Q3 2012 Earnings Call

Company Participants

- Anne Waleski, VP, CFO
- Mike Crowley, Co-President
- Richard Whitt, Co-President
- Tom Gayner, President, Chief Investment Officer

Other Participants

- Adam Klauber, Analyst
- Arash Soleimani, Analyst
- Bob Farnam, Analyst
- David West, Analyst
- Jay Cohen, Analyst
- John Fox, Analyst
- Ray Iardella, Analyst
- Ron Bobman, Analyst
- Scott Heleniak, Analyst

Presentation

Operator

Greetings and welcome to Markel Corporation's Third Quarter 2012 earnings conference call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions). As a reminder this conference is being recorded.

It is now my pleasure to turn the conference over to your speaker, Tom Gayner, President. Thank you.

Tom Gayner {BIO 1896932 <GO>}

Thank you. Good morning. Welcome to the Markel Corporation Third Quarter conference call.

We are pleased to bring you today's report on our solid year-to-date economic return, and we look forward to your thoughtful questions about our strategy, performance, recent developments, and plans for our future. We will also cheerfully answer your other questions.

To start off ,our Chief Financial Officer, Anne Waleski, will review the overall numbers for the first nine months, then my Co-Presidents, Mike Crowley and Richie Whitt, will discuss our International and Domestic insurance activity. I will then cover investments and Markel Ventures operations, then we will open the floor for your questions.

Before getting started with today's line up the rules say that we need to repeat the Safe Harbor Statement. So here goes. During our call today we make forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is described under the captions Risk Factors and Safe Harbor and Cautionary Statement in our most recent Annual Report on Form 10-K, and Quarterly Report on Form 10-Q.

We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures on our website at www.markelcorp.com in the Investor Information section under non-GAAP reconciliations, or in our Quarterly Report on Form 10-Q. With that let me turn it over to Anne.

Anne Waleski {BIO 16735457 <GO>}

Thanks Tom. Good morning everyone. As I will discuss in more detail in just a minute, our financial results for the quarter benefited from strong investment performance, underwriting profits on our ongoing business, and increased revenue and profitability from our Markel Ventures company.

Our favorable year-to-date underwriting performance was driven by fewer than anticipated catastrophe events in the first nine months of 2012. However, we do have exposure to losses from the storm that hit the East Coast last week. Our underwriting claims and catastrophe management teams are currently reviewing our exposure, so we do not expect to have solid estimates of our losses for several more weeks.

Our losses from Sandy will, however, be estimated before year end, and will be reflected in our Fourth Quarter results.

Now we will get into the financial results. I will follow the same format in discussing results as in past quarters. I will focus my comments primarily on year-to-date results.

I will start by discussing our underwriting operations, followed by a brief discussion of our investment results, and bring to the two together with a discussion of our total results. Our total year-to-date operating revenues grew 13% to $2.2 billion in 2012 from $1.9 billion in 2011.

The increase is due to an 8% increase in revenue from our insurance operations, and a 51% increase in revenue from our non-insurance operations, which we refer to as Markel Ventures.

Moving into the underwriting results, gross written premiums for the nine months of 2012 were $1.9 billion, which is an increase of 8% compared to 2011.

The increase in 2012 was due to higher gross premium volumes in each of our three operating segments. Net written premiums were up 7% to the prior year at $1.7 billion. Retentions were flat in 2012 at 89%. Earned premiums increased 8%, again the increase in 2012 was due to higher earned premium volume in each of our three operating segments.

Increases in gross net and earned premiums have all benefited from our recent insurance acquisitions in the Specialty Admitted segment.

Our combined ratio was 96% for the nine months of 2012, as compared to 105% in 2011. The combined ratio for 2012 includes $41 million, or $0.036 related to our prospective DAC accounting standards , and $9 million, or less than 1 point of underwriting loss from Hurricane Isaac in 2012.

The 2011 combined ratio included $133 million, or 9 points of underwriting losses related to the catastrophe events which occurred last year in the US, Australia, New Zealand, and Japan.

Setting aside the impact of the prospective adoption of the new DAC accounting standard in 2012 and the effect of catastrophes in both 2011 and 2012, the improvement in our year-to-date combined ratio was primarily due to lower current accident year loss ratios in the Excess and Surplus Lines, and London Insurance markets segments.

Favorable development on prior years' loss reserves represented 17 points on the combined ratio in both 2012 and 2011. Included in the favorable development is $31 million of unfavorable loss reserve development on asbestos and environmental exposures within our discontinued line segment. We completed our annual review of these exposures during the Third Quarter.

During this year's review we reduced our estimate of the ultimate claim count, while increasing our estimate of the number of claims that would be closed with an indemnity payment. Based upon this information, prior year loss reserves for asbestos and environmental were increased.

Next I will discuss the results of our non-insurance operations, which we call Markel Ventures. In 2012 year-to-date revenues from our non-insurance operations were $345 million, compared to $229 million in 2011. Year-to-date net income to shareholders from our non-insurance operations was $8.6 million in 2012, compared to $8.9 million in 2011.

