Q4 2012 Earnings Call

Company Participants

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

Other Participants

- Doug Mewhirter, Analyst
- Mark Dwelle, Analyst
- Matthew Berry, Analyst
- Meyer Shields, Analyst
- Ray Iardella, Analyst
- Ron Bobman, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Greetings and welcome to Markel Corporation's Fourth 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 turn the conference over to your speaker, Tom Gayner. Thank you, Mr. Gayner, you may 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 Fourth Quarter conference call. Before we get started, we are required to remind you of the Safe Harbor provision, so here goes.

As a reminder, comments made on today's call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate either to Markel or to our proposed acquisition of Alterra

Capital Holdings Limited, and the operations of the combined Company after the acquisition. 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. Please refer to the full disclosure regarding the risks that may affect Markel, Alterra, and the proposed transaction, which may be found in our February 4, 2013 press release, as well as in Markel's and Alterra's most recent Annual Reports on Form 10-K, quarterly reports on Form 10-Q, and the joint proxy statement prospectus relating to the transaction.

Finally, please note that the following communication is not an offer to sell, or a solicitation of an offer to buy any securities, or a solicitation of any vote or approval. We urge investors and security holders to read the registration statement on Form S-4, including the joint proxy statement prospectus, and all other relevant documents filed with the SEC and sent to stockholders, because they contain important information about the proposed transaction. In addition, Markel, Alterra, and their respective Directors and Executive Officers may be deemed to be participants in any solicitation of proxies in connection with the proposed transaction.

Information regarding the interests of these participants can be found in the joint proxy statement prospectus, and Markel's and Alterra's proxy statements filed with the SEC for the 2012 annual meeting. We may also discuss certain non-GAAP financial measures on 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.

With that said, we are pleased that you are joining us this morning, as 2012 stands as an eventful year at Markel. We're also pleased with the financial results that we are reporting to you this morning, and we hope you like the numbers, as well. More importantly, we hope to give you at least some glimmer of understanding of what is going on around here operationally, and some insight into the underlying business reality that these numbers have had to describe. The actions, steps and transactions that we undertook in 2012 changed the arc of our future, and we hope that you are excited and as confident as we are that these are productive steps forward for Markel and its shareholders.

As always, we look forward to your thoughtful questions about the business, and with that as the kick-off, I'd like to turn things over to Anne.

Anne Waleski {BIO 16735457 <GO>}

Thank you, Tom. Good morning, everyone.

I'm really happy to be able to report today that we had an outstanding year. Clearly, as Tom said, there's been a lot going on in Markel in 2012, particularly in the final months. I'd like to take a moment now and recognize all of our Associates, who have driven our accomplishments and results. Without them and their efforts on a day-to-day basis, none of this would be possible.

Our financial results for the year were very strong, benefiting from robust investment performance, underwriting profits on our ongoing business, and increased revenue and profitability from our noninsurance operations, which we refer to as Markel Ventures. Our favorable year-to-date underwriting performance was driven by lower losses for cash fee events in 2012, more favorable development of prior-year loss reserves, and lower attritional losses. Our total year-to-date operating revenues grew 14% to $3 billion in 2012, from $2.6 billion in 2011. The increase is due to a 9% increase in revenue from our insurance operations, and a 54% increase in revenue from Markel Ventures.

Moving into the underwriting results, gross written premiums for 2012 were $2.5 billion, which is an increase of 10% compared to 2011. The increase in 2012 is due to higher gross premium volumes in each of our three operating segments. Net written premiums were $2.2 billion, up 8% to the prior year. Retentions were down slightly in 2012 at 88%, as compared 89% in 2011.

Earned premiums increased 8%. The increase in 2012 was due to higher earned premium volumes in each of our three operating segments. Increases in gross, net and earned premiums have all benefited from higher volume, rate increases, and our recent insurance acquisitions in the Specialty Admitted segment.

