Q4 2017 Earnings Call

Company Participants

- Anne G. Waleski, Chief Financial Officer & Executive Vice President
- Nora N. Crouch, Chief Accounting Officer
- Richard R. Whitt, III, Co-Chief Executive Officer & Director
- Thomas S. Gayner, Co-Chief Executive Officer & Director

Other Participants

- Jeff Schmitt, Analyst
- Mark Douglas Hughes, Analyst
- Mark Dwelle, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Markel Corporation Fourth Quarter 2017 Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions.

During the call today, we may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may differ materially from those contained in, or suggested by, such 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 in the call today. You may find a reconciliation to GAAP of these measures in the press release, which can be found on our website at www.markelcorp.com in the Investor Information section. Please note this event is being recorded.

I would now like to turn the conference over to Tom Gayner, Co-Chief Executive Officer. Please go ahead, sir.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you, Denise. This is Tom Gayner. It's my pleasure to welcome you to our 2017 year-end conference call. As usual, I'm joined by our Chief Financial Officer, Anne Waleski; and my Co-Chief Executive Officer, Richie Whitt. In a minute, Anne will review the numbers for the year and Richie will cover our insurance operations. I will then return with some comments about our investment and Markel Ventures operations.

Before we dive into the details though, I think it's worth stepping back and looking at the big picture of what is happening at Markel. I'm proud to share with you, our fellow shareholders, that 2017 was a transformative year for your company. We are a larger, more profitable, more resilient, more durable and more creative company than ever before, and you can see that reality in a list of some of the things we did in 2017.

For example, one, we provided the record claims to our policyholders with record loss and loss adjustment expenses of $2.8 billion in 2017. These payments help our clients recover from the record level of catastrophes from Hurricanes Harvey, Irma and Maria, as well as earthquakes fires and other losses during the year. Our primary purpose in our insurance business is to help our clients put Humpty Dumpty back together again after catastrophes and losses. And we did so in record amounts in 2017. That's why people buy insurance and we're delighted to have the financial strength and resources to respond to and help restore our clients in the face of devastating losses. Having insurance matters.

Two, we acquired SureTec and added surety to the list of products and services we offer our clients. Three, we acquired Costa Farms and added a substantial and diverse source of earnings to the Markel Corporation. Four, we acquired State National and added a new and important aspect to our insurance operations. State National connects Markel to the growing world of fintech and the changing landscape of insurance providers. Five, we posted new records in comprehensive income, unrealized gains, recurring investment income and revenues, among other measures. Six, we earned double-digit returns on our shareholders' capital in a low-return world. Seven, we were among the companies that benefited from tax reform. We reported a gain from the changes in the tax law due to our large amount of deferred tax liabilities and longstanding conservative financial practices. Eight, we locked in $600 million of long-term fixed rate financing for 10 and 30 years at attractive rates. Nine, we validated our strategy of diversification and specialization in the three-engine strategy, as one of our engines experienced losses, but the other two provided more than offsetting gains, 10, and the list goes on.

In short, 2017 stands as a transformative year for Markel, as we continue our efforts to build one of the world's great companies. We increased the size of your company by roughly a third from disciplined execution and growth of our ongoing operations as well as the acquisitions of 2017. And by the way, we ended the year with fewer total shares outstanding than what we started with.

I want to thank all of the associates of Markel for their outstanding efforts, their dedication to our customers and to each other, and for the diligence and creativity they share with us each and every day. Thank you.

With that, I'll turn it over to Anne to begin the process of unpacking the nearly infinite number of numbers of 2017. Anne?

Anne G. Waleski {BIO 16735457 <GO>}

Thank you, Tom, and good morning, everyone. Our 2017 results provide us with many reasons to celebrate, many of which Tom has mentioned. Operating revenues for the year were a record-setting $6.1 billion, and both net unrealized investment gains and comprehensive income exceeded $1 billion for the first time in our history.

While we experienced a consolidated underwriting loss from seven separate catastrophe events during the year, our U.S. Insurance segment posted an underwriting profit and all three insurance segments saw year-over-year growth in premium.

Our Markel Ventures operations had very positive results and investments had an amazing year as well. Lastly, we completed two insurance-related acquisitions and one Markel Ventures acquisition, adding to the diversified products and services that we offer our business partners. Lots to celebrate, for sure.

Markel's comprehensive income and growth in book value for 2017 reflects strong performance in our investment portfolio and demonstrates the benefit of having diversified operations. We also recognized, as Tom mentioned, a benefit during the quarter resulting from the enactment of the Tax Cuts and Jobs Act, which I'll discuss later in my comments.

