issue. And then, of course, the larger, more material lines, as I mentioned, we wait until the Fourth Quarter to accumulate all those studies. Is that what you were asking about?

Q - Josh Shanker {BIO 5292022 <GO>}

Yes. And is the charges that you took, are they more prone to changing views on the frequency or severity?

A - Dom Addesso {BIO 1428096 <GO>}

As I mentioned, we saw both in [multiple speakers].

Q - Josh Shanker {BIO 5292022 <GO>}

Both. I'm sorry.

A - Dom Addesso {BIO 1428096 <GO>}

We saw both, but not out of the same accident periods. The more recent years, 2009, 2010, 2011, was predominantly due to frequency of smaller claims. It is hard to tell, maybe due to economic conditions, but nevertheless, what we have done is we factored in that increased frequency into our most accident year PIQ. So that influence is the entire booking of all of our results. The severity that we encountered was due to business that has since been discontinued, so there really wasn't any need to make any dramatic adjustment for severity relative to our current book.

Q - Josh Shanker {BIO 5292022 <GO>}

And, finally, in thinking about the pricing on reinsurance, going forward, do you see an opportunity for Everest to buy more XOL coverage in midyear or even thinking about a long-term reinsurance protection plan for the company?

A - Dom Addesso {BIO 1428096 <GO>}

There is always that opportunity. And, as I mentioned, I think, in answer to a previous question, and John even made some reference to it, now that 1/1 is over, we have the opportunity between now and wind season to look at various structures. And we did put a structure in place last year.

Q - Josh Shanker {BIO 5292022 <GO>}

That's right.

A - Dom Addesso {BIO 1428096 <GO>}

Well, actually, it was a renewal last year.

A - John Doucette {BIO 7178336 <GO>}

Josh, this is John. We also -- part of the reason that we decided to start Mt. Logan Re and are very excited about that is it gives us a lot more flexibility in terms of how we position our footprint and how we manage our capital and our cat PMLs. And with Mt. Logan Re and other capital market initiatives, whether it is traditional reinsurance or otherwise, we think we can flow the overall book very profitably and keep the PMLs to a level that we are comfortable with. And it will be accretive to Everest shareholders.

Q - Josh Shanker {BIO 5292022 <GO>}

Well, congratulations on a very strong quarter. Thank you.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

The first question is on the adverse development on the construction liability and umbrella. Curious as to what the deal on those liabilities are. So when will those programs discontinue and so when can we see the end of these claims?

A - Dom Addesso {BIO 1428096 <GO>}

Well, on the construction liability area, I believe it is a seven-year period after which the policy was issued. I don't recollect the exact date, but it was 2008 was the last policy that was issued. I think the claims can be made in a period of seven years after that date.

We feel obviously our reserve addition was sufficient, to answer your question about seeing the end of it, but, as you know, again, reserves can always move around, but, again, in the context of our overall reserve posture, we don't believe it is going to be a problem.

Umbrella, on the other hand, doesn't have a fixed discovery period, if you will, so umbrella claims can come in for a long time. Again, a volatile class, but we feel as if what we booked is reasonably conservative. And, again, in the context of our overall reserve position, we don't feel that either one of these classes or lines of business will present a problem for our future financial performance.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. And when was the umbrella program discontinued?

A - Dom Addesso {BIO 1428096 <GO>}

Three or four years ago. I don't remember the exact date.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. That's helpful. And then, moving to crop, you said $68 million of losses. I believe crop premiums, were they about $300 million-ish last year?

A - Dom Addesso {BIO 1428096 <GO>}

Gross. Yes.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. So, just looking at the combined ratio, that seems to be about a 122 combined ratio. Just curious why it would be that high on crop.

A - Dom Addesso {BIO 1428096 <GO>}

Well, technical ratio was about 112 and then the rest was just expenses. But, and we are a little higher than the industry, at least what has been reported to date, just because of some of the concentration we have, in particular, as John mentioned, in Minnesota and Texas being some of our largest states, which, in fact, relative to the industry, held us in better stead last year. But, Minnesota, for example, has a long history of being a very, very profitable state.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. That's helpful. And for 2014, what is the targeted combined ratio for the primary insurance operations in total? Because I believe that, under workers comp, you said you were reserving to the mid-90s%. The rest of the book, ex-crop, representing 94.6%. So, looking at 2014, what is your targeted combined ratio for the primary business?

A - Dom Addesso {BIO 1428096 <GO>}

We believe that the numbers in the low to mid 90s% would still be achievable and maybe perhaps better, but for now, I will leave it at that.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. And one last, if I may, on the reinsurance business. I think it is changing your business just a tad, moving to write more pro rata versus excess of loss business. Should we see an uptick in the accident year loss ratio ex-cats because of that business mix shift?

A - Dom Addesso {BIO 1428096 <GO>}

Not necessarily. There might be an uptick in certain lines of business due to rate movements, but also as we move the portfolio into other lines of business, particularly new products, that is actually having the impact of lowering our attritional combined ratio. So I am not going to give you a number at this point because we don't really give guidance but, to be honest with you, it depends on what the final mix at the end of the year comes in at, but we are not anticipating an increase in that number. I will leave it at that.

Q - Vinay Misquith {BIO 6989856 <GO>}

Thank you.

