FINAL

Bloomberg Transcript

Q2 2013 Earnings Call

Company Participants

- Anne Waleski, VP
- Michael Crowley, Co-President
- Richie Whitt, Co-President
- Tom Gayner, President

Other Participants

- Adam Klauber, Analyst
- David West, Analyst
- Doug Mewhirter, Analyst
- Jay Cohen, Analyst
- Mark Dwelle, Analyst

Presentation

Operator

Greetings. And welcome to Markel Corporation's Second Quarter 2013 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 introduce your host, Tom Gayner, President and CIO. Thank you.

Mr. Gayner, you may now begin.

Tom Gayner {BIO 1896932 <GO>}

Thank you. Good morning, everyone. My name is Tom Gayner, and along with my colleagues Anne Waleski, Mike Crowley and Richie Whitt, we welcome you to the Markel Corporation Second Quarter 2013 conference call.

Before we get started we are required to remind you of the Safe Harbor Provision, so here it goes. During our call today we may 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 included 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 on the call today. You may find a reconciliation to GAAP of these measures on our website at www.markelcorp.com and our quarterly report on Form 10-Q.

Thanks again for joining us this morning. We're very excited to share our report card from the first half for Markel, or as I like to call it Markel 3.0 for the first half of 2013. The headline for the first half is that we enjoyed positive comprehensive income during the first half of 2013. The components driving that result include underwriting profitability in our insurance businesses, organic growth in our premium values as well as the growth derived from acquisitions, positive investment returns from our portfolio, operating profitability in our Markel Ventures business everyone, and organic growth in those operations as well as the growth from acquisitions.

Those statements are true even after factoring in the transactional expenses incurred to put Markel 3.0 on the field. We could not be happier with our prospects and the long-term opportunities embedded in this Company. We've got multiple cylinders to power the economic engine, and this report shows forward progress and the promise of how it should work in the future.

While this report contains a lot of moving pieces and disparate items, we will attempt to provide as much clarity as we can around each of them and provide you with the reasons as to why we're so excited about our future. We hope you agree, and we look forward to the thoughtful questions from our fellow owners of this firm as well as the questions from those who buy and sell the stock.

With that as prologue, let's start opening up this lovely matryoshka doll of a report with Anne's review of our first half results. Anne?

Anne Waleski {BIO 16735457 <GO>}

At the May 1, 2013, transaction date all Alterra assets and liabilities, including identifiable intangible assets, were set to fair value, with the excess of transaction consideration over fair value at located to goodwill. Thank you, Tom. Good morning, everyone. Needless to say we've had a very busy quarter, with major activities focused on our May 1, 2013, acquisition of Alterra. The transaction was valued at $3.3 billion, including $2.3 billion of Markel common stock and other equity considerations and $1 billion of cash. The transaction resulted in approximately $560 million of goodwill and intangible assets.

The three most significant adjustments were to investments, life and annuity benefits, and unpaid losses in LAE [ph] reserves. At acquisition the amortized cost basis of the fixed maturity portfolio was reset to fair value, and the difference between the estimated fair value and the par value of these securities was $552 million. There were also fair value adjustments to life and annuity benefit reserves of $330 million and to unpaid losses in LAE reserves of $147 million. You can find details on these adjustments in footnote three of our Form 10-Q.

The integration process is in full swing, and we are just beginning to see the benefits of our enhanced scale. Despite significant merger and acquisition costs in the period, we met our goal of generating underwriting profits on a consolidated basis for the first six months of 2013. The legacy Markel operations had strong performance, and the legacy operations performed within expectations.

Our total operating revenues grew 30% to $1.9 billion in 2013 from $1.4 billion in 2012. The increase is due to a 27% increase in revenues from our insurance operations, which includes $225 million from the Alterra segment, and a 64% increase in revenues from our non-insurance operations, which we refer to as Markel Ventures.

Moving into the underwriting results for the first six months of 2013, gross written premiums were $1.8 billion, which is an increase of 42% as compared to 2012. The increase in 2013 was primarily due to the inclusion of $342 million of gross written premium from the Alterra segment from May 1, 2013, as well as higher gross premium volume in the Specialty Admitted and Excess & Surplus Line segments.