Our combined ratio was 97% for 2012, compared to 102% in 2011. The combined ratio for 2012 includes $107 million, or 5 points of underwriting loss, from Hurricane Sandy. The combined ratio for 2012 also includes $43 million, or 2 points of expense, related to our prospective adoption of the new DAC accounting standard. The 2011 combined ratio included $152 million, or 8 points, of underwriting losses related to the catastrophe events which occurred last year in the US, Thailand, 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 2012 and 2011, the improvement in our year-to-date combined ratio was primarily due to lower current accident year loss ratios, and the excess and surplus lines in the London Insurance Market segment. Favorable development on prior-year loss reserves represented 19 points on a combined ratio in 2012, as compared to 18 points of the 2011 combined ratio.

The increase is a result of more favorable development from prior-year loss reserves in the Specialty Admitted and London Insurance Market segments. In the London Insurance Market segment, the favorable development included $39 million from the 2001 and prior accident years. While we believe it is possible that there will be additional redundancies on prior-year loss reserves in 2013, we caution you not to place undue reliance on this favorable trend.

Next, I'll discuss the results of our noninsurance operations, which we call Markel Ventures. In 2012, year-to-date revenues for Markel Ventures were $489 million, compared to $318 million in 2011. Year-to-date net income to shareholders for Markel Ventures was $13.5 million in 2012, as compared to $7.7 million in 2011. EBITDA was $60 million in 2012, as compared to $37 million in the prior year. Revenues, net income to shareholders and

EBITDA from Markel Ventures increased in 2012 as compared to 2011, primarily due to our acquisitions of WI Holdings Inc Weldship [ph] in late 2011, and Havco in 2012.

Turning to our investment results, our investment income was up 7% in 2012 to $282 million. Net investment income for 2012 included a favorable change in the fair value of our credit default swap of $17 million, compared to an adverse change of $4 million in 2011. Excluding the change on the fair value of the credit default swap, lower investment income on our fixed portfolio was offset by increased dividend income on our equity portfolio. Net realized investment gains were $32 million in 2012, as compared to $36 million in 2011. Net realized gains for 2012 included $12 million of writedowns other than temporary declines in the estimated fair value of investments, as compared to $20 million in 2011. Unrealized gains increased $354 million before taxes in 2012, driven by increases in equity securities.

Tom will go into further detail on investments and Markel Ventures in his comments. Finally, looking at our total results for 2012, the effective tax rate was 17% in 2012 as compared to 22% in 2011. The decrease in the effective tax rate is primarily due to higher earnings from our foreign operations, which are taxed at a lower rate. We reported net income to shareholders of $253 million, compared to $142 million in 2011. Book value per share increased 15% to approximately $404 per share at the end of 2012, up from $352 per share at year-end 2011.

I want to take a moment to remind everyone about the change to our EPS calculation, which first occurred in the Second Quarter of 2012. This change was required as a result of our recognition of redeemable noncontrolling interest for some of our Markel Ventures minority shareholders, who have the option to put their shares to us in the future, generally at a fixed multiple of EBITDA. At the end of each reporting period, the carrying value of this redeemable noncontrolling interest is adjusted to management's current best estimate of the redemption value.

The purpose of the adjustment is to report the potential past obligations we may have to the noncontrolling interest shareholders. For the Fourth Quarter of 2012, the redeemable noncontrolling interest balances were marked down $3.4 million. For the full year, the balance was marked up $3.1 million. The change is recorded through retained earnings, and adjusts net income to shareholders when calculating EPS. This calculation will be presented in our 10-K.

Turning to cash flows and the balance sheet, net cash provided by operating activities was approximately $392 million for the year ended 2012, as compared to approximately $311 million for the same period of 2011. The increase in net cash provided by operating activities was due to more underwriting cash flows, as a result of higher premium volume, and increased cash flows from Markel Ventures. Investments and cash at the Holding Company were approximately $1.4 billion at the end of 2012, as compared to a little less than $1.2 billion at the end of 2011. The increase in invested assets is primarily the result of over $400 million in dividends and loan repayments from our domestic and international insurance subsidiaries during the Fourth Quarter of 2012.

