Q2 2017 Earnings Call

Company Participants

- Craig W. Howie, Chief Financial Officer & Executive Vice President
- Dominic James Addesso, President, Chief Executive Officer & Director
- Elizabeth B. Farrell, Vice President-Investor Relations
- John P. Doucette, Executive Vice President, President & Chief Executive Officer of the Reinsurance Division
- Jonathan M. Zaffino, Senior Vice President & President-North America Insurance Division

Other Participants

- Elyse B. Greenspan, Analyst
- Joshua D. Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day everyone. Welcome to the Second Quarter 2017 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.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you. Good morning and welcome to Everest Re Group's Second Quarter 2017 Earnings Conference Call. On the call with me today are Dom Addesso, the company's President and Chief Executive Officer; Craig Howie, Chief Financial Officer; John Doucette, President and CEO of Reinsurance Operations; and Jon Zaffino, President of North American Insurance Operations.

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.

Dominic James Addesso {BIO 1428096 <GO>}

Thanks, Beth, and good morning to all. We are pleased to be able to report $246 million of net income for the quarter, which was $90 million above last year's second quarter. On a year-to-date basis, net income rose $210 million to $537 million. These results were primarily driven by excellent underwriting results of $130 million for the quarter and $313 million on a year-to-date basis, which include $54 million of cap losses in second quarter and $74 million in the six month results.

These results are improving year-over-year due to continued growth in premium, along with a lower combined ratio, due in part to lower catastrophe losses in the quarter. More important is the improvement evident in the Insurance segment where we have an underwriting gain this year versus last. The attritional combined ratio from Insurance has now reached 93.6% for the quarter. The various growth and underwriting initiatives we have implemented are beginning to take hold. Overall premium is up $238 million or 17%, with growth coming from both Reinsurance and Insurance; however on a percentage basis, insurance is up 25% while reinsurance is up 14%.

The growth in Insurance, which Jonathan will discuss in greater detail in a moment is well diversified coming from several new business units. We are extremely encouraged by the growth in all of our segments.

In the Reinsurance businesses, while due to market conditions there are areas where we are contracting; there remains an array of opportunities in the credit and structured solution areas that are contributing to profitable growth. In addition, as John Doucette will cover in his report, proportional transactions including crop reinsurance are presenting profitable opportunities in today's market environment.

The non-U.S. segments have also been a reasonable growth area for us more recently, as we have added resources there and established new locations. While Reinsurance is still a challenged space, we have been successful in achieving better than market returns due to our ability to reallocate our capacity in scale through the better return in opportunities.

Our size and relationships matter in this type of market. Scale also plays a meaningful role in the success we've been having in the Insurance segment. The ability to operate in sophisticated lines of business with meaningful capacity and a strong balance sheet with A-plus ratings matter to customers and brokers. These factors have also enable us to attract terrific talent and armed with our financial strength, have propelled us to over $1 billion of premium in the first half of the year.

At the same time, we have eliminated a number of underperforming businesses. For example, crop insurance and we have strengthened our reserve position. All this is leading to a profitable first half and as earned premium begins to catch up with the written premium, we would expect this profit picture to accelerate.

Our insurance operation is in the best position it has ever been, and is now a recognized market to brokers and their customers.

On the investment front, there was also a positive movement over the prior year as income was up 9% for the first six months. This is a result of some rotation into limited partnerships on public equities and traditional fixed income. However, our allocations are still quite conservative relative to the industry.

Our investment team has done an outstanding job of enhancing performance through this cycle while maintaining quality. Overall, our results were excellent with an ROE of 13% for the first half. Our shareholder's equity growing to $8.6 billion and our market cap reaching $11 billion. These factors have led us to just recently being added to the S&P 500, a great accomplishment and acknowledgement to our shareholders and employees.

Now, I'll turn it over to Craig for the financial report, and look forward to your questions in a bit. Thank you. Craig?

Craig W. Howie {BIO 17579923 <GO>}

Thank you, Dom, and good morning everyone. Everest had a solid quarter of earnings, with net income of $246 million. This compares to net income of $156 million for the second quarter of 2016. On a year-to-date basis, net income was $537 million compared to $327 million for the first half of 2016. The primary differences were an improved underwriting result, higher capital gains, higher investment income, lower catastrophe losses and lower foreign exchange losses compared to the first half of 2016.

Net income included $50 million of net after-tax realized capital gains compared to $30 million of capital losses in the first half of 2016. After-tax operating income for the second quarter was $227 million, compared to $134 million in 2016. Operating income, year-to-date, was $487 million, compared to $357 million for the first six months of 2016.

The overall underwriting gain for the group was $330 million for the first half, compared to an underwriting gain of $234 million in the same period last year. All segments reported underwriting gains for both the quarter and on a year-to-date basis.