Now, let's talk about the details of our results for 2017, starting with our underwriting results, gross written premiums were $5.3 billion in 2017 compared to $4.8 billion in 2016, an increase of 10%. The increase in gross premium volume was attributable to premium growth in all three of our underwriting segments. The increase in gross written premiums in the U.S. Insurance segment was due to growth within our specialty programs, general liability and personal lines businesses, as well as premiums from our new surety and collateral protection product lines.

In the International segment, higher gross written premiums were due to new business in our marine and energy and excess liability product lines. Higher gross written premiums in our Reinsurance segment were attributable to two large specialty quota share treaties that were written in the first quarter of 2017, and assumed reinstatement premiums our property product lines resulting from the 2017 Catastrophes, partially offsetting these increases with lower premium volume in our auto and general liability lines of business.

Net written premiums for 2017 were $4.4 billion, up 10% from 2016 for the same reasons I just discussed, as well as a 1 point increase in retention from 83% last year to 84% this year. Earned premiums increased 10% to $4.2 billion in 2017 due to higher premium in all three underwriting segments and higher retention.

Our consolidated combined ratio for 2017 was 105% compared to 92% in 2016. The 2017 combined ratio included underwriting losses of $565 million, net of reinstatement premiums from the 2017 Catastrophes, which totaled 13 points on the consolidated combined ratio. The 2016 combined ratio included $69 million of underwriting loss from Hurricane Matthew and wildfires in Canada, or 2 points on last year's consolidated combined ratio. Excluding the impact of the catastrophes in 2017 and 2016, our combined ratio increased due to higher current year loss ratios in our International Insurance and Reinsurance segments.

As we discussed in the first quarter, the 2017 combined ratio also includes $85 million or 2 points of adverse development on prior year loss reserves in our Reinsurance segment, resulting from a decrease in the Ogden Rate, which is used to calculate lump sum awards on UK bodily injury cases.

In 2016, the combined ratio included $71 million or 2 points of adverse development on our medical malpractice and specified medical product lines within our U.S. Insurance segment.

Now, I'll talk a little bit about the results of Markel Ventures. Revenues from Markel Ventures increased to $1.3 billion in 2017 compared to $1.2 billion in 2016. The increase was attributable to the acquisition of Costa Farms in August and higher sales volumes in our non-manufacturing operations, partially offset by lower revenues in our manufacturing operation.

Net income to shareholders from Markel Ventures for the year was $104 million in 2017, compared to $56 million last year. EBITDA was $178 million in 2017, compared to $165 million last year. Results for 2017 include $44 million of insurance recoveries, net of related storm losses from Hurricane Irma. Both 2016 and 2017 were impacted by increases in contingent purchase consideration obligation. 2016 also included a $19 million goodwill impairment charge related to one of our manufacturing reporting units. There was no similar charge in 2017.

Net income to shareholders from Markel Ventures also increased in 2017, compared to 2016, as a result of recording a one-time tax benefit of $37 million in the fourth quarter of 2017, following the enactment of the Tax Cuts and Jobs Act. This amount is included in the consolidated tax benefit we recorded during the fourth quarter, which I'll cover more in just a couple of minutes.

Excluding the impact of these items on 2016 and 2017, net income to shareholders and EBITDA from Markel Ventures decreased as a result of higher material cost and lower sales volume in certain of our manufacturing operations, partially offset by higher sales volume in certain of our non-manufacturing operations.

Looking at our investment results, investment income increased 9% from $373 million in 2016 to $406 million in 2017. Net realized investment losses were $5 million in 2017, compared to net realized investment gains of $65 million in 2016. Realized investment losses in 2017 included a $52 million loss on our investment in the Markel CATCo Fund related to the fund share of underlying losses on Hurricanes Harvey, Irma, Maria and California wildfires.

Net unrealized investment gains increased $763 million in 2017, compared to $242 million in 2016. The increase in net unrealized gains in 2017 was due to an increase in the fair value of our equity portfolio compared to last year-end. Given our long-term focus, variability in the timing of realized and unrealized gains and losses is to be expected.

Finally, I want to remind everyone that, beginning in the first quarter of 2018, there are new accounting rules that will require the fair value of certain equity investments to be reflected in the income statement rather than in accumulated other comprehensive income.

So now I'll spend a little time on taxes, since our 2017 results include a $340 million income tax benefit resulting from the enactment of the Tax Reform Act in late December. This tax benefit is due in part to the required re-measurement of our U.S. net deferred tax liability at the lower enacted corporate tax rate, which decreased from 35% to 21% effective January 1, 2018. The tax benefit was net of a provisional charge for deemed repatriation tax on our unremitted foreign earnings, which have not been previously subject to U.S. income tax.

As you can imagine, our tax team has been working very hard to analyze the new tax law. We continue to monitor technical issues associated with the application of some of its more complex provisions. Please refer to our 10-K, which we expect to file with the SEC on February 23, for more details related to our estimation of this benefit.