In December 2012, Markel announced that it had entered into a definitive agreement to acquire Alterra Capital Holdings Limited, for a consideration of approximately $3.1 billion. The transaction is expected to close in the first half of 2013. In January 2013, Markel announced that it had completed the previously-announced acquisition of Essentia Insurance Company. Through Essentia, Markel will underwrite insurance exclusively for Hagerty Insurance Agency and Hagerty Classic Marine Insurance Agency throughout the US.

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

Mike Crowley {BIO 6836605 <GO>}

Thanks, Anne. Good morning.

Total gross written premiums for Markel North America increased 14.6% year-over-year in the Fourth Quarter, and 10.9% for the 12 months ending December 31, 2012. The E&S segment's gross written premium increased 9.1% in the Fourth Quarter, and 7% for 2012. Markel's Specialty segment's gross written premium increased 23.4% in the Fourth Quarter, and 17% for 2012. Within the E&S segment, I'm pleased to report that in all five regions gross written premium increased in the Fourth Quarter and for 2012. This steady growth supports, I believe, that the One Markel strategy is a success, and that most service issues are behind us. This belief is further supported by the feedback that we received recently from our binding and brokerage councils when they met in Florida.

During the Fourth Quarter, our E&S professionals conducted over 233 agent meetings at NAPSLO and 72 meetings at the PLUS Conference. This increased interaction with our agents is well organized, and is one of the reasons for our organic growth. The E&S segment's combined ratio for 2012 was 93.7%. This increase over prior-year combined ratio was driven by the impact of the change in accounting methodology for deferred acquisition costs, and the impact of Hurricane Sandy.

The Specialty Division's growth was driven by the continued conversion of THOMCO's business to Markel paper. At the beginning of the year, we told you that we expect it to book $60 million in 2012, and we actually booked $79 million. We expect to have all of THOMCO's business converted to Markel paper during 2013. The team at FirstComp continues to execute their plans to improve results through rate increases and geographic reorganization. FirstComp was also a strong contributor to the Specialty Division's growth in 2012, with gross written premiums totaling $257 million.

The combined ratio of 107.4% for 2012 for the Specialty Division was affected by the change in accounting methodology for deferred acquisition costs, one-time employee separation costs, write off of an IT system, and the impact of Hurricane Sandy. As mentioned during the Third Quarter call, we will begin booking premium for the Hagerty Collector Car business in 2013, and we're looking forward to a very successful first year with this fine specialty partner.

During 2012, our product line leadership group and underwriting team achieved an overall rate change of approximately 4%. The Property business had the largest increase. However, we achieved positive rate movement on almost every line of business.

Also during the Fourth Quarter, the product line group transferred 12 experienced underwriters to regional roles, in order to put some of our best underwriters closer to our customers. These underwriters produced $4 million of new business in the last two months of 2012, which supports our theory that putting more experienced authority in the field will further improve service and, ultimately, results. With regard to new products, we're launching an Energy program and an Accountants Professional Liability program. We also picked up a national lawyers program that should result in $10 million of new business in 2013.

Looking back on our results in North America for 2012, we cannot help but feel very good about what was accomplished during the year. Our E&S segment, under John Latham's leadership, exceeded budget and prior-year revenues, while continuing to improve service, streamline the organization, and expand our visibility with agents. As pointed out earlier, under the leadership of our Regional Presidents, Steve Girard, Scott Culler, Sarah Gavlick, Susan Swanson and Greg Rubel, all five regions grew in 2012. The appointment of Jeff Lamb to Chief Underwriting Officer for the segment, and Evans Nash to the Head of Marketing has increased the cooperation and communication between our product line leaders and our regions, continuing to fuel organic growth.

In our Specialty Division, the appointment of Greg Thompson as President of Markel Specialty completed the leadership team of that division. The continued integration of FirstComp has progressed according to plan under Matt Parker's leadership. The THOMCO acquisition and integration has also gone according to plan. Markel America grew organically under Audrey Hanken's leadership, and our Carrier Alliance business had a stellar year under Mary Pat Joyce's leadership.