Revenues from our non-insurance operations increased in 2012 compared to 2011 primarily due to our acquisitions of WI Holdings Incorporated, Weldship, in late 2011, and Havco in 2012.

Next turning to our investment results. Investment income was up 6% in 2012 to just under $208 million. Net investment income for the nine months of 2012 included a favorable change in the fair value of our credit default swap of $13.7 million, compared to an adverse change of $2.7 million in 2011.

During 2012 financial markets improved and credit spreads narrowed which favorably impacted our credit default swap.

The net realized investment gains from $25 million in both 2012 and 2011. Net realized gains for the nine months of 2012 included $4 million of write-downs for other than temporary declines in the estimated fair value of investments, compared to $15 million in 2011.

Unrealized gains increased $330 million before taxes in 2012, driven primarily by increases in equity securities. Tom will go into further detail on investments in his comments.

Looking at our total results for 2012, the effective tax rate was 19% in 2012 compared to an effective tax rate of 17% in 2011.

The increase is primarily due to anticipating a smaller tax benefit related to tax-exempt income as a result of projecting higher pre-tax income for 2012 as opposed to 2011. We reported net income to shareholders of $197 million, compared to $92 million in 2011. Book value per share increased 12% to $395 per share at September 30th, 2012, up from $352 per share at year-end.

Finally, I will make a couple of comments on cash flow and the balance sheet. Net cash provided by operating activities was approximately $240 million for the nine months ended September 30th, 2012. Compared to approximately $261 million for the same period of 2011.

The decrease in net cash provided by operating activities was due to lower underwriting cash flows for the London Insurance Market segment, primarily due to increased claim settlement activity during 2012. Investments in cash at the holding company were approximately $1.1 billion at the end of September, as compared to a little less than $1.2 billion at December 31st, 2011. The decrease in invested assets is primarily the results of acquisitions made during 2012.

With this, I will turn it over to Mike to further discuss operations.

Mike Crowley {BIO 6836605 <GO>}

Thanks, Anne. Good morning. Third quarter results for both E&S and Specialty divisions were again positive from a gross written premium perspective.

As Anne said, E&S gross written premiums increased 6.9% for the quarter versus 2011, and 6.3% for the nine months versus 2011. The Specialty division gross written premium increased 9.1% for the quarter, and 14.9% for nine months compared to the same period in 2011.

The growth in the Specialty Admitted segment was substantially due to the booking of $17 million in the quarter, and $43 million year-to-date from the THOMCO acquisition which was announced in January, and a 16% increase in volumes for the Workers' Compensation line of business.

To date our retention of the THOMCO business through nine months is exceeding our expectations. Growth from THOMCO and FirstComp was offset by reduced volume in our Accident and Health, Property and Casualty, and Individual Risk business in the Specialty division, due to the decision to exit certain lines of business.

The combined ratio for the E&S segment was 89% for the quarter, and 91% for the nine months, compared to 89% and 88% respectively for the same periods in 2011. The combined ratio for the Specialty Admitted segment was 109% for the quarter, and 108% for the nine months, compared to 116% and 109% for the same periods in 2011.

With regards to the expense ratios, the E& S segment expense ratio was flat for the quarter, and slightly better for nine months, excluding the impact of the new DAC accounting methodology, and the increased profit sharing accruals.

For the Specialty division, the expense ratios excluding DAC and higher profit sharing expenses in 2012 was slightly improved for the quarter, but flat year-to-date compared to 2011.

Clearly one of the highlights for the quarter was our announcement of the new Hagerty/Markel relationship. We are extremely pleased that Hagerty's management chose to select Markel as its underwriting partner for the future.

As all of you know, Hagerty is widely known as the broker in the collective car and the mode insurance business. They are a well-managed, highly-focused specialty firm that continues to grow their business. Markel looks forward to a long and profitable relationship with McKeel Hagerty and his team.

Another important highlight for the Specialty division was the appointment on Monday of this week of Greg Thompson as President of Markel Specialty. Greg has been in the insurance business for over 30 years.

He led THOMCO for 32 years, growing it from a small operation to a large program administrator. Markel acquired THOMCO on January 1 of 2012, and in his new role Greg will report directly to me. I am confident that his leadership and experience will be a great boost for our Specialty division.

Additional highlights for the Specialty division include Markel American, the launch of a new product targeted at avid bicyclists, which offer physical damage for high-end bicycles, and liability and medical payments for the rider.

Markel agents new to FirstComp submitted more than 3,000 new accounts year-to-date, resulting in new premiums in excess of six figures. Also, year-to-date 611 FirstComp agents have signed producer agreements with Markel, which should contribute to our cross-selling efforts.

Regarding the E&S segment the recent creation of the chief underwriting position is producing positive results. Jeff Lamb is proving to be a valuable link between product management and the regions, and our product line leadership group. Our E&S division is working closely with our product line management on growing profitable lines of business.