In 2017, our total income tax benefit was $313 million, compared to income tax expense of $169 million in 2016. Excluding the tax benefit attributable to the new tax legislation in 2016, income tax expense for 2017 reflects an increase in the proportion of U.S. earnings taxed at 35% compared to 2016 and a change in the impact of our foreign operations.

One last thing on taxes before moving on. I suspect many of you may want to know how to think about our 2018 effective tax rate. Given the changes to the accounting for equities that I mentioned earlier and the continued interpretation of the new tax legislation, we're not able to provide a reasonable estimate. We expect in most years that the enacted lower statutory tax rate will be favorable to our financial results.

Looking at our total results for the year, we reported net income to shareholders of $395 million for 2017, compared $456 million for 2016. Comprehensive income for 2017 was $1.2 billion, compared to $667 million for the end of 2016. And as a result, book value per share at the end of 2017 was $684 million, an increase of 13% since the end of 2016.

To wrap up, I'll make a few comments on cash flows and the balance sheet. Net cash provided by operating activities was $859 million for 2017, compared to $535 million in 2016. Operating cash flows for 2017 included higher premium collections and lower payments for income taxes and employee profit sharing compared to 2016. Operating cash flows for 2017 also reflected higher claims settlement activity across all of our underwriting segments compared to 2016, primarily as a result of the catastrophes that occurred in the second half of 2007.

As of December 31, 2017, we had paid approximately 27% of our total estimated losses on the 2017 Catastrophes. Our holding company had $2.7 billion of invested assets at December 31, 2017, compared to $2.5 billion at December 31, 2016. The increase in holding company invested assets is primarily due to dividends received from our subsidiaries and net proceeds from our fourth quarter issuance of $600 million of unsecured senior notes, partially offset by cash paid for acquisitions and capital contributions to our subsidiaries.

With that, I'll turn it over to Richie to talk more about our underwriting results and operations.

Richard R. Whitt, III {BIO 7084125 <GO>}

Thanks, Anne, and good morning, everyone. Today I'll focus my comments on our underwriting operations and also provide updates on our State National operations which, as you heard, we acquired during the fourth quarter, and Markel CATCo.

Following Anne's theme of 2017 successes, we had numerous successes in our underwriting operations even with the 2017 catastrophic events. As Anne mentioned, we grew organically in all three insurance segments. We completed acquisitions of two outstanding companies to further add to our insurance capabilities, SureTec and State National. And, in addition, our team worked hard to successfully launch the combination of our wholesale and global insurance operations as Markel Assurance effective January 1, 2018.

It was an incredibly busy and productive year. There is a lot to celebrate, but we are also well aware that our 2017 combined ratio of 105% did not meet our longstanding goal of consistent underwriting profitability. Each time catastrophes happen, we learn from them and we're getting better at managing the risk in the future. We're proud to be able to help our customers recover from these events and we recognize that they buy our products for this very reason.

So, let's start with the U.S. Insurance segment. Gross written premiums for the quarter are up $79 million, or 12%, compared to the fourth quarter of 2016. For 2017, writings are up $250 million, or 9%, compared to 2016.

Our Markel surety line, acquired in the second quarter of 2017, added $21 million and $55 million, respectively, for the quarter and the year. State National's collateral protection line added $30 million in both periods. Premium growth excluding these newly acquired product lines was driven by growth from our specialty programs business, our personal line products, primarily a classic car program, and our general liability lines for both the quarter and full-year. Earned premiums were up 13% for the quarter and 9% for the year, due to the same reasons as gross written.

The combined ratio for the U.S. Insurance segment was 83% for the fourth quarter of 2017, compared to 88% for the same period a year ago. The 4-point year-over-year decrease in quarter-to-date combined ratio was primarily due the impact of Canadian wildfires on 2016 results. The combined ratio in 2017 was 95%, compared to 93% in 2016. Cat events contributed a 5-point increase to the 2017 combined ratio. Excluding the impact of cat events in both 2017 and 2016, the stagnant combined ratio decreased due to more favorable development on prior year's loss reserves in 2017.

For 2017, prior year redundancies were $302 million, compared to $205 million for 2016. Our 2016 results included $71 million of adverse development on our medical malpractice and specified medical lines versus no significant development on these lines in 2017. In addition, prior year's favorable loss development increased in 2017 in our workers' compensation and programs product lines.

Next, let's discuss the International Insurance segment. Gross written premiums were up $66 million or 27%, compared to the fourth quarter of 2016. For 2017, writings are up $136 million or 12%, compared to 2016. New business in our marine and energy and general liability product lines within our Markel International division drove the growth on both the quarter and full-year basis. Earned premiums were up 28% for the quarter and 11% for the year due to increases in gross written premium.