The year-to-date combined ratio for the group was 88.3%, down from 90.7% reported in the first half of 2016, with lower catastrophe losses contributing to this favorable variance. In the second quarter of 2017, the group saw $54 million of current year catastrophe losses, net of Reinsurance.

Of the total, $25 million related to wildfires in South Africa, $15 million related to U.S. storms in Colorado, and $14 million related to floods in Peru. This compares with $124 million of catastrophes during the second quarter of 2016.

On a year-to-date basis, catastrophe losses totaled $74 million, compared to $134 million for the first half of 2016. Excluding the catastrophe losses, the current year attritional combined ratio through the first six months was 85.6%, essentially flat from the 85.7% for the first half of 2016. Our expense ratio remains at 5.8% for the first two quarters of 2017.

From investments, pre-tax investment income was $135 million for the quarter and $257 million year-to-date on our $18 billion investment portfolio. Investment income was up 9% from one year ago. This result was primarily driven by the increase in limited partnership income, which was up $40 million for the first half of 2016 primarily due to the turnaround in energy-related investments compared to last year. The pre-tax yield on the overall portfolio was 2.9%, with a duration of just over three years.

Foreign exchange is reported in other income. For the first half of 2017, foreign exchange losses were $5 million, compared to $31 million of foreign exchange losses in the first six months of 2016. The 2016 foreign exchange losses reflected the weakening of the British pound during 2016 related to the Brexit vote.

Other income also included $4 million of earnings and fees from Mt. Logan Re in the first six months of 2017, compared to $3 million of income in the first half last year. The increase reflects the lower level of catastrophe losses during the first half of 2017 compared to 2016, resulting in a higher profit share to Everest.

On income taxes, similar to the first quarter of 2017, the 9% year-to-date effective tax rate on operating income was lower than the expected range for the year. The 2017 rate is lower than the 10% tax rate for the full year 2016 due to a FASB tax accounting change related to share-based compensation and the utilization of foreign tax credits for years 2008 and prior. These two items reduced the effective tax rate by about 1 point.

The effective tax rate is an annualized calculation that includes planned catastrophe losses for the remainder of the year. Should catastrophe losses come in lower than this estimate, it would be expected that the tax rate would increase.

Stable cash flow continues with operating cash flows of $634 million for the first half of 2017, compared to $684 million in 2016. The decline reflects a higher level of paid catastrophe losses in 2017 compared with 2016.

Shareholders equity for the group was $8.6 billion at the end of the second quarter, up $500 million or 6% over year-end 2016. This is after taking into account capital return for $103 million of dividends paid in the first half of 2017. Our capital position remains very strong and continues to grow.

Thank you. And now, John Doucette will provide a review of the reinsurance operations.

John P. Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning. We are pleased to report another strong quarter with $126 million of Reinsurance underwriting profit. The second quarter combined ratio improved to 87.4% from 89.9% in the second quarter 2016.

The loss ratio improvement of 1.2 points to 60.2% was driven by lower catastrophe losses, offset by a 3.6 point increase in the attritional loss ratio. This was an anticipated outcome and was mainly due to the crop reinsurance book new this year, as well as the increased property pro rata writings, offset by reduced attritional loss ratios on the international book.

Total gross written premium for the second quarter was $1 billion, an increase of 14% compared to the prior Q2. This growth is due to several factors, but largely can be attributed to $54 million of crop premium associated with our strategic crop reinsurance relationship that resulted from the sale of Heartland last year.

In our U.S. Reinsurance segment, second quarter gross written premium was up 17% to $475 million, driven by the new crop treaty and the impact of a large premium portfolio out in Q2 2016. The second quarter combined ratio in this segment was up 8 points, primarily due to the weighting of crop and property pro rata earned premium in the quarter with higher attritional loss ratios.

While both lines have higher combined ratios, they maintain attractive ROEs due to their low capital consumption. The increased loss ratio was offset by a 1.5 point drop in the expense ratio, mainly due to lower contingent commissions in the quarter.

Our International Reinsurance segment second quarter gross written premium was $320 million, down 6% partly due to some large one-off deals with strategic client written in the prior year. Net written premium for the quarter was down 3%, but up 7% on a year-to-date basis due to the impact of timing on the receipt of several accounts. The combined ratio for the second quarter dropped to 93.7% from 115.8% in Q2 2016, due to lower catastrophe losses given the Fort McMurray wildfires and the Ecuadorian earthquake last year.

The attritional loss ratio also dropped 6.2 points to 50.1%, due to continued favorable loss trends. The lower loss ratio was offset by a 2.6 point increase on the expense ratio, primarily driven by the higher mix of pro rata premium affecting the commission ratio.