We reorganized the Specialty Commercial business under the direction of Don Faison and Alex Martin, and positioned that unit for a successful 2013. Gerry Albanese, Executive Vice President and Chief Underwriting Officer, and his team of product line leaders achieved positive rate movement in the vast majority of our product lines, added new products, and enhanced others during the course of 2012. Tom Smith and his team did a great job leading the charge on our brand initiatives, website development and sales initiatives.

So often in today's hurried pace, we fail to take a breath and look back at these accomplishments. I'd like to take this opportunity, as Anne said, to thank all of our leaders and Associates that comprise Markel's North American operations, and all of our leaders and Associates around the world for what they accomplished in 2012.

Now I will turn the call over to Richie.

Richie Whitt {BIO 7084125 <GO>}

Thanks, Mike. Good morning, everybody.

Markel International had a great year in 2012. Gross written premiums increased 8% to $887 million. Significant areas of growth continued to be marine, energy and liability, as well as catastrophe-exposed property. Throughout the year, we continued to see price increases on Catastrophe-exposed Property, and Marine Energy and Liability business. However, as the year progressed, price increases in this areas did moderate.

Our overall average increase at Markel International on 2012 renewal business was approximately 4%. CAT property increases were generally in the 10% to 20% range. Marine, energy and liability have seen mid-single-digit increases. All other lines have seen relatively stable pricing. Despite price increases in certain areas, in many areas of the market still remains very competitive, particularly in our Professional Liability, Retail areas, and Equine divisions.

January 1 '13 renewals were relatively stable. Accounts that were impacted by Hurricane Sandy saw some increases, while all other areas were relatively flat. International's combined ratio for 2012 was 89%, which included 2 points of expenses related to the adoption of the new DAC accounting standard, and this also included approximately $50 million, or 60 points, of loss and reinstatement premiums from Hurricane Sandy in the Fourth Quarter. The 2012 results, as Anne said, benefited from $192 million of prior-year favorable development across a variety of programs.

We've said it many times, but I'll repeat it. We always strive to establish reserves that are more likely redundant than deficient. However, the releases we experienced in 2012 are more than we would normally expect, and are the results of both the favorable developments that I've mentioned across a number of products, including significant favorable reserve development of $39 million in 2001 and prior reserves. I want to congratulate William Stovin, Jeremy Brazil and the entire International team on a great year.

Now I'd like to just turn to Alterra, and just talk about what we've been doing since the announcement in -- on December 19. We have been extremely busy since that announcement. Before the end of the year, we filed our joint proxy, which went effective on January 18 and was mailed that next week to all of the shareholders. The shareholders' votes are scheduled for February 26. We're in the process of obtaining regulatory approvals. We already have clearance under the Hart-Scott-Rodino Act, and have made filings with insurance regulatory authorities in the UK, Ireland, Brazil and the US. While we can't predict the timing of the approval process with any great certainty, we believe that the transaction could close as early as April 2013.

During January, we made multiple visits to most of the Alterra offices, and held meetings with Alterra's Associates. These business have confirmed our findings from due diligence. Alterra's people are extremely impressive, and will be great additions to Markel. We formed a cross-functions integration team led by Peter Minton, COO of Alterra, and that's comprised of Associates from both Markel and Alterra. The team is working on a short-term tactical and long-term strategic goals for the integration. Our short-term goals are to quickly integrate the companies under the Markel brand with as little disruption to Alterra's customer base as possible. Our goal is to be able to lay out the new organizational structure in detail to our Alterra Associates shortly after the shareholder vote in February.

At a very high level, we envision a structure that includes the existing Markel insurance operations of E&S, Specialty and International, plus Reinsurance and Large Account business units. We're just getting started on the task of building the new Markel, but we are pleased with the progress to date and are excited for the deal to close, so that we can move on at full speed with the integration process.

I would now like to turn it over to Tom. Thanks.

Tom Gayner {BIO 1896932 <GO>}

Thank you, Richie.