The fourth quarter combined ratio was 101% compared to 92% for the same period last year. The increase in the combined ratio was driven by higher current year loss ratio and a lower impact from favorable prior-year development due to higher earned premiums in 2017 compared to 2016. This was partially offset by a lower 2017 expense ratio. The higher current year loss ratio is due to individually large losses in the fourth quarter of 2017 on our marine and energy lines. The reduction in the expense ratio is driven by lower profit sharing expenses and the impact of higher earned premiums.

The 2017 combined ratio was 104% compared to 94% in 2016. Cat events contributed a 12 point increase to the 2017 combined ratio. Excluding the impact of 2017 Cats, the combined ratio was lower due to an increase in favorable development on prior year losses and a lower expense ratio, partially offset by higher current year loss ratio.

The current year accident year loss ratio increased slightly to an increase in the attritional loss ratio on our property lines. Favorable development on prior year's losses increased to $199 million in 2017 versus $165 million in 2016, but this had a muted impact on the combined ratio due to the growth in earned premium in 2017. The reduction in the expense ratio was driven by lower profit sharing expenses and the impact of higher earned premiums.

Next, let's discuss the results of the Reinsurance segment. For the fourth quarter, gross written premium for the segment are down $35 million or 29% compared to the fourth quarter of 2016. For the year, writings are up $71 million or 7% to 2016.

For the quarter, premiums are up – excuse me, are down due to the reduction in writings in our general liability and professional liability lines due primarily to the timing of binding renewal contracts. For 2017, growth was primarily driven by the booking of two new large specialty quota share treaties in the first quarter totaling $137 million, along with net assumed reinstatement premiums related to the 2017 Cat events. Partially offsetting these increases were reductions in auto due to non-renewals and general liability due to the timing of binding renewals and the impact of multi-year contracts.

As mentioned in previous quarters, significant volatility in gross written premium volume can be expected in our Reinsurance segment due to individually significant deals and the timing of renewals of multi-year contracts. Earned premiums are up 6% for the quarter and 12% for the year due to increases in gross written premium.

The fourth combined ratio was 122% compared to 87% for the same period last year. Cat events contributed 19 points of increase to the fourth quarter combined ratio. Excluding the impact of cat events, the segment combined ratio increased due to a higher current year loss ratio and a decrease in the impact of prior year development, partially offset by a lower expense ratio.

The current year loss ratio increased due to prior period adjustments in our general liability and property product lines. For the fourth quarter of 2017, favorable prior year's development was $14 million compared to $35 million in 2016, with the largest decrease coming from professional liability and the property product lines. The expense ratio was favorable due to lower profit sharing expenses and the impact of higher earned premiums on our G&A expenses.

The 2017 combined ratio was 132% compared to 87% in 2016. Cat events contributed 28 point increase to the 2017 combined ratio. Excluding the impact of cat events, the combined ratio increased due to less favorable development on prior year's losses and a higher current year loss ratio. This was partially offset by lower expense ratio due to lower profit sharing expense and the impact of higher earned premiums.

The 2017 result included $8 million of adverse development on prior year loss reserves compared to $126 million of favorable development in 2016. As Anne discussed, the 2017 development on prior year's losses is impacted by $85 million of reserves strengthening in UK motor, which we took in the first quarter of the year, which added 9 points to the segment's 2017 combined ratio.

Excluding the impact of the strengthening in the UK motor reserves for the 2017 results, there was less favorable development in prior year's loss reserves in our property and professional liability lines.

I'd next like to make a few comments about our State National acquisition. Just to kind of level set, the State National business is comprised of two primary products. First, the collateral protection insurance coverage, results from which will be included - are included and will be included going forward in our U.S. Insurance segment; and secondly, a fronting platform, which provides insurance licenses, rated paper and services for fee. We refer to this business as our program service business. The business can be considered largely non-risk-bearing to Markel since the business ceded to third-parties and, in the most cases, fully collateralized. It is reported separately from our underwriting operations.

As I mentioned in the U.S. Insurance segment discussion, the collateral protection insurance line acquired as part of the State National transaction contributed $30 million in gross written premium in both the fourth quarter and for the full-year. The program services business contributed $254 million of gross written premium in the fourth quarter, with none of that premium being retained, that business contributed $15 million of ceding fee commission income from the gross written premium funded during the period, which was reported in other revenues within our operating results.

To make a few comments about the market, as I think most people expected, following the significant third and fourth quarter catastrophic events, property rates are moving higher. The exact extent of rate increases seems to be open to debate, but in general, the trajectory of property rates is higher. The market appears to be differentiating accounts, loss-impacted accounts receiving the highest rate increases, and clean accounts or accounts with minimal cat exposure are receiving smaller increases.