Our Bermuda segment second quarter gross written premium increased 47% to $238 million or up 51% on a constant dollar basis. The growth was derived from new product opportunities, timing of certain accounts, additional pro rata treaties in property, credit and casualty line, increased writings in UK motor, post Ogden rate changes and some large multi-class programs with core client. The combined ratio increased to 90.3% from 88.9% due to a 7.9 point increase in the loss ratio, offset by a 6.5 point decrease in the expense ratio.

The loss ratio comparison was affected by a sizable capacity reserve release in 2016, a shift in business mix and an increase in the current year loss ratio due to the change in the Ogden discount rate this year. The drop in commission was caused by a larger mix of business with naturally lower commission ratios.

Turning to the 6/1 and 7/1 renewal, Everest continued to dynamically allocate capital to opportunities with the best risk-adjusted returns. Rather than chase the market down on non-performing deal, we reduced or declined these and selectively deployed capacity towards deals that were priced well.

On balance, this approach resulted in similar amounts of capacity deployed with only a marginal deterioration in expected returns. This ability to successfully shift risk capital to the benefit of our overall portfolio which grew at 6/1 in Florida and at 7/1 in the U.S., Canada, Latin America, Bermuda, London, Zurich, Singapore, China and Australia, highlighting our very diversified portfolio and global origination capabilities. We also wrote more structured and customized transactions that are somewhat more shielded from market pressures.

International property rates were on average down about 5% for us this 1/1 – this 7/1 with some isolated pockets of rate increases in loss affected area.

In the U.S. property markets, June 1 XOL rates continue to edge down. Lower-rated, smaller reinsurers, and non-traditional players bore more of the brunt of the rate pressure. As cedents gravitated to higher-rated leading reinsurers like Everest, who received larger lines overall and better signings on the more attractively priced layers.

We also cut participation on poorly performing XOL deals. Despite declining their placements, we typically continue to trade with many of those clients on different products or different attachment point. We saw ongoing demand for our capacity on higher layers, where we currently find better risk adjusted returns. This combination of strategies resulted in a better than market outcome for us, as we saw rates for our Florida XOL June 1 book being closer to down only about 3%, and the rest of our U.S. July 1 book being closer to flat.

In addition, having been impacted by Hurricane Matthew and AOB claim issues, some Florida exposed pro rata deal saw improved reinsurance terms, and we deployed more capacity accordingly to that.

With our strong franchise, we have been able to increase our depth in various U.S. and international markets, continue to expand in areas dislocated by loss activity or grow with existing clients in new lines business.

Repeatedly, we are a go-to-market for shortfall covers, as market stabilization in these specific lines prevent deals from completing at aggressive firm order terms. In our causality book, reinsurance terms are mostly stable but original rate and loss trends pressure economics. We judiciously deploy our capital and cutback when necessary, favoring lines with healthier returns.

Recently, some large casualty deals were not completed at the firm order terms, resulting in either not placing the deal and the clients retaining it net or the buyer had to improve terms for the reinsurers to get the deal fully priced, both signaling the casualty market is trying to find a floor.

The persistent strength and financial success of the Everest franchise reflect the value that we are constantly trying to deliver to our reinsurance clients. We continually strive to build enduring and strategic client relationships, highlighted by the fact that 75% of our reinsurance clients have been trading with us for at least a decade and over 50% of our clients worldwide have been trading with us for over 30 years.

Leveraging our leading global franchise, our empowered underwriters nimbly provide customized solutions to our client, earning us a first look at new and unique market opportunities. Consequently, we remain optimistic about our future and our ability to deploy capital profitably despite the tough market. All said, the mid-year renewals continued the macro theme of delivering the most value for reinsurance clients at the best cost.

Thus, the reinsurance market continues to sprint towards: one, more capital efficiency through size, scale and diversification; two, alternative risk transfer mechanisms to enhance capital efficiency and best match capital to risk; three, increased focus on distribution to access profitable business which is becoming increasingly more important; and four, improved operational and expense efficiencies.

Those reinsurers that can execute on these objectives will succeed in both good and bad reinsurance markets, but those that do not could be disintermediated or diminished as the reinsurance value chain compresses. Everest continues to remain nimble in its approach to this change in market environment, adapting its operating strategies to ensure success today, and into the future in the new reinsurance world order.

Thank you. And now, I will turn it over to Jon Zaffino to review our insurance operations.

Jonathan M. Zaffino {BIO 16652236 <GO>}

Thank you, John, and good morning. Our global specialty insurance operations delivered a solid quarter of performance. The significantly transformed Everest Insurance platform continue to take shape and the momentum we are generating in the market as a result remains encouraging.

The second quarter marks the highest level of quarterly gross written premium realized in our insurance operations history. The achievement of this milestone was a result of highly-diversified growth generated from over 150 specialty products despite no premium contribution from the now divested Heartland Crop portfolio.