The increase in Specialty Admitted is driven by premiums from the Hagerty and THOMCO businesses. Within the Excess & Surplus Line segment the increase is due in part to the impact of more favorable rates and improving economic conditions. Net written premiums for 2013 were approximately $1.6 billion, up 39% to the prior year for the same reasons I just mentioned.

Net retention was down in the first six months of 2013 at 86% compared to 89% in 2012. The decrease in net retention is due to the inclusion of premiums written by Alterra from May 1, 2013. Net retention in the Alterra segment for the period was 74%. Excluding premiums written by Alterra, consolidated net retention would have been flat over the period.

Earned premiums increased 29%. The increase in 2013 was primarily due to the inclusion of $225 million of earned premiums from the Alterra segment from May 1, 2013, as well as higher earned premium volume in the Specialty Admitted and Excess & Surplus Line segment. The increase in Specially Admitted is due to earned premiums from the Hagerty and THOMCO businesses.

Our combined ratio was 98% for the first six months of 2013, as compared to 93% in 2012. The increase in the combined ratio for the quarter was driven by a higher current accident year loss ratio and less favorable development on prior year loss reserves compared to the same periods in 2012. The results are also impacted by the Alterra segment, which added 8 points to the year-to-date combined ratio, primarily driven by $62 million of merger and acquisition costs and $25 million of catastrophe losses.

Favorable redundancies on prior year loss reserves increased to $204 million or 15 points of favorable development, compared to $191 million or 18 points of favorable development in 2012. The expense ratio for 2012 was unfavorably impacted by the perspective adoption of the new DAC accounting standards, which increase our expenses by $35 million or 3 points on the 2012 combined ratio.

Next I'll discuss the results of Markel Ventures. In the first six months of 2013 revenues from Markel Ventures were $314 million, compared to $191 million in 2012. Net income to shareholders from Markel Ventures was $11 million in 2013, compared to $400,000 in 2012. EBITDA was $40 million in 2013, compared to $19 million in 2012. Revenues, net income to shareholders and EBITDA for Markel Ventures increased in the first six months of 2013 compared to the same period of 2012, primarily as a result of more favorable results at AMF Bakery Systems and our acquisitions of Havco and Reading Bakery Systems in 2012.

Turning to our investment results next. Investment income was flat in 2013 and just under $143 million. Net investment income for 2013 included $17 million of investment income attributable to Alterra, which was net of $21 million in amortization expense from adjusting Alterra's fixed maturity securities to a new amortized cost basis at the acquisition date. Net investment income also included favorable changes in the fair value of our credit default swap of $7 million as compared to $12 million in 2012.

Excluding the impact of Alterra and the credit default swap, net investment income for the first six months of 2013 decreased compared to 2012, due in part to a decrease in our fixed maturities and an increase in our cash and cash equivalents. Net realized investment gains for 2013 were $30 million, compared to $20 million in 2012. Included in that realized gains were $5 million of other than temporary impairments, as compared to $1 million in 2012. Tom will go into further details on investments in Markel Ventures in his comments.

Looking at our total results for the six months, the effective tax rate was 28% in 2013 compared to an effective tax rate of 23% in 2012. The increase is primarily due to the impact of including the operations of Alterra in the Company's effective tax rate beginning at acquisition, and anticipating a smaller tax benefit related to tax exempt investment income as a result of projecting higher pre-tax income for 2013 than in 2012.

We reported net income to shareholders of $117 million, compared to $147 million in 2012. Book value per share increased approximately 12% to $452 per share at June 30, 2013, from $404 per share at year-end. The increase is primarily due to equity issued in connection with the acquisition of Alterra and $109 million of comprehensive income to shareholders.

Finally, I'll make a couple of comments on the cash flows and balance sheet. Net cash provided by operating activities was $240 million for the six months ended June 30, 2013, as compared to $105 million for the same period of 2012. The increase was driven by higher cash flows from underwriting activities and Markel Ventures. The increase in cash flows from underwriting is primarily a result of the acquisition of Alterra, which added $38 million in the period, and higher premium volume, primarily in our Specialty Admitted and Excess & Surplus Lines segment.