We have also seen some spillover of rate increases in the casualty reinsurance, mostly for lower ceding commissions. Primary casualty is also showing some signs of price improvement.

We have heard some people express disappointment in the level of rate movement so far. We continue to believe that the extent of rate increases will play out over the rest of the year. It would be naive to believe that the rating impact of the 2017 events would be as significant as past events that have led to hardening markets. While the 2017 events were certainly significant by any measure, the amount of insurance and reinsurance capital and the flexibility of that capital today are very different to past market cycles. We will be actively seeking appropriate rate increases across all of our product lines as we move through 2018.

Finishing up with Markel CATCo, I'd like to make a few comments. Assets under management, including funds held that will be used to settle claims for incurred losses, increased to $6.1 billion at December 31, 2017. This is up from $3.6 billion at December 31, 2016. This included approximately $2.2 billion of funds raised during the fourth quarter that we expect to be deployed in 2018. As of December 2017, Markel's investment in Markel CATCo funds was approximately $189 million. During the third and fourth quarter of the year, we recognized losses of approximately $52 million due to changes in the net asset value of the funds, given the estimated losses from the 2017 cat events.

With that, I'll turn it over to Tom. Thank you.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you, Richie. The results from our investment in Markel Ventures operations are wonderful. We earned 25.5% on our equity portfolio in 2017 and continued our nearly three-decade-long record of outperforming the S&P 500. This record stands as one of the finest in the investment industry and continues to add meaningful value to Markel. At year-end, equity stood at 63% of total shareholders' equity, compared to 56% a year ago. We continue to invest regularly and repeatedly as has been our longstanding pattern.

We continue to find attractive investment opportunities and we continue to invest in them in our measured and disciplined way. Overall, prices remain high in many sectors, and we think retaining some dry powder makes sense. At reasonable equity investment allocation, coupled with our cash inflows from our insurance and Markel Ventures operation, allows us to be in a position to respond to volatility and attractive investment opportunities on a moment's notice.

We also protect our balance sheet at the same time. I sleep well with this approach and our long-term record of compounding suggests that our process works. In our fixed income portfolio, we earned 3.4%, a result in line with the coupon and recurring interest income from the portfolio.

We continue to invest in the highest quality fixed income securities that we can find and we match the duration of our portfolio to the duration of our insurance liabilities. We also keep a pleasant amount of walking around money in cash and short-term investments.

At Markel Ventures, we produced total revenues of $1.3 billion, compared to $1.2 billion a year ago. Net income nearly doubled from $56.2 million to a $103.6 million. EBITDA grew to $177.6 million, compared to $165.1 million a year ago.

There are a few salient points I'd like to communicate regarding Markel Ventures. One, our existing operations enjoyed a solid year. As expected, some of our highly cyclical companies experienced slight declines, compared to the white hot conditions in their markets in 2016. In absolute terms, we remain thrilled with their earnings and economic performance. My expectation for 2017 is that, we will still face tough comparisons in our cyclical operations. That said, the businesses produce meaningful cash flows, which we reinvest throughout Markel.

Two, the balance of our companies produced excellent results. I simply could not be happier with the management teams and the results from the array of Markel Ventures operations.

Three, we added Costa Farms, one of the largest growers of houseplants in the world. We've spoken previously about Costa and the quality of the people in the business. I remind you that, within a few weeks of closing, Hurricane Irma passed through Costa's main location and disrupted operations substantially. The losses from the event, the insurance recoveries, the normal seasonality of the business along with the way we account for continued consideration, taxes and other items< means that you as Markel shareholders really haven't seen the full financial effects of this acquisition yet. Please stay tuned. The first quarter at Costa is seasonally modest and plants still need to grow to fill in the pipeline of what was lost in the hurricane. By the second quarter, though, things should begin to normalize and the financial results should become more evident. I think, you'll like what you see.

Four, as time continues to pass, the distortions of purchase accounting continue to burn off. So, we expensed much of the contingent consideration from all of the Markel Ventures acquisitions at this point and we've written off all of the goodwill associated with several deals. As such, these subtractions from net income start to go away. You can see some of that affect this year's EBITDA with many of accounting aspects I mentioned for Costa and several other entities grew 7.6% from $165 million to $177 million, while net income grew 84.3% from $56.2 million to $103.6 million. If we did not continue to do acquisitions, the rate of change in net income and EBITDA would start to converge. Don't worry. I'm confident, we'll continue to find ways to grow and invest your capital at attractive rates of return, so that we can build the value of your company and still talk about accounting.