Importantly, this quarter build upon the underwriting profitability achieved in the first quarter of this year. Most notably, when compared to the second quarter of 2016, we achieved an excess of $30 million of improvement to underwriting profit. The many strategic actions executed upon since 2015 are beginning to take hold and evidence themselves in our results.

Turning to the financial results for the quarter and year-to-date period. As in prior quarters, due to the divestiture of Heartland in late third quarter of 2016, I will discuss comparative results excluding this business.

For the second quarter of 2017, the Global Insurance operations produced $569 million in gross written premium, an increase of $164 million or 41% over second quarter 2016, a tremendous result considering the challenging market conditions.

On a year-to-date basis, we achieved $1 billion in gross written premium, again another record performance. This represents growth of $240 million or 31% over the comparable period in 2016. Contributions were relatively balanced across most underwriting divisions. The significant addition of new products which continue to gain scale, coupled with strong performance from our many existing product areas, namely Accident and Health in the quarter, contributed to this excellent result. This represents the 10th consecutive quarter of growth for our Global Insurance operations.

Also in the quarter, our new product launches and recently assumed portfolios contributed 19% to total premium production, along with an additional 4% from our Lloyd platform; numbers that are consistent for the year-to-date period.

Let me offer a bit more context at the divisional level. Our property portfolio experienced a meaningful growth in the quarter and year-to-date period. The U.S. wholesale property book, aided in part by the previously announced renewal rates transaction, closed at the end of the first quarter was a large driver of this growth. Further contributing was the steady expansion of both our Inland Marine and newly-launched retail property groups.

Growth in various other property portfolios globally was balanced and in line with our expectations. Globally, this line represents roughly 28% of our year-to-date premium production.

Everest Specialty Underwriters. The division focused on professional and management liability in various other specialty products also grew nearly 25% over the prior year-to-date period. Growth, however, was not experienced across the board. Some of our management liability books were down significantly in the same period as we simply did not find the rating environment to be supportive of our profitability ambitions. We have been able to redeploy our resources to areas within ESU that better meet our objectives.

The Everest Risk Management division, which houses our primary and large account casualty operation, our monoline work comp unit, the commercial casualty team, and our multinational group also achieved meaningful growth in the quarter and year-to-date period. Overall, premium production increased 41% and 33%, respectively, over the prior year quarter and year-to-date period and profitability remains solid.

This business is also strong bellwether of the growth in our brand across the market. In the case of large account primary, we work with our brokers and risk managers to design thoughtful risk financing casualty programs, inclusive of a suite of services.

There are many hurdles to entering this business, yet we find ourselves in a position of growing strength as the operation continues to mature. Everest Underwriting Partners, our delegated authority operation, was essentially flat in the quarter and, in fact, down 3% in the year-to-date period. Yet, profitability was the strongest we've seen in several quarters. Impacting our growth were various underwriting actions taken to address a few underperforming portfolios, namely non-standard auto.

Finally, our Lloyd's operation also continued its expansion. The syndicate contributed $24 million to the insurance growth in the quarter and $45 million year-to-date. The steady and cautious build of our portfolio continues with a balanced contribution from several lines of business, including professional indemnity, financial institutions, liability, accident and health, and contingency.

Again, we remain deliberate in our growth pursuits and we'll continue to seek opportunities for profitable expansion. So, again, meaningful growth coming from balanced contributions across the global portfolio. Yet, not all divisions are growing as profitability remains our number one objective.

Turning to net premiums. As we've shared in the past, net written premium slightly lags gross written premium growth due to the marginally more conservative reinsurance position we've taken to support the growth across our underwriting divisions.

Net earned premium in the quarter was $364 million, an increase of $70 million or 24%. For the year-to-date period, net earned premium of $688 million increased by $118 million or 21% over the prior year period.

Earned premium growth has lagged net written premium growth due to a few factors. First, our growth rate has accelerated in the recent quarters as our new underwriting divisions become fully operationlized in the market. Second, various lines of business we are writing, long-term very profitable lines, earn over a period longer than 12 months. As these businesses gain additional scale, we expect earned premium growth to accelerate, which we are confident will lead to growing underwriting profit.

Turning to the combined ratio. For the quarter, the GAAP combined ratio was 99.1%, almost a 10 point improvement from the second quarter of 2016. While we are pleased to have produced an underwriting profit of just over $3 million in the quarter, there were some headwinds from various cat events that distort the progress we expect to show on a run rate basis, which I'll get into. On a year-to-date basis, the GAAP combined ratio was 98.8%, a 4 point improvement over the first half of 2016.

Our attritional results for the quarter and year-to-date period are 93.6% and 95.7%, respectively. This compares favorably to 2016 second quarter of 95.7% and 95.8% year-to-date. So, again, improvement in the quarter and stability on the year-to-date result.