During the quarter we also shifted 13 experienced underwriters to direct underwriting roles in the regions, our goal is to get more experienced underwriting authority closer to the field, and improve our response times for our agents and increase our chances for success.

A number of our E&S associates attended the Annual NAPSLO Conference, where we held 243 meetings with various agents and brokers.

Based on those meetings we remain very encouraged about our opportunity to continue to grow our E&S business. I would like to congratulate Scott Culler, who heads our West region on his appointment to the NAPSLO Board.

I am also pleased to announce that Phil Freda joined Market as Managing Director for Public Entity business. Phil brings more than 20 years public entity experience to Markel, he previously managed a significant book of this business. Our goal is to significantly expand our position in this niche which has been very profitable for Markel.

Also, Mike Vought has been promoted to Managing Director of Casualty. Michael continues to shoulder his responsibilities for our Umbrella business. He has 25 years experience and is well-equipped to direct this important line of business for Markel.

Throughout North America and the entire Company, we continue to work aggressively to reduce costs. Richie and I have asked the leaders of all of our shared services to focus on process improvement and deliver their services more efficiently.

These efforts are critical to reducing our expense ratios, and our leaders have embraced this initiative. Finally, with regards to the rate environment, rates remain stable enabling Markel to achieve single-digit rate increase on CAT property businesses and Workers' Compensation.

The Casualty business remains competitive but we expect it to achieve modest rate increases there as well. At this point we anticipate a similar rate environment for 2013.

I will turn the call over to Richie to talk about our International operations. Richie.

Richard Whitt {BIO 7084125 <GO>}

Thanks, Mike. Good morning, everyone. I will start off talking a little bit about results at Markel International for the quarter and nine months, and then I will cover a few things at the corporate level.

During the first nine months of 2012 Markel International gross written premiums grew 4% to $705 million. There was a little bit of FX effect on that, if you would have kept a constant rate of exchange, it would have been about 6% growth.

Significant areas of growth continue to be in the energy and catastrophe exposed property areas, this has been partially offset by decline in some of our professional liability lines. Price and trends that we talked about the first two quarters have largely continued in the Third Quarter.

We continue to see price increases on CAT exposed property in the Marine Energy business. However, as the year progressed, price increases in these areas have moderated, our overall average price increase on our renewal business for the first nine months of the year was right around 5%.

CAT property increases have generally been between 10% and 20%, and Energy has seen single-digit increases. All of the other lines have seen relatively stable pricing.

Despite price increases in these areas, and many areas of the market are still pretty competitive. As and example, while we have been able to maintain our modestly push pricing in our professional liability division, premium volume is down against prior year as a result.

Internationals combined ratio for the nine of 2012 was an 88, that includes 2 points of expenses related to the adoption of the new DAC accounting standards.

Obviously as opposed to the significant CAT losses experienced in 2011, our first nine months of 2012 results include minimal catastrophe losses. With Hurricane Isaac being the largest single event at approximately $3 million.

The nine results also benefited from $119 million of prior year favorable development across a variety of programs, I know we have said it a lot of times, and I will say it again, we always strive to establish reserves that are more likely redundant than deficient.

However the releases we have experienced in the first nine months at Markel International are more than we normally would have expected, and are the result of favorable developments across a number of product lines, including the 2001 and prior reserves.

Moving to the Markel level while the first fine months of 2012 as Anne said were benign from a catastrophe standpoint, Markel's Fourth Quarter will be impacted by Hurricane Sandy which hit the Northeast US last week.

Our thoughts go out to all of those affected, which include many of our Markel associates. We are currently working to assist our policyholders with their claims and recovery efforts, but it is still very early in loss adjustment recovery phase, and we are going to have to work over the next several weeks to determine the storm's financial impact to Markel.

Finally, I would like to mention two promotions at the Markel Corporation level. Brad Kiscaden has been promoted to Executive Vice President of Markel. Brad has been with Markel for over 25 years, many of these years as our Chief Actuary.

Brad and his team have been instrumental in implementing and safekeeping our reserving philosophy, which has been one of cornerstones of our success over the years. Brad will be adding IT to his area of responsibility, and is going to be moving to Richmond to join our Senior Executive team.

Ron Herrig is going to be stepping into the role of Chief Actuary for North America. Ron has been Brad's partner for many years, and played a critical role in the recent implementation of our data warehouse. I would just like to congratulate both Brad and Ron. I inadvertently failed to mention them on last quarter's call.

At this point I would like to turn it over to Tom, and afterwards we will be glad to take your questions.

Tom Gayner {BIO 1896932 <GO>}

Thank you, Richie. In what I am sure comes as relief to my colleagues, my comments today will be shorter than usual since I think the numbers largely speak for themselves.

As Anne mentioned earlier, book value per share rose to a new record high of $395 as of September 30th. Our comprehensive income so far in 2012, $426 million created an increase in book value per share of roughly $43, or 12% during the first nine months. I am very happy with those results, and I hope you are as well.