Higher cash flows from Markel Ventures were driven by increases at AMF Bakery Systems and our acquisitions of Havco and Reading Bakery Systems in 2012. Invested assets at the holding company were $1.1 billion at June 30, 2013, compared to $1.4 billion at December 31, 2012. The decrease in invested assets is primarily the result of cash paid to the Alterra acquisition, partially offset by a net increase in debt.

At this point I would like it turn it over to Mike to further discuss operations.

Michael Crowley {BIO 1871008 <GO>}

Thanks, Anne. Good morning. The results for the Second Quarter of 2013 for legacy Markel North America were slightly better than the First Quarter of 2013. Gross written premiums for North America increased 28.9% for the quarter and are up 25% for the first six months of 2013. The combined ratios improved as well.

The E&S segment had another excellent quarter, with gross written premiums increasing 20% year-over-year compared to the Second Quarter of 2012 and 15% year-to-date compared to the first six months of 2012. For the third consecutive quarter all five regions of the E&S segment grew their volumes [ph]. E&S segment's combined ratio for the Second Quarter was 76.9%, an improvement of 9.8 points from the same period of 2012. The combined ratio for the first six months is 77.2%, an improvement of 14.4 points compared to 2012.

Prior year losses were favorable due to higher takedowns consistent with Markel's historical practices. These excellent results reflect our continued efforts to improve efficiency and service to our agents and brokers. They also reflect our ongoing marketing initiatives designed to better inform our agents and brokers about our underwriting appetite, and as a result our buy to submit ratio has increased.

The Specialty Admitted segment's gross written premiums increased 41% year-over-year for the Second Quarter compared to 2012 and 39% for the first six months compared to 2012. This increase, as Anne mentioned, was driven by the THOMCO and Hagerty lines of business. The Second Quarter combined ratio for the Specialty segment was 106%, or 3.4 points higher than the same period in 2012. This increase is the result of higher expenses on the Hagerty and THOMCO business due to lagging earned premium.

Excluding Hagerty and THOMCO the expense ratio would have been 5.4 for the quarter. The combined ratio for the first six months was 107%, slightly better than the same period in 2012. During the quarter we implemented a plan to exit certain unprofitable lines of business and non-renew specific accounts within lines that we would continue to underwrite. This action is the result of an in-depth review that we discussed in our First Quarter comments. We fully expect these actions will improve our underwriting results going forward for the Specialty Division.

I would also like to point out that our FirstComp business continues to grow, and the results are improving according to our original long-term plan. Under Gerry Albanese's leadership our product line leadership group has begun the process of integrating Alterra's underwriting operations into Markel. Leaders for wholesale property, large account property, Professional Liability, Inland Marine, and large account casualty have been announced.

In addition the senior underwriting teams for all of these lines of business have been meeting and working to together to develop and implement a consistent and a coordinated approach to our business going forward. With regards to the current rate environment, overall rate increases continue at a steady pace, averaging about 4% across all lines of business.

I would like to take this opportunity to congratulate and thank our Markel associates and all of our former Alterra associates for their efforts during the integration process. I'm very confident in saying that we're well on our way to being one Markel. I will turn the call over to Richie Whitt for his comments.

Richie Whitt {BIO 7084125 <GO>}

Thanks, Mike. Good morning, everyone. I will start my comments with Markel International's first half results and then give an update on the Alterra acquisition.

Markel International had a good first half of 2013. Gross written premiums increased about 2% to $526 million. Areas of growth included our specialty book as well as our Singapore and Netherlands branch offices. Second quarter pricing trends were largely in line with recent quarters' modest price increase. Despite some price increases, however, in many area the market remains competitive.

This was particularly so in the CAT property reinsurance, Professional Liability, retail and equine area. Property CAT reinsurance rates began to fall in the Second Quarter, as additional competition including ILS markets impacted rates. Florida rates were up any were from 10% to 25% at June 1 renewal, and as a results Markel International and legacy Alterra reduced writings of Florida business at June 1, 2013.

International combined ratio for the first six months of 2013 was 90%. This compares to 86% in the first six months of 12. The increase was primarily due to less favorable loss reserve development in 2013. Both years benefited from relatively light catastrophe losses.