Operator

Greg Locraft, Morgan Stanley.

Q - Greg Locraft {BIO 4221265 <GO>}

Congrats on a great year and a strong quarter. I wanted to understand. I am just looking at the profitability of the insurance segment, and it hasn't been profitable on the underwriting side for many years. I certainly understand the reasons why this particular year. But how do we think about net investment income allocation to this segment? Is it just kind of pro rata with premiums, or is there more investment income being earned out of this book of business?

A - Dom Addesso {BIO 1428096 <GO>}

We don't really do a specific allocation that we could talk about in this call, but I would think about it more in the context of a premium allocation.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. So for those of us that are looking and saying, oh, they're not making any money in underwriting, the reality is you are making, call it, $100 million-plus, probably, in investment income as well, if you were to actually break it --

A - Dom Addesso {BIO 1428096 <GO>}

But our focus, quite frankly, Greg, is on the underwriting account. That is where our attention is. And we don't rely on the investment income because, at today's yields, that is not really giving you the appropriate return and, as I mentioned, our current year attritionals are in very good position. And, given the way we increase it, we are continuing to get in California comp. What we are doing in the property E&S space, our other strategic initiatives in the insurance platform, we are quite bullish on it. So, the profitability issues that you are seeing are things that relate to, frankly, a lot of which was discontinued four or five years ago.

Q - Greg Locraft {BIO 4221265 <GO>}

And crop as well. Yes.

A - Dom Addesso {BIO 1428096 <GO>}

Well, the crop -- and the crop in particular is -- remember, it is not -- we look at that not unlike we look at our reinsurance catastrophe business, right. And also, even though it is reported within the insurance segment, we have capabilities now globally. As John somewhat mentioned in his comments, we look at weather and crop in other jurisdictions kind of jointly. We have capabilities that we can look across the organization and how we are doing in crop and that is part of [technical difficulty] as well, even though they are reported in two different segments.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Great. And then turning to capital management, on the one hand, you bought back 9% of the shares outstanding at the beginning of the year, so it was a robust buyback in a strong year. On the other hand, it was only 68% of capital return via buybacks and dividends on the year. So you actually, in a way, you held back. It looks like you haven't done much the month of January. You have done a little bit, but I'm sort of wondering. What is -- you know, stock is below book value. What is keeping you from doing more on the buyback front?

A - Dom Addesso {BIO 1428096 <GO>}

Well, we were in January as long as we could be in the month of January. Of course, as you know, at some point during the month, we begin to know the numbers and we are basically restricted from being in the market. So, that is really the only thing that held us back in the month of January.

In the Fourth Quarter, we were buying stock even at above book value, but we couldn't get all of the stock that we wanted at the prices that we wanted it that.

So we will continue to work. We continue to be bullish on share repurchase, balance that up against what the market opportunities are. As has been pointed out, we had a strong 1/1. We will consider that in the upcoming 4/1 as we evaluate and price of the stock, as we evaluate what our share repurchases will be in this quarter and the upcoming quarters. But, I think it is fair to say that we are still very interested in share repurchases.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Great. And congrats again on the year. Excellent job.

Operator

Meyer shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning. Two quick questions, if I can. One, is there any way of ball parking, given the growth you had at 1/1, how much more capital you think you need this year compared to last year?

A - Dom Addesso {BIO 1428096 <GO>}

How much more capital we need? Well, I guess if you wanted to ballpark it, you could relate to PMLs and to premium growth.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Yes. I just wanted to know if there is any offset to that. And, second, was there any adjustment to the accident year 2013 loss PIQ for workers' compensation in the quarter, given the adverse development on recent years?

A - Dom Addesso {BIO 1428096 <GO>}

No. There was not.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Are you confident with the level of pricing that you have been implementing, let's say, over the last six months?

A - Dom Addesso {BIO 1428096 <GO>}

Well, our reserve numbers are -- that we pick in the most recent accident year is what I call bridged off of the previous accident year. So, it is taking into account the experience of those years. Plus layer on top of that rate increases that we have had. And as John pointed out, over 60% rate increase, cumulative rate increase, since 2009. And then subtraction from that would be assumed loss cost trends. So our most recent accident years are a reflection of the development we have seen plus pricing.

Q - Meyer Shields {BIO 4281064 <GO>}

Right. But I guess the question is that you have known the pricing for a while, but the base on which (inaudible) seems like it would be higher.

A - Dom Addesso {BIO 1428096 <GO>}

I'm not sure I understand that question.

A - Craig Howie {BIO 17579923 <GO>}

I think what has happened here as well -- this is Craig -- is that you are essentially picking a conservative number to begin with, and we have not let that number come down just because of the pricing that Dom was talking about. Does that help?

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Understood. Thanks very much.

Operator

I will now turn the call back to the presenters for any additional or closing remarks.

A - Dom Addesso {BIO 1428096 <GO>}

This is Dom. I just want to close with thanking you all for participating on the call. As you have heard, we are quite bullish on our opportunities and trajectory going into 2014. We think we have the capital to take advantage of market conditions while, at the same time, maintaining our interest in share repurchases. So again, thank you for your interest.

Have a good day.

Operator

That does conclude today's conference. Thank you for your participation.