After some details, during the first nine months, the total return on the investment portfolio was 7.4%. Equities enjoyed a return of 15.5%, and fixed income produced a positive overall return of 4.5%. At Markel Ventures, we enjoyed a great Third Quarter, and that brought year-to-date results closer to my expectations.

Revenues totalled approximately $345 million, and EBITDA totalled roughly $41 million. This compares to revenues of $228 million a year ago, and EBITDA of roughly $34 million. As always, the reconciliation of EBITDA for net income is available on the Markel Corporation website.

Additionally during the quarter we completed the acquisition of Tromp Bakery Systems in the Netherlands, which makes equipment for pizza, pastry, pie, and bread makers.

We also purchased controlling interest in Redding Bakery Systems, which makes bakery equipment for the production of crackers, pretzels, cookies, and other baked snacks.

They will operate as part of our AMF Bakery Systems business, and we think we will do very well with these businesses as long as the Atkins diet doesn't become popular again.

Additionally, the growth of Markel Ventures should provide our shareholders with positive returns and cash flows, even when we are seeing news headline that affect the short term results of our insurance business.

We are relentless in our drive to build the value of the Markel Corporation, and Markel Ventures should continue to be a growing force to help make that happen.

In the equity portfolio, our focus on high-quality securities, as well as our commitment to continuing to invest in equities paid off. During the first nine months we earned 15.5% compared to the S&P500 total return of 16.4%.

I never like to underperform ever, but in shorter-term measurement periods it happens all of the time. I am comforted by the fact that we earned these returns in 2012 despite not owning one of the most popular stocks of all-time which contributed several hundred basis points to this year's S&P return.

We have a long history of earning excellent investment returns without owning the stocks that most people are talking about, and over time this approach has served to reduce risk and create outperformance during tough periods.

Over the last 23 years a longer and more meaningful timeframe, we have outperformed the S&P500 by 150 basis points a year. Our equities have also outperformed the Barclays Aggregate Bond Index by 280 basis points a year, which demonstrates the value we add to our shareholders, by sticking with the relatively unpopular idea of investing in stocks.

Equities now represent roughly 62% of our total shareholders equity, up from 55% at year-end. We continue to steadily and regularly add to our equity investment portfolio, and we expect to continue to do so.

As you have heard from my colleagues revenues are going up around here, and we have got ideas for where to invest the money. In our fixed income operations, we earned a total return of 4.5%. I will repeat what I have repeated before, and be just as surprised to say it this time as the last time.

Interest rates moved lower yet again during the Third Quarter, so we overearned the coupons from our bond portfolio. Yet again, I continue to be amazed that this is happening, and we remain ever more defensively positioned for this portfolio. Duration for the overall bond portfolio is now at a new record low for us, at slightly less than three years.

The perverse good news is that the opportunity costs of holding an ever-shorter duration bond portfolio continues to go down. Given the low rates at the front and long end of the curve, we could not stretch our yield even if we wanted to.

There isn't any worthwhile yield out there to be had. As such, we have a portfolio where the difference between what one would call cash and equivalents and longer-term fixed income instruments continues to diminish.

That means that for all practical purposes we have a lot of cash, and all of the options that go with it, such as deploying it at higher rates of return when we get the chance to do so. It also means we are protecting our balance sheath against a rise in interest rates, even more than last quarter and last year.

You might recognize the familiar sound of these comments. I remain convinced though, that this is a prudent way to manage the portfolio. In total the comprehensive results of our insurance, investments, and Markel Ventures operations, produced excellent results for your Company so far this year.

I am excited as we continue our long-term path of building one of the world's great companies, and we look forward to your questions.

With that, Kathleen, if you would open the mike for questions.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions). Our first question is coming from Adam Klauber of William Blair. Your line is live.

Q - Adam Klauber {BIO 1494359 <GO>}

Thanks. Good morning everyone. Nice quarter.

A - Tom Gayner {BIO 1896932 <GO>}

Hey Adam.

Q - Adam Klauber {BIO 1494359 <GO>}

A couple of different questions. You mentioned that you are discontinuing a couple lines in the E&S segment, and A&H some Property, some Specialty. Roughly how big are those books of business, and if--?

A - Tom Gayner {BIO 1896932 <GO>}

It was in the Specialty segment.

Q - Adam Klauber {BIO 1494359 <GO>}

Specialty. Sorry, Specialty I meant.

A - Tom Gayner {BIO 1896932 <GO>}

We are not exiting a couple of lines that we are exiting Adam are very small.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay.

A - Tom Gayner {BIO 1896932 <GO>}

They have been lines that we have had for a while. Question just aren't growing them.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay.

A - Tom Gayner {BIO 1896932 <GO>}

Also in the A& H segment we are exiting several lines that just haven't been profitable for us, and we are shrinking our A&H division because of that, but I don't have the total in front of me.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. Okay. And do you think that process will be done by the end of this year, or is that going to run into 2013?