Comprehensive; I want to start off my comments with that word, and I plan to repeat it about 1,000 times, because it is such an important descriptor of how we think about things at Markel. I suspect that we have some new folks joining the conference call compared to previous periods, and I'd like to convey a bit of how we view our challenges and opportunities in running this Business.

At Markel, we think about things comprehensively. We have a comprehensive set of tools to create comprehensive income, and all of them worked in 2012. The sum total of our comprehensive income from doing so was approximately $500 million. Just to provide you with some frame of reference on that number, the entire retained earnings of the Markel Corporation didn't exceed $500 million until the end of 2004, eight short years ago. 2004 was the year we celebrated the 75th anniversary of Markel. That means we made more money in 2012 than we made cumulatively in the previous 75 years up to 2004.

Now 2012 is just the latest chapter in the story of Markel, and these results would not have happened without the hard work, the values and the culture that was created by all that went before. That said, the results are accumulating nicely, and the work of 2012 should produce even better outcomes in years to come. The components of comprehensive income are one, underwriting results; two, investment results; three, Markel bankers' results; and four, capital management activity.

On cylinder one, underwriting results, Anne already gave you the numbers, and Mike and Richie spoke about our insurance operations. Fortunately, we've got some good underlying trends in place in our insurance operations, and we are all optimistic about prospects for the existing Markel activity, as well as those at Alterra, and we are even more optimistic about the prospects for the combined organization.

On cylinder two, the investment side, today is a fun day to report our investment returns. The numbers are good, and it's always more fun to talk about good results than bad ones. That said, before I get too far into the numbers for 2012, I'd like to reiterate that these numbers are just outcomes. They are mere shadows cast by the underlying reality of the values and principles that guide our approach. The joy of Markel is that our values and principles remain unchanged. Every year, every quarter, every month and every day, we try to do our best to serve our customers across diverse markets, whether that meeting insurance needs, supplying baking or dredging equipment, or slicing pickles. We also stick to conservative and time-tested principles on how to manage the investment funds these activities generate.

In 2012, the results were very pleasant; in some years, it will not be as good. The good news, though, is that when you work from the right set of principles and values, more years are good than not, and time has a way of validating a sound long-term approach, such as what we've practiced at Markel for decades. In 2012, all the factors available to produce comprehensive income were positive. All of them contributed to the total, and there were no negatives. The total investment return of the portfolio was 9%. We earned 19.6% on our equity investments, and 5.1% on our fixed income portfolio.

Over the last 23 years, we've earned nearly 200 basis points of excess return per year compared to the S&P 500 index on our equity investments, and we've earned more than 350 basis points of excess return from our equities compared to the Barclays aggregate fixed income index. We're happy to accept a bit of volatility to earn these returns, since they add up to real money in the pockets of Markel shareholders over time, and 2012 continued to build upon this record of adding value.

On the fixed income side, we earned 5.1% for the year, and I'm very pleased with this result. I remain of the belief that the number one feature in the investment landscape is that interest rates are too low. They keep going lower and lower, although the early days of 2013 are a tad different so far. Our response to this development is to keep owning bonds of shorter and shorter maturities. Simply put, we just don't think that we are being paid appropriately to accept the risks of owning longer-term bonds. The net effect of this is that we are tactically building our balances of cash and cash-like fixed income (inaudible).

Don't worry, we haven't fallen in love with cash, and we do not expect to have this barbell of cash at one end of the investment portfolio and the equity from Markel's ventures operations at the other end, with very little in-between for us. What we have created is the option of redeploying this cash when opportunities arise. Fortunately, with low interest rates and a flat yield curve, the opportunity cost of doing so is minimal.

We're incorporating this thinking into our anticipated actions once the Alterra deal closes, and I want to assure all of our shareholders that the mantra for fixed income, as well as our equity activities, is safety first. I believe that we will be presented with interesting and attractive investment opportunities over the next several years, and we have relatively unique structural and tactical advantages which should create good outcomes for Markel continually [ph].