Now I would like to give an update on our acquisition of Alterra. As Anne said, we closed the deal on May 1, and everyone remains focused on a smooth transition and realizing the potential of the new Markel. We continue to make good progress bringing the two organizations together. We have successfully combined our New York, Richmond and London offices at this point.

We're also rebranding all operations of Markel and have -- hope to have this effort completed in all major markets before the end of the year. We have kicked off our budgeting and planning process for 2014. This process is going to give all operations, both new and old, the opportunity to work together to lay out our strategy for 2014 and beyond. We've already had several meetings and more are scheduled to provide opportunities for our people to work together to capitalize on our now expanded capabilities.

While we have made tremendous strides in a very short period of time, we still have some work to do with our systems and our back-office processes in order to fully integrate all elements of the legacy Alterra operations into our business model. As such we are managing and reporting the results of legacy Alterra operations, which include US insurance, Alterra at Lloyd's, global insurance and global reinsurance as our Alterra segment and expect to continue to do this through the remainder of the year.

We have several initiatives in place to make the changes in systems and processes, which are required in order to implement a new segment reporting structure for the First Quarter of 2014. You're also going to note that we have included the legacy Alterra life and annuity book, which is a runoff, in our other discontinued line segment. We continue to make good progress on the integration. Despite modest CAT losses in the Second Quarter, Alterra legacy operations are performing as expected through the first half of the year.

With that I would like to turn it over to Tom.

Tom Gayner {BIO 1896932 <GO>}

Thank you, Richie. There are three things I hope to cover this morning. Item one, the first half investment results in our public securities portfolio. Item two, the first half results of Markel Ventures. And item three, an update on our initial actions with our investments that we add as a result of the Alterra acquisition.

As to item one, I'm very pleased with our results through the first half. In our equity and fixed income portfolios we are earned total returns of 16.7% and negative 1% respectively. Total return for the portfolio was 2.5%. The equity results speak for themselves, and I'm very happy with them.

While equity returns always have been and always will be volatile, we've he earned a double digit return on our equity portfolio for the last 24 years, a roughly 200 basis points advantage compared to the S&P 500 index. No steroids were used to achieve those you results.

In addition to the outperformance of S&P 500 equity index, these returns produce aide roughly 450 basis points advantage compared to the Barkleys aggregate fixed income index. We've added value both to our allocation decision to own equity as opposed to fixed income alternatives, and we've added value in our specific equity selections. We've also been very tax efficient and kept those funds working for the benefit of our shareholders with low portfolio turnover.

In our equity portfolio, as has been the case for the last several years, we continue to predominantly own a set of high quality global successful companies. In many cases the dividend yields comfortably exceed what we can earn on an appropriate fixed income alternatives. We also continued our long standing process of step by step measured and selective additions to the equity portfolio through the first half.

In our fixed income portfolio we continue to maintain a portfolio of the highest credit quality that we can find, and we continue to let the duration roll in. Last quarter I repeated our belief [ph] that we remain of the opinion that interest rates were too low and that the risk of longer-term fixed income commitments outweighed the rewards. During the Second Quarter interest rates did, indeed, begin to move upward a little bit, and we minimized the damage that would otherwise have occurred with our short duration stance.

The portfolio assets we added from the Alterra acquisition were longer duration, and the combination moved our duration out approximately one year from approximately 3.5 to 4.5 years. We will continue to let that number roll in a bit, and we will move it out only when interest rates and prospective returns look better to us than they do now.

The net of all this is that our fixed income portfolio could go to a Halloween party dressed as cash and pull it off. Halloween can be scary, and I'm scared of what could happen to interest rates, so we'll continue to be cautious and deliberate as we redeploy the portfolio. At June 30 equities represented 44% of our shareholders' equity, compared to 62% at year-end. That decrease in percentage comes solely from the math of adding in the Alterra balance sheet.

We invested in equities during the first half. The investment returns were strongly positive and the value fixed income portfolio went down due to the rise of interest rates. The addition of the Alterra portfolio was a sudden de facto reallocation of investment allocations, and it is appropriate for you to assume that we will methodically and opportunistically guide the equity investment percentage back up towards our historical levels over time.

On to item two. Markel Ventures operations also performed very well during the first half. Our other revenues of $330 million that you see in the income statement are largely those of the venture company. Those revenues rose 50% compared to last year. Other expenses were $293 million, up 47% from a year ago.