A - Tom Gayner {BIO 1896932 <GO>}

Mostly so. So some of the lines we have not announced yet.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay.

A - Tom Gayner {BIO 1896932 <GO>}

That will happen over the course of next year, but those are the smaller lines. I mean they are really small. But all of this is to improve our results, and our loss ratio on the Specialty business.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. And your accident year of loss ratios ex-catastrophe again were good and lower than last year, but sequentially they were up in the Third Quarter compared to the first half in both E&S and Specialty Admitted. I guess why were they up a little?

A - Anne Waleski {BIO 16735457 <GO>}

Adam, I think that is primarily related to adjusting our profit sharing accrual in the Third Quarter. Just something we do each year. We will be looking at it again this year in the Fourth Quarter, given the storm that just occurred, but I think that is what is driving what you are seeing.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. Thanks for that. And then as far as FirstComp, what sort of rate increases are you getting on that book of business, and will that business be more profitable going forward, do you think?

A - Tom Gayner {BIO 1896932 <GO>}

Yes the FirstComp is trending to exactly the way we want it to trend, and they are in the same boat. They are getting 4% or 5% rate increases, but we are also as I said in the last quarter call, changing our geographic mix there.

I mean they are on track to do exactly what we want them to do. They are moving in the right direction, the trends are good, and they are not only adjust rate where they can, but there are changing their geographic mix, and we are exiting some areas where it is not profitable being out there.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. That was all of my questions. Thank you.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you.

A - Anne Waleski {BIO 16735457 <GO>}

Thanks.

Operator

Thank you, our next question is coming from Arash Soleimani from Stifel Nicolas. Your line is live.

Q - Arash Soleimani {BIO 18869554 <GO>}

Hi. Good morning.

A - Tom Gayner {BIO 1896932 <GO>}

Good morning.

Q - Arash Soleimani {BIO 18869554 <GO>}

Just a couple of questions here. I know that you have talked about rates a little bit. But looking at CID and market cut recently it looks like they ticked down, so my question is, is that just lumpiness, or is that indicative of a trend? I wanted to get your thoughts around that?

A - Tom Gayner {BIO 1896932 <GO>}

I would say it is lumpiness. I mean, if you look at the CID analysis and other analysis that some of them show this ticking down a little bit, but it was minor. It is lumpy.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. That is fair. And then I think you mentioned something about the tax rate for the first nine months, but looking at the Third Quarter. What was that attributable to the pretty low tax rate there?

A - Anne Waleski {BIO 16735457 <GO>}

During the Third Quarter we changed our estimate of how much of our foreign income would be taxed in the US, so basically we caught up the benefit of the lower rate in the quarter, which ultimately changed the expected tax rate for the year downward.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay.

A - Anne Waleski {BIO 16735457 <GO>}

Okay?

Q - Arash Soleimani {BIO 18869554 <GO>}

And then just sort of back maybe talking in terms of the rate environment, but in terms of the Specialty business heading back to the E&S is that continuing, is that slowing down or accelerating? I just wanted to get some thoughts around that?

A - Tom Gayner {BIO 1896932 <GO>}

In terms of what, the volume or the rate?

Q - Arash Soleimani {BIO 18869554 <GO>}

Just the volume?

A - Tom Gayner {BIO 1896932 <GO>}

Are you talking about the E&S segment, or are you talking about the Specialty segment?

Q - Arash Soleimani {BIO 18869554 <GO>}

I am sorry. Let me clarify. I was talking more about the standard carriers sending business back, or letting the Specialty carriers handle that business moreso than they have in the past?

A - Mike Crowley {BIO 6836605 <GO>}

The only way I can answer that is that we continue to be pleased with the submission counts that we are getting, and obviously our E&S business is growing.

Based on all of the business that we had, and I have attended a lot of it myself at NAPSLO, we are very encouraged with our relationships with the wholesale brokers, and we are seeing some modest improvement there, business flowing back. It is not certainly not a waterfall at this point.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. Great. Thank you, so much for your time. Appreciate it.

Operator

Thank you. The next question is coming from Ron Bobman of Capital Returns.

Q - Ron Bobman

Hi. Good morning.

A - Mike Crowley {BIO 6836605 <GO>}

Good morning.

Q - Ron Bobman

I had some Sandy E&S questions of a general nature. I was wondering if you could talk a little bit about the prevalence in I guess it is hard to use the word traditional E&S, but if there is sort of a core E&S product, how prevalent flood sublimits appear in that line of business, or that sub-segment?

And then also sort of BI. How often are there sort of constraints or limitations of coverage with respect to BI in core E&S commercial products? Thanks for your thoughts on that subject.

A - Mike Crowley {BIO 6836605 <GO>}

Well, Richie is going to jump in on this too, but a lot of it has to do with the perils obviously that are insured under their property policy, and if there is no flood coverage for the property, there is not going to be any flood coverage for business interruption. It depends on the risk. We write some flood, not a lot of flood. And our exposure is more wind.