With the passage of time, some things become easier to say. As one item of the perspective that time brings consider this. Five years ago, in 2012, Markel Ventures produced revenues of $489 million and EBITDA of $60 million. In 2017, it produced revenues of $1.2 billion and EBITDA of $177.6 million. We've also dividended hundreds of millions of dollars from the recurring operations of the Markel Ventures companies up to the parent corporation. As is the case with our insurance operations, our culture, our performance and our daily work continue to create opportunities to form new relationships and deepen existing ones. We remain incredibly excited about what we're doing at Markel and we're grateful for the long-term support and perspective of our shareholders as we continue to build one of the world's great companies.

With that, we would now like to open the floor for questions. Denise?

Operator

Thank you, Mr. Gayner. At this time, we will begin the question-and-answer session. Your first question this morning will be from Mark Hughes of SunTrust. Please go ahead.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Yes. Thank you very much. Good morning.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Good morning.

A - Anne G. Waleski {BIO 16735457 <GO>}

Good morning.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

You had mentioned that the primary casualty pricing was also improving. Any way to sharpen up that number? What specifically are you seeing and do you think that'll get better as we go through the year?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Mark, yeah, we're seeing some improvement. It's spotty at this point. I'm delighted to say we are seeing it though. I was wondering how long it would take before price increases from property would bleed over into other areas. It's modest, very modest, single-digit, probably low single-digit and it's not on every account, but you have to stop going down before you can start going up. And so, I'm an optimist and I'm happy with what I'm seeing. And I know some other people that have been a little bit down in the mouth about the reaction of rates. But you got to start somewhere and this is a start and we and I know a number of others who I think are pretty disciplined players who are going to be trying to push rate because we need rate. So, I'm optimistic, but we're going to have to see how it plays out over 2018.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

In the Markel Ventures, in the manufacturing operations, if we do get a stronger economy here, could some of those cyclical businesses start seeing some firming?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah. Part of the comparison is 2016 was just a blow-the-doors-off kind of number and the CEO of one of those businesses has said, in some bit of irony, I wish 2016 wasn't so good, because 2017 was fantastic. What they are most sensitive to would be auto sales and just general freight circumstances. So, I'm delighted with the absolute levels of cash those businesses are producing right now and would be happy to sign up for a long time to come. And if you want to know directionally what's going to happen, watch auto sales.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

And then, a final question. Tom, your general view on inflation?

A - Thomas S. Gayner {BIO 1896932 <GO>}

I believe there's flation. There's inflation in the things that you buy and deflation in the things that you have.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

If you were to put that into numbers, do you think the inflation is going to accelerate? Does this increase in wages worry you, or how would you position the portfolio for it?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Well, I was polling everybody in the room as you were asking your question. The profound consensus is that neither they nor I know. I mean, we don't know. And we really don't spend any time thinking about it. But what we have is a spectacularly well-positioned portfolio for whatever kind of circumstances we find ourselves in. So, the fixed income portfolio, what we have there is something that is, in many ways, a treasury function. It is there to have cash to write checks when we write insurance claims and we max that up and we earn a spread. And that spread is relatively constant, whether rates are smaller or high, because it's just a spread. It's a spread business. And in the equity portfolio, what we have are things that can move and respond and be dynamic for whatever environment we find ourselves in. And that's also true of the Markel Ventures businesses themselves, which are in effect equity investments. So, we own the residual equity economics of a lot of businesses, which succeed and prosper and figure out whatever environment they find themselves in.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Understood. Thank you.

Operator

The next question will be from Jeff Schmitt of William Blair. Please go ahead.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi. Good morning, everyone.

A - Anne G. Waleski {BIO 16735457 <GO>}

Good morning.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Couple of questions. On Costa Farms, the contingent liability said was $19 million for the year, the increase. Last quarter, there was a $10 million incentive payment. Was that the same or is sort of $10 million and then $9 million this quarter, is that $19 million on the fourth quarter, that increased?

A - Thomas S. Gayner {BIO 1896932 <GO>}

I'm going to let Nora Crouch, our Chief Accounting Officer, opine on that. What I will say before she jumps in is, qualitatively, you've seen a consistent pattern over the last couple of years, where the contingent expense from the deals that we incur a charge for that. What that means is, those deals are working better than what we expected when we first bought them. So, she'll give you the precise number, but the qualitative information is more important.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Right.

A - Nora N. Crouch {BIO 16735452 <GO>}

There was a recognition in the third quarter upon accounting for the purchase that was associated with the original estimation. That estimation increased in the fourth quarter. We've now recognized the full amount of the contingent consideration associated with the Costa Farms transaction. So, there will be no more impacts in the future. But there were two pieces, one in the third and one in the fourth.