Now, those expenses include noncash amortization and purchase accounting entries that are separate and distinct from the ongoing operational performance of the Markel Ventures company. As such, we used EBITDA in our internal review and management of these operations, and EBITDA more than doubled to $40 million from the first half compared to $19 million in the previous year. A reconciliation of EBITDA to GAAP net income is available on our website and 10-Q.

We are very happy with the underlying economic performance of our Markel Ventures company. While the overall business environment remains extremely competitive and full of challenges, the managers and teams of the Markel Ventures company are doing a first rate job of building their businesses. They operate with the Markel style, just like our insurance operations, and the focus on market leadership, excellence, innovation, and having fun while doing so is paying off. We expect to continue to add to Markel Ventures over the long-term.

Item three. As was the case roughly 70 days ago when we closed on the Alterra transaction, the biggest single challenge and opportunity on asset is the future investment and capital allocation decisions that we will make with assets we acquired as well as cash being generated by our operations. We will invest the money in the same way that we've invested the over the years.

Specifically, on the fixed income side we will continue to focus on high credit quality and maintaining the duration that is shorter than our natural of matching duration of the insurance liability with our bond portfolio. We will continue to do this until interest rates are higher than they are today and we feel that we are being paid appropriately to accept the risk of longer-term commitment.

On the equity side we have a vibrant and profitable insurance business. We have a strong balance sheet and plenty of cash. Our constraint is finding appropriate ideas and protecting and preserving l the balance sheet. For now we will continue to methodically invest in many of the same securities that we already own. Prices are still reasonable in many cases, and we will pick up investment yield [ph] from the dividends as we go.

Given the position of Markel 3.0, we have a lot of dry powder, and we will look to deploy that as rectively [ph] as opportunities present themselves. We are in a unique and what I think is a fantastic position in that we have capital to deploy in what could be a rapidly changing environment. Rest assured that the same disciplines and thought processes we've used for decades to make these decisions for Markel remain in place.

I'm optimistic about our opportunities to make positive capital allocation decisions in the coming years as well as the ultimate results for Markel shareholders. I know that analyst reports on Markel rarely address comprehensive income in their estimates and discussions about us, but comprehensive income is what we as shareholders ultimately receive as the owners of this business.

As such, that is what we focus on as the stewards of this company. We're please today report positive comprehensive income for the first half of 2013 despite the transition expenses, and we are optimistic about our opportunities going forward.

With that I would like to open up the floor for questions. Rob, if you would be so kind as to open up the floor.

Questions And Answers

Operator

Thank you. (Operator Instructions). Our first question is from the line of Jay Cohen of Bank of America Merrill Lynch. Please proceed with your question.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you. Several questions. I guess the first, in the Specialty Admitted area you had mentioned that there were some lines that you were exiting. I'm wondering if you can give us a sense of how big they are. As we go forward, if they will have a meaningful impact on revenue growth there.

A - Michael Crowley {BIO 1871008 <GO>}

There's several lines -- Jay. It's Mike. There are several lines. None of them among themselves are significant. I think over a 12 months period you could see possibly a $40 million reduction there in those lines of business in total, all lines included.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. That's very helpful. And then I guess on the E&S side the premium growth accelerated pretty noticeably from the First Quarter. In the Q and on the call you mentioned price and economy, but from a pricing standpoint it didn't sound like the price increases accelerated at all, and the economic growth doesn't seem terribly robust. I'm wondering kind of really what's behind this acceleration.

A - Michael Crowley {BIO 1871008 <GO>}

It's pretty simple, Jay. We've spent the last few years refreshing our product, improving our service to our agents. We are well past the one park [ph] Markel initiative that we had for the E&S operations. And quite frankly our relationships and our efficiency and our improved products and our service to our larger wholesale brokers, and really all of our wholesale brokers, has paid off in significant organic growth. It's organic growth.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. Thank you.

Operator

Our next question is from the line of Mark Dwelle of RBC Capital Markets. Please proceed with your question.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes. Good morning. A couple of questions. I would like to start in the investment portfolio. There was the asset adjustment there, and a portion of that I guess as I'm understanding the footnote is going to be amortized back through investment income. Could just talk through the mechanics of that a little bit and maybe give some sense of, from a big picture standpoint, how long of a time this will kind of be a drag or an offset against the investment income line?