A - Richard Whitt {BIO 7084125 <GO>}

And I think, Ron, I think it is going to be across-the-board. Mine different people are going to do different things in terms of the flood sublimits, or the waiting period for the business interruptions.

I mean it is going to be all over the map, but it typically as Mike said, if there is no flood coverage for the property there will be no flood coverage for the BI, and it will depend if people do have flood coverage, there are usually pretty substantially deductibles on those policies, so it is going to be different depending on what the property is, and who the coverage is with.

Q - Ron Bobman

Is there anything uniform or common practice in the New York/New Jersey, Pennsylvania E&S market where by those policies as compared to other geographies had more or less flood sublimitting or--?

A - Mike Crowley {BIO 6836605 <GO>}

There is really nothing standard in the business anywhere. I think that clearly sometimes you think that if you think of the southern East Coast, or you think of earthquake in California, you tend to think that is a more exposed area.

Q - Ron Bobman

That is a more what area?

A - Mike Crowley {BIO 6836605 <GO>}

More exposed area.

Q - Ron Bobman

Okay.

A - Mike Crowley {BIO 6836605 <GO>}

Just in terms of, but there is not, there is just no standard. Clearly there is exposure in New York and New Jersey as we unfortunately found out, but everybody knew it was there. It was just a matter of the frequency.

Q - Ron Bobman

Right. And is it the kind of thing where one E&S company may have had a more restrictive form or underwriting selection process?

A - Mike Crowley {BIO 6836605 <GO>}

That could happen. I mean again there is no standard.

Q - Ron Bobman

Yes. Any other thoughts worth sharing on the topic of BI or flood in E&S, or in the context of Sandy?

A - Mike Crowley {BIO 6836605 <GO>}

I think we are all just going to have to wait and see how the situation is obviously still developing.

I mean the recovery efforts were delayed with the recent storm, so I think it is going to just take everybody a little while to see what the actual situation ends up being.

I mean everybody has seen the numbers that the industry numbers that people have been attempting to predict, and I think most people feel those are going to continue to creep upward.

We are just going to, I think we all just need to let the people work on recovery, and let the claims come in and we will figure out what it looks like.

Q - Ron Bobman

Thanks for your thoughts. Is it safe to assume, that I don't want to call it the pressure, or the appearance in personal lines with respect to storm sublimits not being windstorm sublimits basically being eviscerated, is it safe to assume that we are not going to face that in the commercial area in any form?

A - Tom Gayner {BIO 1896932 <GO>}

I would say, it is going to, I mean everybody remembers in Katrina there was obviously lots of legal action, and the departments of insurance were active in terms of interpreting, helping to interpret what they thought coverage meant.

I would suggest and I would assume that it would be a similar situation that you would see, you would see people trying to work through what the coverage is, so I expect a very similar sort of situation there.

Q - Ron Bobman

Alright. Thanks everybody. Best of luck.

A - Mike Crowley {BIO 6836605 <GO>}

Thanks.

A - Anne Waleski {BIO 16735457 <GO>}

Thanks.

Operator

Thank you. Our income question comes from Ray Iardella of Macquarie.

Q - Ray Iardella {BIO 16279337 <GO>}

Thanks and good morning everyone.

A - Tom Gayner {BIO 1896932 <GO>}

Morning.

Q - Ray Iardella {BIO 16279337 <GO>}

Just to follow-up a little bit on Sandy. I am not going to estimates or anything of that nature. Just curious in terms of business segments, do you think you will have exposure in each one, or is the Specially Admitted market not going to have any exposure, I am assuming that is the answer is no?

A - Tom Gayner {BIO 1896932 <GO>}

No. We will have exposure in each of our segments.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay. Thanks. And then I know Tom had mentioned the amount of cash you guys have. Just curious on, I know you have been a little bit inquisitive on the Markel Ventures side, but just curious in terms of too on the insurance side, how is the M&A environment looking these days?

A - Mike Crowley {BIO 6836605 <GO>}

Well, I would say on the insurance side it is normal. I mean we see things. We have things presented to us, and as we have said on this call before, we may look at 10 or 15 or 20 things before we find one that we might find attractive, and then of course then it is a matter of can we do a deal that meet our return results, requirements.

A - Tom Gayner {BIO 1896932 <GO>}

And I would echo Mike's comes in terms of the acquisition environment, fortunately Markel has become a well known acquirer of insurance and other businesses, so as a consequence, we get a lot of inbound phone calls and the good news about that is to find the one that you really want to do, it helps to look a lot that you don't, so being part of the flow is very helpful and we continue to see robust flow.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay. That is helpful. I mean in terms ever return requirements, is there any sort of benchmark that we should be thinking about when you guys look at acquisitions?

A - Tom Gayner {BIO 1896932 <GO>}

Well, before we would lay out a dollar of capital that we have any discretion about at all, and this would be the public equity investment portfolio, looking at an insurance company deal, looking at a non-insurance company deal, it has got to start with double digits, for us to be willing to expend capital and that remains the case.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay. That is helpful. Thanks again.