The quarter's loss and loss adjustment expense ratio improved significantly from the prior-year period to 70.3% from 80.2%. As you'll recall, the second quarter of 2016 was impacted by significant cat activity from the Texas hailstorms and the Fort McMurray wildfires, which combined had a 13.1 point impact to the loss ratio. While this quarter was also impacted by a variety of well-publicized cat events, it was not of the same magnitude of last year.

On an attritional basis, the second quarter 2017 loss ratio improved to 64.8%, 3 points better than the 67.8% attritional produced for the first quarter of this year and 2 points better than the attritional loss ratio of 66.9% in the second quarter of 2016. We are beginning to see the drift down in the attritional loss ratio based upon improved mix, the benefits from the many new businesses launched and the strategic underwriting actions of the past two years.

Looking at the year-to-date period, the GAAP loss ratio improved to 69.3% in the prior year period of 74.3%, a 5 point betterment. The attritional loss ratio also improved a full point to 66.2% from 67.3%.

A few additional comments, first, as I mentioned the second quarter experienced another elevated level of cat activity in the U.S. PCS cat events 17, 32 (31:38), the Colorado hailstorms in particular impacted our North American results by almost 4 points. Second, the significant convective storm events across the first and second quarter added roughly 2 points to our attritional loss ratios; certainly, all manageable outcomes based on the profitable growth in our earned premium base, but nonetheless creating some quarterly pressure on results.

We also recognized a small amount of adverse prior year development from our non-standard auto book of nearly 2 points in the quarter. This is an area we continue to de-emphasize in our go-forward portfolio. Offsetting these increases to our lost ratio was a 4 point improvement in the Accident and Health division's accident year loss ratio. Our A&H group delivered an outstanding quarter.

Our expense ratio in the second quarter was 28.8%, down from the first quarter result of 30.2%. For the year-to-date period, the expense ratio is 29.5%, up slightly from the 28.5% in the comparable period of 2016. Our operating expense ratio for the second quarter was 12.5% compared to 12.4% for the prior year quarter, essentially flat. Year-to-date operating expenses were 12.8% for 2017 compared to 12.2% last year.

Again, we anticipate the expense ratio has stabilized as we continue upon our growth plan, and as earned premium continues to come through. As we have stated in prior calls, an expense ratio of roughly 30% remains very competitive in the specialty insurance segment.

Turning to the operating environment. The second quarter trended quite similar to the first quarter. Suffice it to say that it's a competitive market and underwriting excellence is paramount in this environment. Clarity of risk appetite, clear knowledge of the rating environment, and the thoughtful assumption of risk are all key attributes of our approach.

As in prior quarters, the overall level of rate change can vary meaningfully by major line of business. In general and outside of commercial and personal auto, there are various degrees of rate pressure; workers' compensation, particularly in California, professional liability and various causality lines are all feeling some degree of mild pressure generally in the flat to mid single-digit range, again consistent to prior quarters.

Commercial and personal auto remain the outliers and are each achieving low double-digit rate increases across our portfolio. As discussed in prior calls, we feel that U.S. property market continues to find the bottom. While the rate environment has not turned consistently positive as yet, we feel it is flattening out, again with some caveat between cat and non-cat exposed areas. So another quarter of predictable trend for our each line yet with a tone of stabilization across the overall portfolio.

In conclusion, we are pleased with our results to-date. As our portfolio continues to gain scale, we are encouraged by the increased resiliency of our platform to achieve underwriting profitability. Our attritional results are especially encouraging. Our many new and existing colleagues continue to execute well on their individual underwriting mandates and we look forward to continuing our momentum and reporting back to you on our progress next quarter.

Now, back to Beth for Q&A.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you, Jon. Operator, we are ready to take questions at this time.

Q&A

Operator

We'll have our first question from Elyse Greenspan.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi, good morning. My first question is on the Reinsurance growth. Pretty strong growth again in the quarter. Last quarter, you guys had pointed to about high single-digit growth as a sustainable level that you saw at the time for that book; the second quarter was stronger than that, and I think part of that was probably due to some of those property pro rata signings you pointed out. But how do you see, I mean the rest of the year trending just in terms of on the growth prospects of your Reinsurance business just based of how you saw June and July renewals and how you're thinking things through right now?

A - Dominic James Addesso {BIO 1428096 <GO>}

Elyse, this is Dom and I'll ask John to comment as well. But as we mentioned and you mentioned, part of it was due to the shift to a couple of new proportional deals, which that premium then will have an impact on the remainder of the year, so that will affect premium growth. And then also the crop – the new crop reinsurance transaction, which will also have similar impact on the remainder of the year. But absent that, the renewal seasons are pretty much over other than we had in July 1, but again most of the activity is in the first half of the year in terms of renewals and new business opportunity.