On cylinder three at Markel Ventures, we enjoyed revenues of approximately $490 million in 2012, up over 50% from $317 million in 2011. Markel Ventures' EBITDA grew over 60%, from $37 million to $60 million, and we remain optimistic about our opportunities in 2013 and beyond. Markel Ventures contributes cash flow to the comprehensive picture at Markel, in excess of the reported net income, since the amortization expense related to purchase accounting is a non-tax charge, and not reflective of the underlying profitability of the Ventures Company. I'm pleased with the results of our Markel Ventures group, and the returns that they are producing.

Currently, we remain somewhat quiet on the acquisition front, given our focus on Alterra, but the opportunities to grow and expand this feature of Markel remain vast. As the old saying goes, when your only tool is a hammer everything looks like a nail. The beauty of Markel is that we are not limited to working with just a hammer. When you look at our opportunity set in insurance, investments, industrial equipment and machinery, healthcare, real estate, our other products and services, along with the cylinder four, our capital allocation discipline and activities, we have a comprehensive toolkit of hammers, drills, screwdrivers, wrenches, saws, measuring tapes, T-squares, levels and duct tape.

We have, and will, use all of them at appropriate times and places, to create the sort of comprehensive returns for you like what we are reporting today. This is an amazing and unusual toolkit that continues to work well for our shareholders, and we look forward to working on the projects on our to-do list in 2013 and beyond.

With that, I'd now like to open the floor for your questions. So Operator, you can open up the call, please.

Questions And Answers

Operator

(Operator Instructions).

Our first question comes from Mark Dwelle with RBC.

Q - Mark Dwelle {BIO 4211726 <GO>}

Good morning. Just a few questions to start off with. Richie, you gave the amount of Sandy losses that had impacted Markel International. Could you provide the same information for the other two segments?

A - Anne Waleski {BIO 16735457 <GO>}

I don't think I have the break-out. The details will be in the K for sure. The total was 107, so you can probably take Richie's number and back out to the other two, but I don't have the split with me.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Is it fair to assume that nearly all the rest was on the E&S segment? Just by majority?

A - Anne Waleski {BIO 16735457 <GO>}

Hold on, I'm looking at something that Mike just handed me.

A - Richie Whitt {BIO 7084125 <GO>}

Mark, we'll give you a call with that. But I don't think -- I don't think we have the numbers handy.

Q - Mark Dwelle {BIO 4211726 <GO>}

No worries. The second question I had, the -- you had indicated the Essentia deal will close, or has closed, and will begin booking revenues for 2013. In general, what is the size of the gross revenue opportunity there? Just maybe something, what they did in 2012 for example?

A - Richie Whitt {BIO 7084125 <GO>}

We don't have their final 2012. Keep in mind that we don't own Hagerty, it's a privately-owned firm. What we've said so far is if you go back to couple years ago and look at the best reports, that they had booked $170 million in Essentia. So you can -- that's a fact, and then you can assume that they are a growing organization, and we expect them to continue to grow in 2013.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay, so $170 million is kind of my baseline starting point, and I can assume what I want over the top of that.

A - Richie Whitt {BIO 7084125 <GO>}

Yes.

Q - Mark Dwelle {BIO 4211726 <GO>}

Tom, you normally provide the duration of your portfolio, the fixed income portfolio. Could you give us that information?

A - Tom Gayner {BIO 1896932 <GO>}

Sure. Including the cat [ph] it's less than three years now, which is a record low.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. So really no change from kind of what you had said in the Third Quarter?

A - Tom Gayner {BIO 1896932 <GO>}

90 days shorter.

Q - Mark Dwelle {BIO 4211726 <GO>}

(Laughter). Fair enough. The last question I had was really just kind of a pricing environment sort of question. You had suggested kind of mid-single digits. Is that fairly broad across most of the product lines, or I guess my comment is specific to the E&S and Specialty Admitted business, is that fairly broad across most lines of business or are there some that are standing taller than them?