Operator

Thank you. Our next question coming from John Fox of Fenimore. Your line is live.

Q - John Fox {BIO 18976738 <GO>}

Yes. Good morning, everyone.

A - Anne Waleski {BIO 16735457 <GO>}

Morning, John.

Q - John Fox {BIO 18976738 <GO>}

Two questions and a comment. Did I miss it in London if I am reading this correct, the gross written premium was down?Did you comment on that.

A - Mike Crowley {BIO 6836605 <GO>}

It is down a little bit in the Third Quarter, John. I mean it is up year-to-date.

Q - John Fox {BIO 18976738 <GO>}

Alright.

A - Mike Crowley {BIO 6836605 <GO>}

But we have been doing some acquisitions and opening offices over the last several years, so I think we have kind of gotten to a sort of steady state in London now, and as I said, we have had some nice growth in the CAT exposed properties, and the Marine and Energy, but the other side of that is that we have had a little bit of shrinkage on some of our professional liability lines, because as I was saying they are still very competitive there.

Q - John Fox {BIO 18976738 <GO>}

Okay. Yes. I just wanted to, I saw a kind of general lift in rates. I mean am I being too optimistic, or are the rate increases not that great?

A - Richard Whitt {BIO 7084125 <GO>}

No. We are still seeing rate increases. The other thing, and Mike pointed out, is we did discontinue our US binding property earlier in the year, so that obviously is impacting it a little bit, but there is no concern there. It is sort of what we would have expected for the Third Quarter.

Q - John Fox {BIO 18976738 <GO>}

Okay. Then I know you guys talked year-to-date, but I have another question on the Third Quarter, and if I am doing this correct with the accounting change, but the expense ratio looked higher than it has been, and I am just using the $225 million?

A - Anne Waleski {BIO 16735457 <GO>}

Yes. John, again I think that is the profit sharing accrual, the incentive comp accrual increase that we did in the Third Quarter.

Q - John Fox {BIO 18976738 <GO>}

Okay.

A - Mike Crowley {BIO 6836605 <GO>}

Yes, John. And this is something that is probably worth just talking about for everybody.

Q - John Fox {BIO 18976738 <GO>}

Okay.

A - Mike Crowley {BIO 6836605 <GO>}

We have pretty, we have had very nice prior year redundancies come through this year. We pay out our profit sharing to the underwriters as the year is developed. So as we have more favorable development, we increase the profit sharing accruals so that prior year development is wonderful when it comes through, but it has an impact on the current year expense ratio when we have to put up the bonus accruals, we love having to do that quite honestly.

Q - John Fox {BIO 18976738 <GO>}

Yes. That is terrific. Okay. And the comment is for Tom Gayner. The 10-year treasury yield has declined 1 basis point since the end of the quarter, Tom.

A - Tom Gayner {BIO 1896932 <GO>}

Well, the rate of change is flowing there.

Q - John Fox {BIO 18976738 <GO>}

That is wonderful. Okay. Thank you.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you.

Operator

Thank you, our next question comes from Scott Heleniak with RBC Capital Markets.

Q - Scott Heleniak {BIO 15171212 <GO>}

Yes. Good morning.

A - Mike Crowley {BIO 6836605 <GO>}

Morning, Scott.

Q - Scott Heleniak {BIO 15171212 <GO>}

I just wondered if you had any other details on the Hagerty acquisition you made. I am assuming that is an MGA that would convert to fees to premiums. Can you talk about what kind of size that book might be?

A - Tom Gayner {BIO 1896932 <GO>}

The only thing that we have said is that if you look at the AM Best guide for 2011 essentially that we are acquiring a shell company therefore the Hagerty business and their previous carrier, and they had $170 million in that entity in 2011.

Q - Scott Heleniak {BIO 15171212 <GO>}

Okay. And how much of that do you plan to keep? I don't know if you are going to talk about that?

A - Tom Gayner {BIO 1896932 <GO>}

Hagerty is a growing business.

Q - Scott Heleniak {BIO 15171212 <GO>}

Okay. Alright. Fair enough. Then I wanted to ask just about the pricing environments. Some of the competitors is have talked about how they expect rates to increase pretty significantly next year in the Northeast, just because of what we are seeing with Sandy on property. Do you see that playing out and if so, do you think that has any kind of staying power?

A - Tom Gayner {BIO 1896932 <GO>}

I think we have to wait and see. As I said in my earlier comments, obviously I can understand why somebody would say that.

Q - Scott Heleniak {BIO 15171212 <GO>}

Right.

A - Tom Gayner {BIO 1896932 <GO>}

But we are expecting right now we are expecting the same kind of rate environment in 2013 that we have seen so far in 2012. And we are planning accordingly.

Q - Scott Heleniak {BIO 15171212 <GO>}

Okay. And then just the final question I had was just on Markel Ventures. I think the target that you gave a few years ago was for Venture to reach $500 million. You are kind of running, almost at that run rate $500 million in revenue, and just wondering if there is a particular target where you see that going in the next sort of five to ten years, or longer term?