The growth areas for us though continue to be mortgage credit, structured solutions, and that's where absent the other items I just mentioned, that's where frankly the growth opportunities are and that our previous guidance on that in terms of growth as you indicated a high single-digit would still remain. Unless John has anything to add to that.

A - John P. Doucette {BIO 7178336 <GO>}

I agree.

A - Dominic James Addesso {BIO 1428096 <GO>}

Does that answer your question?

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. And then, in terms of the Insurance business, pretty strong growth and a lot of commentary that you guys gave. If the growth remains at 40%, do you think that based as how you put it all together that you could maintain an underlying margin in the low 90s? And one question I had on, you did call out, John the convective storms of about 2 points, is that stuff that sell outside of your cat definition in the Q2, meaning that the margin might have been better adjusting for that, I'm just trying to tie that together? Thanks.

A - Dominic James Addesso {BIO 1428096 <GO>}

Yes. The 2 points that Jonathan referenced falls within the attritional number that he quoted, so that's not, in our vernacular it's not a cat, all right. They're cat events, but they don't yet disclosed by us as a cat or recorded in our numbers as a catastrophe. It is in the attrition.

And again, in terms of the growth, no, I think, we said for some time that we would anticipate an improvement in our attritional, and we're at those levels where we think it is sustainable. We have great diversification across the entire platform. So, we're not dependent on any one line of business or any one product, which not unlike the Reinsurance sector, enables us to increase our capacity or increase our appetite in those lines of business that we feel are giving us the requisite profit and return on our capital, and de-emphasize those classes of business that are not. It doesn't mean we totally withdraw, but it allows us to shift our capacity around. So, several new business units and allows for great diversity in of course the entire platform. John, if you want to add?

A - John P. Doucette {BIO 7178336 <GO>}

No. (39:31) well done.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. And then one last question. Can you talk the losses in the quarter, you guys had some losses in South Africa and Peru. Can you just talk about your exposure there, and what kind of returns are you getting in normalized years in both of those markets?

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

Good morning, Elyse. It's Jon. So, we have write a significant portion of our business outside the U.S., and have been strong in many countries around the world including those. And we write in each of those countries, we have a strong franchise, an attractive book of business, and writing for many years. They would typically run in the 80s across the cycle. So, 80s combined ratio, it could go up or down based on cat activity.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Elyse.

Operator

We'll go next to Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. First question is on the follow-up in the Insurance segments. The – if second quarter top-line growth is 41% ex-crop, and a margin improvement of a 210-basis point, it's very impressive. I just wonder, you mentioned it's a very competitive marketplace. Can you tell us a little more how exactly do you gain market share in the marketplace, and why actually improving your margin? Because assuming if you grow very fast, probably, there are certain so-called, I don't know, you could term the new business apparently apply to these line of business as well. Can you maintain the margin or even improve the margin going forward?

A - Dominic James Addesso {BIO 1428096 <GO>}

Kai, this is Dom. I don't necessarily agree with your assertion or assumption that growth comes – with growth, comes underwriting deterioration. It's as I just kind of described in response to Elyse's question of diversification of costs, many different product segments allows us to maintain our underwriting integrity and increase capacity for those lines business where we're getting adequate returns.

We do think that we are improving our attritional and there's still some improvement that we think we can garner, particularly in the property segment, remembering at the first half of the year. For property as Jonathan pointed out, had a number of cat events but also as we described in non-cat cat events, adding 2 points to the attritional. And we anticipate that as the year plays out that we'll have some improvement in those areas. So we would certainly anticipate an improving combined ratio picture on the Insurance side, again coming from diversity, diversification amongst business unit and products within those various business units, and remembering that we are a specialty insurer and we are not writing small commercial. We're not in the BOP business or those areas that are subject to, in our view, some of the more competitive pressures in the marketplace.

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

I would add to that Kai that there's really a couple of things here to remember. Number one is that we have doubled our underwriting staff over the last two years. So we have a lot more boots on the ground, seeking profitable opportunities in the lines of business we have chosen.

Secondly, we have launched literally dozens of products, so to Dom's point about diversification across the platform, it's significant. It's coming from a number of different areas and to the point I tried to raise earlier it's not - growth is not linear across our platform, it's not at all moving in lock step. There are several actions being taken still to try to drive a better attritional result. So we're seeing now the effects of all those efforts that have happened over the last couple of years.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you for the expansive answers. My second question on Reinsurance side. You talked a little bit more about what caused the deterioration, 210 basis point, what are the moving parts? And you mentioned by the cropping reinsurance about property pro rata treaties. Could you quantify how much each basically contributed to the year-over-year deterioration and do you think that that will be a kind of normal stable run rate going forward?