A - Anne Waleski {BIO 16735457 <GO>}

Yes, Mark, basically you have to, at the acquisition date, take the portfolio to fair market value, and then the life of the assets you amortize it back down to par. So it will be amortizing over the course of the duration of the portfolio, so call it 4.5 to five years.

A - Richie Whitt {BIO 7084125 <GO>}

Yes, Mark, this is Richie. If you think about it, what you have basically done is converted the Alterra portfolio. You had a book yield coming through the P&L. Now you have the effective yield coming through the P&L with the amortization of that premium.

Q - Mark Dwelle {BIO 4211726 <GO>}

And, again, just to kind of clarify slightly with the numbers, the mark on that adjustment was $552 million, and it's that $552 million being amortized --

A - Anne Waleski {BIO 16735457 <GO>}

That's right.

Q - Mark Dwelle {BIO 4211726 <GO>}

Over whatever the duration would be. And then I guess I would presume that to the extent that Tom decides to sell some of those, that would accelerate that more quickly?

A - Anne Waleski {BIO 16735457 <GO>}

That's correct.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. And then I guess likewise I would suppose that won't be a terribly straight-line oriented amortization. It's going to depend -- apart from the sales, it's going to be a weighted duration, so some of that may stay with us for well beyond 4.5 years?

A - Anne Waleski {BIO 16735457 <GO>}

That's a fair statement. It's a little hard to predict.

Q - Mark Dwelle {BIO 4211726 <GO>}

Right. Okay. Okay. That's my first question. My second question, more for Tom, also staying on the investment portfolio. Is the investment income earnings in the quarter, setting aside these amortizations and the addition of the Alterra portion, it seemed like the legacy Markel portion was relatively lower. Were you more oriented into cash just in anticipation of the deal? Was there something -- was there some aspect of the positioning that would have made the -- I'll call it the core or the legacy run rate lower than I might would have expected otherwise?

A - Tom Gayner {BIO 1896932 <GO>}

I mean we're building cash in anticipation of the transaction, but also I would say we were building cash by rolling down the duration curve. So that's just a math of what interest rates are at the short end of the curve.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Yes, I certainly get that. The second question related to the portfolio repositioning. I mean, I've watched you in action for many years. I know that you will do this opportunistically and kind of take the opportunities as the market allows, but do you have a general time line in terms of the asset classes that came over from Alterra that may not be completely consistent with things that you have historically owned in terms of recognizing any gains or losses there? Or would you more plan to just let that mature off and then redirect the proceeds?

A - Tom Gayner {BIO 1896932 <GO>}

I would say in the context of the 80/20 rule, 80% of things that we're comfortable just letting them roll off, and 20% we've taken and will continue to take some more immediate actions. But in the 80/30 rule context it can roll off appropriately.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. All right. I guess that's my last question on the investment portfolio. One other question, kind of more operationally. In one of the notes with respect to the Specialty Admitted business, I was just unclear about the syntax of the sentence. It said there were $62 million, that I wasn't clear whether that related to just Hagerty premiums in the quarter, whether that was Hagerty, THOMCO and any other acquisition premiums within the quarter within the Specialty Admitted business.

A - Tom Gayner {BIO 1896932 <GO>}

It's primarily Hagerty.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. I will stop there. Thank you.

Operator

Our next question is from the line of Adam Klauber with William Blair. Please go ahead with your question.

Q - Adam Klauber {BIO 1494359 <GO>}

Thanks. Good morning. A couple of different questions. In Specialty Admitted are the combined ratios for THOMCO and FirstComp still running above the average of the segment, and are they improving from where they were last year?

A - Tom Gayner {BIO 1896932 <GO>}

Yes, they both are, but keep in mind that we also continue to build a margin of safety in all of those nice [ph] new lines of business; Hagerty, THOMCO and FirstComp. Hagerty -- I mean, excuse me -- THOMCO, has some extra expenses in it. The FirstComp business as I said earlier on the call is absolutely trimming [ph] exactly to according to plan, so we feel very good about the actions they've taken with regards to their expense ratio and with regards to the geography in which they're playing in.