A - Thomas S. Gayner {BIO 1896932 <GO>}

And by the way, since you asked about accounting, and I know you love to talk about it. One of the things that I think is descriptive of the conservatism of the organization is those kinds of numbers we're putting to the income statement. That's an expense. Remember, in my point of view, this is the capital amount that we're paying for the business itself. It's almost like, if you bought a house, you paid a certain amount of money for it, and between the time you put the contract down and the time you close, you also added a sunroom or something like that. Well, in the house itself and the mortgage financing you did, that's a capital transaction. The amount of money that you're spending to do the renovation work or add the sunroom, we, in effect, are flushing that through the income statement immediately. The bank will be more than happy to loan you money for the increase in value of the business that you have. So, I think it is fundamentally a very conservative way of presenting things.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Right, exactly, yeah. And I was just trying to look at that, pulling that out. So that is $10 million and $9 million, so those are both – that $10 million last quarter was part of the $19 million. Does Costa Farms flow through non-manufacturing, by the way, or is that in manufacturing?

A - Thomas S. Gayner {BIO 1896932 <GO>}

We will be revisiting the presentation of that in light of the new accounting rules and possible changes going forward. So stay tuned on that.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay.

A - Anne G. Waleski {BIO 16735457 <GO>}

In 2017, is a non – it's a non-manufacturing in 2017.

A - Thomas S. Gayner {BIO 1896932 <GO>}

That's right.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Got you. Got you. And then...

A - Thomas S. Gayner {BIO 1896932 <GO>}

And I might add, if I may. We're trying to get away from that term non, because you think about Markel and the development of Markel over time, someone joked we have insurance and non-insurance revenues. And in the non-insurance revenues, that non-manufacturing people had a pretty good year. So I was almost thinking of getting some T-shirts printed up that said the non, nons because they were the stars of the day (43:57). So we just think this is probably bad terminology in the way people would feel. So, that's why I blanched at that question.

Q - Jeff Schmitt {BIO 19747235 <GO>}

All right, got you. In the $20 million inventory charge last quarter, was that in the manufacturing piece?

A - Anne G. Waleski {BIO 16735457 <GO>}

That charge was a loss related to Hurricane Irma and it was inventory-related and it was last quarter.

Q - Jeff Schmitt {BIO 19747235 <GO>}

In manufacturing?

A - Anne G. Waleski {BIO 16735457 <GO>}

No, it was Costa. So, it would be non...

Q - Jeff Schmitt {BIO 19747235 <GO>}

It was Costa. Got you, got you, okay. And then...

A - Thomas S. Gayner {BIO 1896932 <GO>}

And if I may continue to answer that question, you will be going down the looking glass, Alice in Wonderland terms, when you try to back in what's recurring and non-recurring through what happened in Costa in the period of ownership, because things that seem like their insurance recovery, actually the bulk of that and the largest single item in that was federal crop insurance where in effect were sort of pre-selling some of the inventory to the crop insurer rather than (44:59). I mean, there's just lot of ins, lot of outs, lot of strands here. So, I would suggest that you stay tuned until you get through to the second and third quarter of this year to see what Costa looks like on a normalized basis.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Got it. Okay. And then, one last question. Just looking at – in the U.S. segment, looking at those accident year losses backing out catastrophes, it looks to be down year-over-year and I think every quarter, but the first, which is a little different than what we're seeing at some peers. Can you maybe speak to what you're seeing in terms of loss cost trends?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

I don't have the numbers in front of me, Jeff. But I would say, in terms of loss cost trends, there are, Tort reform, which was big a few years ago. Someone else mentioned the potential of some inflation in the future. Those things are – Tort reform has been slowly eroded and there is some inflation out there. So, the trend is up and that's why we will be pushing for rate, as we go through 2018. I'm not sure if some of the benefit was from prior year development where we have a consistently conservative approach to prior years and some of that which we're seeing could just be prior year releases.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. Thank you.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

I would expect – I guess, to kind of try to bring that around, I would expect us to be booking our current accident year higher than previous years as a result of trend and what we see happening in the markets.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Got it, okay. That's helpful. Thank you.

Operator

And the next question will come from Mark Dwelle of RBC Capital Markets. Please go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yeah. Good morning. A couple of questions. First, I guess, in Markel Ventures, kind of further to some of the questioning on the last caller asked, I just want to make sure I understand all of the – particularly to the fourth quarter only some other kind of unusual ins and outs. So, you had $44 million of benefit from the insurance recovery. You had a $9 million charge related to the contingent payment. Were there any other unusual adds or subtracts along those lines in the fourth quarter alone?

A - Thomas S. Gayner {BIO 1896932 <GO>}

I think those...

A - Anne G. Waleski {BIO 16735457 <GO>}

That will be the only thing.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah. And part of that...

Q - Mark Dwelle {BIO 4211726 <GO>}

All of that – yeah, excluding tax entirely.