A - Dominic James Addesso {BIO 1428096 <GO>}

Will what be a stable run rate? The attritional that we have on the Reinsurance portfolio?

Q - Kai Pan {BIO 18669701 <GO>}

Yeah, exactly, yeah.

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

Well, some of that is dependent upon what happens with future rate levels, right? And I don't know that we have all the details I could give you there. And we do have some of it. So growth in crop, that have 4.6 point impact. We had some of the increase due to pro rata, had an impact of approximately 3 points. So that will give you some indications on the attrition.

Q - Kai Pan {BIO 18669701 <GO>}

That's in the...

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

That's what was driving the higher attrition.

Q - Kai Pan {BIO 18669701 <GO>}

That's in the U.S. Reinsurance segment?

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

That's U.S., yes.

Q - Kai Pan {BIO 18669701 <GO>}

Okay, great. Last one...

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

And on the international side, we had a 6 point improvement in some of the operations there. Middle East, Africa showing some improvement in the non-cat loss trend. On the Bermuda side, we had an increase due to higher ELR on some of the treaties we've written. So it varies across the entire portfolio. And the reason I kind of go through some of this in detail is to reflect the fact that it's what I said before, Everest generally has an operating strategy, moves around various lines of businesses. And I can't tell you necessarily what one month, for example, will bring us and we could change our portfolio again. So...

A - Dominic James Addesso {BIO 1428096 <GO>}

Right. And...

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

...it's a little too difficult to answer.

A - John P. Doucette {BIO 7178336 <GO>}

And, Kai, this is John. Just to add a little bit color to that. And a lot of it is you also may be better to look at the year-to-date numbers, as opposed to the quarter, because there's always going to be quarterly volatility just from large risk losses that happened, non-cat, cat events, or weather loss that happened that moved these things around. So we think the year-to-date attritional combined ratio is more reflective for the Reinsurance operations.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Thank you so much. I'll probably get back in the queue. Thank you.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Kai.

Operator

We'll go next to Josh Shanker, Deutsche Bank.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Yeah. Good morning, everyone. You guys have always advised (46:52) yourselves on expense ratio and expense management were not being much better than peers. To what extent do you need to grow the Insurance business to be competitive from an expense management standpoint?

A - Dominic James Addesso {BIO 1428096 <GO>}

What do we need to grow the expense ratio to? Is that...

Q - Joshua D. Shanker {BIO 5292022 <GO>}

No, no, no, the overall volumes for you as a scale where you think that you cannot have a competitive run rate expense ratio better than peers?

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

Hi, Josh. This is John. I think we're there, candidly. I think we're...

Q - Joshua D. Shanker {BIO 5292022 <GO>}

You're there now?

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

We're there now. I mean, if you look at where we are year-to-date, I think that expense ratio compared to those who write the lines of business we do across the geographies we write them, I think it will stack up very, very well. In fact, well above the peer average.

Secondly, when you look at a lot of the activities that we have pursued, our investments have been all across our platform. We're equally excited about the investments we're making in our claims departments, our actuarial teams, technology, et cetera. So I think we have a pretty good feel for the expenses that are coming into the system and against the earned premiums that we're forecasting. I think we feel pretty good about it.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Okay. And as you grow optimal personal capital, you are not buying back stock, you're using it to grow your own business. Are you growing at the pace of excess capital generation or is that something that you factor that if you had more capital you could grow faster or are you growing faster than you're generating capital?

A - John P. Doucette {BIO 7178336 <GO>}

Our capital growth is kind of consistent with our premium growth. Our premium growth is – we have sufficient capital for the growth that we've had for the first half of the year. If anything, our excess capital position has maybe just inched up very little bit, but not enough to warrant that we would go back in in terms of them as short-term. We purchase particularly at the levels that our stock is at today.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Okay. That's it. Thank you very much.

A - John P. Doucette {BIO 7178336 <GO>}

Thank you.

Operator

We'll go next to Meyer Shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning. Two really quick questions. One, is it fair to infer within U.S. Reinsurance that the movement to higher attachment points is limiting your exposure to what seems to have been really bad non-catastrophe weather?

A - John P. Doucette {BIO 7178336 <GO>}

Hi, Meyer. This is John. There's certainly some of that that would, and I think that you saw that last quarter as well that some of the noise. So, in general, market losses of a certain size are going to be more an insurance loss than a reinsurance loss. And I think directionally, given what we've been doing with the book, it would mean that it would take larger, the real noteworthy headline cap losses and not just the things you see on TV with the good video images. It would really take larger ones to cause larger losses for us.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks. And then broadly, I guess, this would be Insurance and Reinsurance. There's been a lot of commentary about sort of accelerating social inflation. Are you seeing that and how are you booking that in your current (50:28)?

A - John P. Doucette {BIO 7178336 <GO>}

I'll ask Craig to speak to that.