A - Richie Whitt {BIO 7084125 <GO>}

The Property is standing taller in both segments. The larger increases were in the Property segment, and then more modest increases in some of the Casualty lines. On average middle single digits, and we expect the same kind of environment in the early part of this year.

Q - Mark Dwelle {BIO 4211726 <GO>}

I will stop there and let somebody else have a chance, thanks.

Operator

(Operator Instructions).

Our next question comes from Ray Iardella from Macquarie Group.

Q - Ray Iardella {BIO 16279337 <GO>}

Thanks. Good morning, and Tom I can certainly appreciate duct tape being a tool used, I appreciate that analogy. The one question I just want to hit on quickly was the portfolio. I mean, assuming the Alterra acquisition goes through, maybe you can talk about what you envision for the portfolio longer-term, just given that their portfolio allocation is a little bit different than Markel?

A - Tom Gayner {BIO 1896932 <GO>}

Sure. More of a term [ph] that it will be recast into the nature and the form and substance of the same way we've been doing things at Markel for a long time. The barbell right now is a tactical decision, that is not a fundamental strategy. It's just to preserve optionality, at a time when there is very little opportunity cost to do so. Longer-term, what we would hope to do is to deploy a good chunk of that into the equity sort of securities, and things to earn positive total returns over time, and the speed and the pace of that will largely be driven by opportunities.

Q - Ray Iardella {BIO 16279337 <GO>}

And then I guess on the fixed income side, and the type of asset class that is more attractive, I know in terms of duration, short, but corporate or municipal bonds, any color there?

A - Tom Gayner {BIO 1896932 <GO>}

In general, cash is king in that regard, because if you had some numbers of relative returns or basis points on top of the benchmark rate, you would still get a very low nominal total return. So the idea of taking credit risks for small amounts of bips [ph], that doesn't seem like that good of an idea to me. So we're very high credit quality, and just higher and higher all the time.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay. Thank you, very much.

A - Tom Gayner {BIO 1896932 <GO>}

And by the way, that also is a tactical statement about today's market. Should the opportunity set be different, and the rates in different securities be different and more attractive over time, we are completely intellectually open-minded and willing to go wherever it makes sense to go.

Q - Ray Iardella {BIO 16279337 <GO>}

Got it. Thanks for the color.

Operator

Our next question comes from Matthew Berry with Lane Five Capital Management.

Q - Matthew Berry {BIO 16846746 <GO>}

Hello, everybody. I have a quick long-term question, which is if we were to see an extended period of inflation, could you just talk me through the sequence of impacts across the business? Across sort of current year expenses and the prior-year reserve adjustments, current year out reserves, and so on, and then the steps that you'd take, and how we would see that impacting the financial's?

A - Tom Gayner {BIO 1896932 <GO>}

Sure, this is Tom. You can't be precise in sequencing these, because you really don't know what the form and nature that inflation [ph] would take. Though -- the ultimate answer to your question though is that rough, rough, rough, essentially 1/365 of whatever business is on the books, whatever expense picture, whatever operations we have, that sort of expires each day, and you come to business the next day, and you get to re-price your insurance rates, you get to re-think about what resources you need to run the business, and try to make good, common sense, logical decisions on account of that. We are not victims of huge fixed commitments and huge fixed assets which can be tracked in the form of -- if they were in [ph] an inflationary environment, and we get to redo 1/365 of our business every single day. What would happen in the period of inflation, deflation, stable prices, whatever, as we would re-work that business the next day when we came to the office.

Q - Matthew Berry {BIO 16846746 <GO>}

Okay. Thank you, Tom.

Operator

Our next question comes from Graham Lehard [ph] with Loeb Capital [ph].

Q - Unidentified Participant

Hi guys, yes, I'm calling on the deal front. I'm just wondering if there is sort of any updates in terms of the regulatory approval fronts, and just timeline in general? Thanks.

A - Richie Whitt {BIO 7084125 <GO>}

As I said earlier, we are proceeding apace with the regulatory approvals. Obviously, the States and the various regulatory entities, you can't control their timing, but things seem to be moving along nicely, and with any luck we think we could get this done in April.