A - Anne G. Waleski {BIO 16735457 <GO>}

Yeah. And that would be it, other than tax.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thanks. Speaking of tax, I guess, I'll ask that question next, and then this is really from an overall Markel perspective, not just Ventures. Would it be reasonable to assume from a taxation standpoint that since you've always paid a rate below the statutory rate that your go-forward rate would likewise be below the revised statutory rate?

A - Anne G. Waleski {BIO 16735457 <GO>}

It would be reasonable to assume that the new rate will be beneficial to our financial result. If you want to eliminate for purposes of hypothesis any volatility that may come from the new equity accounting rules, you could say that in most years we would expect a range of 16% to 18%. However, I will caution you that I feel like that is worth exactly what you were paying for.

Q - Mark Dwelle {BIO 4211726 <GO>}

Understood. And just to make sure I understand the interplay on that. So, what you're saying and I believe is, in periods where you would have realized or unrealized gains related to the portfolio, you would like – you would most likely have, in your hypothetical, a favorable rate. But in periods where you had unrealized or realized losses, you would most likely have a percentage that was well above the 21%. Would that be a correct thinking?

A - Anne G. Waleski {BIO 16735457 <GO>}

What I would say is, you're correct. It's a volatility from the movement in the unrealized position may have an outsized impact and may in fact render the concept of ETR for us to be not meaningful. But we just don't know that yet.

Q - Mark Dwelle {BIO 4211726 <GO>}

I think we're on the same page....

A - Anne G. Waleski {BIO 16735457 <GO>}

Okay.

Q - Mark Dwelle {BIO 4211726 <GO>}

I'll stop sharing that line.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

But at the end of the day, Mark, 21% is hell of a lot better than 35%. So...

A - Anne G. Waleski {BIO 16735457 <GO>}

That's right, that's right.

Q - Mark Dwelle {BIO 4211726 <GO>}

Agreed.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

The final analysis is good.

Q - Mark Dwelle {BIO 4211726 <GO>}

Right. Jumping over to CATCo. I just want to ask, you provided, as you usually do, the level of Markel's investment in CATCo. Did Markel participate in any of the various offering rounds that you did during the fourth quarter? I was just kind of trying to generally reconcile last quarter's two hundred and some odd million dollars of investment to the $189 million in view of the $52 million of losses?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Right. We did subscribe and then other people's demand, other investors' demand for the fund was so great. We did not want to squeeze other people's investments down. So, ultimately, we got – we didn't take our subscription, so that other people could participate. So, end of the day, we applied for it, but did not take it. So, the decrease is totally market value decreased in our investment.

Q - Mark Dwelle {BIO 4211726 <GO>}

Got it. And then, I guess, the last question I had, and it relates to the third quarter catastrophe losses, the amounts that you booked. I'm thinking, if I'm doing my math right that you may have taken favorable development related to some of the third quarter or prior quarters', I suppose, cat losses. Is that – is my math that good or am I off on math?

A - Anne G. Waleski {BIO 16735457 <GO>}

Your math is that good.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. I presume that was all primarily – I think, that was all in the U.S. book that I calculated that, was there any on the Reinsurance side?

A - Anne G. Waleski {BIO 16735457 <GO>}

I don't have that detail with me, but you are correct, we did see improvement in the numbers for the third quarter catastrophes.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah, we definitely did, Mark, but I just – I want to give a health warning there. Maria, as well as the California fires are just a little different than what people have seen in the past. And so, we're being pretty cautious about those two, and actually, I think, PCS came out with some numbers today, and they moved some numbers up. So, we're going to be very careful just because the events that happened in 2017, a couple of them just have no precedent.

Q - Mark Dwelle {BIO 4211726 <GO>}

Great, okay. I appreciate the insight and that is all my questions. Thanks.

A - Anne G. Waleski {BIO 16735457 <GO>}

Thank you.

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Operator

The next question is a follow-up from Mark Hughes of SunTrust. Please go ahead.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Just curious, any thoughts you might have on the workers' comp business, pricing has definitely been down there. Is pricing down too much relative to loss trends or how are you viewing that business now?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah, workers' comp has been very good for the last few years. And, as a result of that, the way that market works is the States set the loss cost multiplier. So, you're kind of going off of that base to set your pricing. There's loss cost multipliers in most of the states because of the good experience of going down. And so, as a result, our price is going down some since we base off of that. We still believe there's margin in that business and we're trying to hold as much of that price as we can. But, as a result of the great results, the pricing is under a bit of pressure in workers' comp.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Thank you.

Operator

And, ladies and gentlemen, this will conclude our question-and-answer session. At this time, I would like to turn the conference back over to Tom Gayner for any closing remarks.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you very much for joining us. We're going back to work. Thank you.

Operator

Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. At this time you may disconnect your lines.