They obviously are writing less [ph] California business, so we feel good about that plan. Again, overall in the Specialty segment we have taken a really hard look at all of the products that we have and all of the programs that we have in Specialty, and the plan that we put in place and initiated beginning in the Second Quarter is a very specific plan targeted to improve the overall profitability in Specialty.

Q - Adam Klauber {BIO 1494359 <GO>}

So is FirstComp today running -- is the margin better today than it was a year-ago, or is it still running a pretty high combined?

A - Tom Gayner {BIO 1896932 <GO>}

Yes. It's better.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. That's helpful. As you take a look at the Alterra business, which you've been doing, but it sounds like you're still looking at the positioning, do you think that business will be trimmed down over the next year or so compared to what it was last year?

A - Tom Gayner {BIO 1896932 <GO>}

That is hard to say. I can tell you that in some of their lines of business, in the large property, the large excess casualty, the Inland Marine, the large professional line, they're tracking right according to their plan.

A - Richie Whitt {BIO 7084125 <GO>}

Volume was -- this is Richie. Volume was pretty flat for the first six months. There's probably a few -- just liken our existing or legacy Markel operations, there's always lines you're looking at and maybe getting out of, but at the same time there's things you're doing or things that are growing, so I think it's a little early to say whether we would think it would trend down or trend up. (multiple speakers).

Q - Adam Klauber {BIO 1494359 <GO>}

Okay, but is it fair to say that you're still assessing that, or do you think you have a pretty good feel for it now?

A - Richie Whitt {BIO 7084125 <GO>}

Well, I think we're looking at it as -- I said we're starting our 2014 planning. I mean, that's where we're really going to dig into it and all the leaders of the various areas, ask them what they think the business plans look like for next year. So I think we will know a lot better in the next couple months as we work through that process.

A - Tom Gayner {BIO 1896932 <GO>}

Yes, let me just add this. I just got back from -- I was in Bermuda earlier in the week meeting with several of the leaders of these lines of business, the orange com [ph] business. One, we continue to be very, very impressed with the talent and with those leaders and with their philosophy with regards to their line of business, which is very consistent with Markel's historically. So at this stage of the game I would be hard for us to say that we could feel much better about the talent that joined Markel.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. And then as far as the favorable reserve development, just on a ballpark basis, is that pretty evenly spread over the last say seven, eight years? Or would you say there is more in the old years versus say the last three, four years?

A - Tom Gayner {BIO 1896932 <GO>}

In other words, what accident [ph] years.

Q - Adam Klauber {BIO 1494359 <GO>}

Yes. Just ballpark.

A - Anne Waleski {BIO 16735457 <GO>}

For the releases this quarter?

Q - Adam Klauber {BIO 1494359 <GO>}

Yes.

A - Anne Waleski {BIO 16735457 <GO>}

They were spread pretty good. E&S was primarily in the casualty business, and that was over a number of years, and within mint [ph] it was primarily the 2010 year.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. Okay. That's helpful. And then just a technical question. On the amortization of the investment income will that increase or decrease investment income?

A - Anne Waleski {BIO 16735457 <GO>}

Decreases investment income.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. That's what I thought. Just double-checking. Thank you, very much.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you.

Operator

(Operator Instructions). Our next question is from the line of Jay Cohen with Bank of America Merrill Lynch. Please proceed with your question.

Q - Jay Cohen {BIO 1498813 <GO>}

Yes. Thank you. Just a quick follow-up on that last one. When you do amortize this, the mark on the investments, will it show up in the net investment income or will it -- I should say it this way. If you sell some of these securities and the amortization is accelerated, does that amortization show up in realized gains or realized losses or in net investment income?

A - Anne Waleski {BIO 16735457 <GO>}

Right, so in the instance of a sale of a security it will flow through realized.

Q - Jay Cohen {BIO 1498813 <GO>}

Okay. That makes sense. Accounting doesn't always make sense. That does. The second question is on the Alterra business. As you had mentioned with THOMCO and Hagerty, you go through a process once you buy something of getting that business onto your reserving methodology, which almost is always more conservative, and one would argue here is more conservative. I recall in the past with Markel International that process took several years. How long would you expect that process to take with Alterra?