A - Mike Crowley {BIO 6836605 <GO>}

Well, the real target is the to lay out capital and produce double-digit returns for having done so, and to do that in a crawl-walk-run fashion, and we continue to do that. You are correct the run rate of revenue is probably north of $500 million at this point.

We continue to see opportunities and we are pleased in large part with the way the businesses are run and developing, but we are also learning lessons as we go along and we will continue to be prudent and if I look out five or ten years, I would certainly expect it to be a bigger business, but that will come in lumps, depending on our skills and the opportunities we see.

Q - Scott Heleniak {BIO 15171212 <GO>}

Alright. Thanks.

Operator

Thank you. Our next question is comes from Jay Cohen, Bank of America Merrill Lynch. Your line is live.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you. A couple of questions. I guess if you could breakout in the International business, roughly what percent of that business would be catastrophe reinsurance?

A - Tom Gayner {BIO 1896932 <GO>}

Well, catastrophe reinsurance is probably about a $60 million to $70 million book of business.

Q - Jay Cohen {BIO 1498813 <GO>}

That is very helpful. Thank you. And then secondly, obviously, the Venture's earnings is a relatively new business, it is growing, it is hard to pin down quarter-to-quarter from our standpoint.

There does seem to be just looking the last two or three years, some seasonality where the Third Quarter seems to be bigger from an earnings standpoint. Am I reading too much into this?

A - Tom Gayner {BIO 1896932 <GO>}

Well, a little bit. We do have one business that is very concentrated in the Third Quarter, but it is small. I mean that is our dorm room furniture businesses for colleges and universities.

You can think about when students are out of school that is when we scramble and put everything in place and sends our bills, so the biggest chunk of earnings would be concentrated in the Third Quarter, but that is a relatively small business. The other factor is just sort of the luck of the draw over the last couple of years.

The capital equipment business by definition is a lumpy business, and we just happened to hit on some larger orders during the Third Quarter, but I wouldn't assign seasonality to those factors.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. That is helpful. Thanks, Tom.

Operator

Thank you. Our next question is coming from David West of Davenport and Company.

Q - David West {BIO 1838548 <GO>}

Good morning.

A - Tom Gayner {BIO 1896932 <GO>}

Hey David.

A - Anne Waleski {BIO 16735457 <GO>}

Good morning.

Q - David West {BIO 1838548 <GO>}

Mike, one for you first. In your comments on the Casualty environment you described it as competitive. Can we infer from that rates are flat, or are you getting any rate increase at all?

A - Mike Crowley {BIO 6836605 <GO>}

We are still getting modest single-digit rate increases there, it is just more competitive I think than maybe some of the property lines this year, but we are getting rate increases there, David.

Q - David West {BIO 1838548 <GO>}

Okay. Alright. Very good. Thanks for that clarification. And Tom, just looking at Ventures, the EBITDA margin year-to-date has run about 12 versus 15 last year.

I guess given your pretty conservative nature, the way you book things at Markel and account for them, as you are being acquisitive, should you expect some pressure on the EBITDA margins potentially?

A - Tom Gayner {BIO 1896932 <GO>}

Not really. I mean the businesses that we look at typically they have to be double-digit EBITDA margins to be attractive to us, so some businesses will have higher EBITDA margins, oftentimes they have a little higher capital spending requirement, so you sort of net that out.

I mean I am looking at the true cash returns, but as a general rule, I want double-digit EBITDA margins, and would not and I would be disappointed if they go below that.

Q - David West {BIO 1838548 <GO>}

Thanks so much.

Operator

Thank you. Our next question is coming from Bob Farnam of KBW.

Q - Bob Farnam {BIO 15005467 <GO>}

Hi. Good morning, I just had one question on reinsurance. I know you are not heavers users of reinsurance at all, but just curious if you can tell us what type of property CAT reinsurance coverage you have?

A - Tom Gayner {BIO 1896932 <GO>}

Well, we have several pieces of reinsurance around property CAT, and so it is a little hard to kind of give you a thumbnail sketch of it.

One of the things you can do is AM Best in their reports, they put kind of a quick and dirty profile of the reinsurance, and that might be worth looking at, but basically we have both risk insurance, so for example, we have some quota share on some of our business, we have some excess of loss reinsurance that will come into play, and then we buy CAT reinsurance, which for the majority of our business attaches at about $100 million, and then we will participate to some extent in the layers as it goes up, but it is not as easy as telling you we have got one tower, we have vary various towers, and we have various types of reinsurance both risk and CAT that will respond.

Q - Bob Farnam {BIO 15005467 <GO>}

Okay. Thanks.

Operator

(Operator Instructions). I am showing no further questions coming into queue at this time.

A - Tom Gayner {BIO 1896932 <GO>}

Alright. Well, with that thank you very much for joining us. We look forward to seeing you around the neighborhood. Take care.

Operator

Thank you. Ladies and gentlemen, that does conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.