A - Craig W. Howie {BIO 17579923 <GO>}

I'm sorry, could you repeat the question?

A - John P. Doucette {BIO 7178336 <GO>}

Social inflation, and its impact on our portfolio.

A - Craig W. Howie {BIO 17579923 <GO>}

I think we always take a look at what the inflation is, when we look at loss cost trend on the overall portfolio, Meyer, and we look at not only social inflation, but we look at everything that's going on; claim inflation, social inflation. We look at the frequency and severity of the claims as they come through as well, but that's always part of our process as we go through picking our loss estimates.

A - John P. Doucette {BIO 7178336 <GO>}

Yeah. And, Meyer, it's John. Just to add a little more. I think also there is no one simple one-line answer to that. We have – across the group, we have 300 IBNR groups in many lines of business, in many territories around it and what and how social inflation or claims inflation or other things like that are driving loss cost. It is dynamic. It varies. I would say though that we have spent a lot of time between feedback loops between pricing actuaries and underwriters and reserving actuaries, and the underwriting in pricing to make sure that we are thoughtful in how we think about that and are able to respond to what we see as changing market conditions.

A - Craig W. Howie {BIO 17579923 <GO>}

And that's not something that's new to the industry. It's something that all companies have to deal with. As you look at our reserving history, I think it demonstrates that we're properly taking those factors into account in establishing our reserve position.

Q - Meyer Shields {BIO 4281064 <GO>}

Right. No, no, that's very helpful. I'm just – I'm trying to get a handle on whether on the sort of simplistic trends or aggregate trends that we look at from the outside, whether there's anything material going on?

A - Craig W. Howie {BIO 17579923 <GO>}

No. Loss cost trend has obviously been rather tamed for a number of years. And it's a little tough to project when that social inflation, for example, kicks in but general inflation, of course, has been relatively modest other than healthier trends, of course, which impacts the work comp line most significantly.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. Thank you very much.

A - Craig W. Howie {BIO 17579923 <GO>}

If any – I don't think we have any other questions on the call.

Operator

We'll go next to Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Thank for. Just a couple of follow-ups. First one, there's a – on your Lloyd's business, recently there is some additional interest in the acquisition in the marketplace. You are building your own at this time, do you still prefer build versus buy?

A - Dominic James Addesso {BIO 1428096 <GO>}

Across all of our businesses that's our preference. It doesn't mean however that we wouldn't if something came across our desk that looked very strategic and could propel us to a different level more quickly, and didn't have huge integration issues and/or legacy concerns, we'd certainly consider it. And of course, if you're pointing to Lloyd's. But I would say that Lloyd's is a platform. It's not necessarily the entire strategy, if you will. It's a platform that enables us to execute our Continental European strategy as well as outside of North America and Europe. And we can – we have other areas that we're pursuing or other platforms that we're considering again internal build, that would enable us to move forward on those ventures.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Last one if I may for Craig is about the tax rate though. What's your normalized tax rate, if you think about your budget level of catastrophe losses?

A - Craig W. Howie {BIO 17579923 <GO>}

Well, we typically have looked at a range before, Kai. When we look at our tax rate, we essentially go and we look at with and without catastrophe losses, as you heard us say in the past. So last year for 2016, was a mild year for tax rates. But – and we had a full year effective tax rate of about 10%. What I would say to you is if we had no catastrophes in the year; in other words more taxable income that rate could go as high as up to 13%. But that would give you a relative range of where I would expect to be.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. Thank you so much for your time and good luck.

A - Craig W. Howie {BIO 17579923 <GO>}

Thank you, Kai.

Operator

That does conclude our question-and-answer session. I'll turn the conference back over to Mr. Addesso for any additional or closing remarks.

A - Dominic James Addesso {BIO 1428096 <GO>}

Again, thank you very much. And thanks again to all for your participation this morning in the call and your questions. As we mentioned, the growth in the first half for us has been strong, both Insurance and Reinsurance, but our first priority continues to be underwriting profit. That's why you see us continually optimizing our portfolio on the Reinsurance side, for example, as we change attachment points, increase pro rata, non-renewal of certain layers, diversify into various regions and rotating to other risk classes like mortgage, credit or structured solution. So it is with an emphasis on underwriting profit.

In the Insurance segment, our underwriting strategy is product specialty and diversification again, which is as I said earlier allows us to provide capacity to the most attractive areas and also clearly minimize the impact of any one-line of business to the extent it reaches some difficulty. So, diversification and specialization remain the cornerstone of what we do. And so for the reasons that I just mentioned, we remain optimistic that through the cycle we can outperform the overall market.

Again, thank you very much and I look forward to meeting with many of you in the weeks ahead. Have a good day.

Operator

That does conclude today's conference. Thank you for your participation. You may now disconnect.