A - Richie Whitt {BIO 7084125 <GO>}

Jay, it's Richie. You bring up Terra Nova, and I will just say that the fact that one took longer than we expected. There were -- we had some issues as you will recall, at Terra Nova, and that probably took us longer than we would have expected.

At this point in the game, and I think we said back when we were talking about the due diligence we did on Alterra, we felt d we felt pretty good with the level of reserves they had. We didn't feel like they were quite to the standards or the margin of safety that we like to carry. So I think we're really -- it certainly doesn't get done in a year, but as we sit here today over the flex two to three years that's what I'm thinking.

Q - Jay Cohen {BIO 1498813 <GO>}

That's helpful. The Terra Nova deal was clearly done in a different type, so I see the difference. And I appreciate the response. Thanks.

A - Richie Whitt {BIO 7084125 <GO>}

No problem.

Operator

(Operator Instructions). Line of Doug Mewhirter of SunTrust. Please go ahead with your question.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Hi. Good morning. Just two quick questions. First, Mike, about the workers comp market, I know that rates across-the-board have been outperforming P&C rate trends. How do you see the sustainability of those trends? And also do you feel that Markel's participation in that is outperforming the market or lagging the market, just based on where you --

A - Michael Crowley {BIO 1871008 <GO>}

The rate increases that FirstComp is getting are a little higher than some of our other lines of business. We don't see that changing in the near future, but it's hard to predict. Obviously, we would like for it continue for the foreseeable future. It's hard to tell. But the rates we are getting on FirstComp business are higher than some of our other lines of business. But keep in mind we are also changing the geographic spread there too, which is also a positive.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Okay, thanks for that. And my second and final question is more an Alterra related question. Roughly what was the overlap between I guess what you used to be call the original Alterra US business -- there on the smaller side -- and your Markel's E&S business? Because I know you did compete in certain areas.

A - Michael Crowley {BIO 1871008 <GO>}

We did, and the E&S business is being rolled into our E&S operations here. And the teams are working together to deal with any potential overlap that we have. We'll be consistent in our underwriting philosophy there. With regards to our other lines of business, not as much at all. Alterra on the large casualty, the large property, the professional lines for the most part played in an area where we didn't play.

A - Richie Whitt {BIO 7084125 <GO>}

And one of the nice things we're seeing -- this is Richie. One of the nice things we're seeing is even where we may be -- let's say were both on an account. Well, it's a bigger organization now, so we don't immediately have to say, oh, we have to drop one of these -- one of these participations. We have -- we can have a bigger appetite now with $6 billion of capital and often what we have done is said we're fine keeping both.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Yes. That's definitely a fair point. So -- and just a clarification, Mike, you mentioned that you will be rolling the Alterra -- the smaller Alterra E&S into the Markel E&S. For reporting purposes will it still be in the Alterra segment though?

A - Michael Crowley {BIO 1871008 <GO>}

For the rest of this year.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Okay. Thanks, that's all my questions.

Operator

Thank you. Our next question is from the line of David West of Davenport & Company. Please go ahead with your question.

Q - David West {BIO 1838548 <GO>}

Good morning. A question for Tom. As you're facing these investment alternatives, what do you see in terms of valuation levels for public equities versus what you're seeing in the private equity market when you evaluate the opportunities for ventures?

A - Tom Gayner {BIO 1896932 <GO>}

I would say in the private world prices have gone up more dramatically and more consistently across-the-board than would be the case in the public world, so the multiples we were paying of the things that we bought in Markel Ventures in 2008 and 2009, that generally speaking is not available right now. And you will notice we've been quiet. We haven't bought any major platforms within Markel Ventures for a while.

In public markets there tends to be more dispersion, so you will have headlines of things that are wildly popular and wildly unpopular at the same time. So making a general statement means less in the public markets than it does in the private market. So I would say the opportunity set is actually a little bigger on the public side than the private side as we sit right now.

Q - David West {BIO 1838548 <GO>}

Thanks very much.

Operator

Thank you. At this time there are no additional questions. I would like to turn the floor back to management for closing comments.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you, very much. Thank you for joining us. We look forward to catching up with you again soon. Bye-bye.

Operator

This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.