Q - Unidentified Participant

April, really? Okay. Thank you, very much guys.

Operator

Our next question is from Ron Bobman with Capital Returns.

Q - Ron Bobman

Thanks a lot, and congrats on the Alterra prospect and the progress so far. I had a couple questions as it relates to the combination. On the Markel invested portfolio, and equity holdings that you have, where liquidity isn't an issue should we assume that you will sort of gross those positions larger, reflecting the larger investment portfolio that you will now be managing?

A - Tom Gayner {BIO 1896932 <GO>}

Yes. I don't want to imply that is going to happen day one after the close. That will depend on, as you say, liquidity and relative pricing, and what's most attractive to do, but over the period of time that is exactly what should happen.

Q - Ron Bobman

Thanks, and my other question on the combination, sort of corporate organizational structure, and what I mean is obviously you've got, I presume, numerous US insurance entities that are capitalized that you use for different purposes and lines, and I'm sure Alterra brings some number of those, as well as believe you both have presence at Lloyds, if I'm not mistaken. I'm wondering if there's much material opportunity for you to streamline where capital fits in the underwriting entities globally, and for you to more efficiently or at least sort of extract capital out from under some of these regulated [ph] entities? Thanks.

A - Richie Whitt {BIO 7084125 <GO>}

There's certainly opportunities to streamline it significantly. On day one, the goal would be to make sure we don't disrupt anything we're doing for clients. So we will do the short-term things first, and then we will come back and start looking at the legal entity structure, but I think it's safe to assume we can over the next year or so really streamline the capital in the various companies. We don't need as many insurance companies as we'll have after this deal is completed, and we'll work on what is the best solution for that, and make sure our people have the right paper available to write the business.

Q - Ron Bobman

How about Lloyds? Thanks.

A - Richie Whitt {BIO 7084125 <GO>}

Lloyds will have -- will go forward with one syndicate and one managing agent, and that will be Markel Syndicate 3000.

Operator

Our next question comes from Meyer Shields with Stifel Nicolaus.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning, everyone. I apologize if this has been covered before, but can you go through I guess the progress on the FirstComp book, and any reserve changes that happened in the Fourth Quarter?

A - Anne Waleski {BIO 16735457 <GO>}

I think the book progressing is we expected it would, probably even early days after the acquisition, and there weren't really much in the way of adjustments during the quarter.

A - Mike Crowley {BIO 6836605 <GO>}

There just -- this is Mike. They're absolutely executing on plan. They have really reorganized with regard to geography and where they're running business. We have given them different targets, moving down incrementally to where we want them to be, and they have hit every target that we've laid out there for them. And we're operating a year in advance, we've already given them their target for 2014, and they're executing on that as well, so we're very pleased with the progress they've made and what they're doing in that business.

Q - Meyer Shields {BIO 4281064 <GO>}

And I think, Mike, you talked before about the more rapid conversion of THOMCO premiums onto Markel paper. Is that because THOMCO is growing faster than you expected, (inaudible) or are you just converting it faster?

A - Mike Crowley {BIO 6836605 <GO>}

We converted it faster. When we set out to do this, we weren't sure of the time frame of converting some of these (inaudible) programs. I guess we will finish converting them in 2013, but 2014 would be the first year (inaudible) that we had 100% of the THOMCO business on Markel paper. But we just converted them a little faster. But they are growing, and they did have a good year.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, thanks so much.

Operator

Our next question comes from Doug Mewhirter with SunTrust Robinson.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Hi. Good morning, I just had one question about I guess on the liability side, especially your loss cost trends maybe in the North American business. It seems like it still a pretty benign, I guess, legal or judgment environment, especially on your longer-tail business.

I didn't if want to -- if you had any color on that, Mike, just how they trend? It looks like you are still having a considerable amount of favorable development, and I realize a lot of that is conservatism, but is there any -- have you seen any changes or fluctuations in the underlying drivers behind frequency or severity, especially in the long-tailed lines?

A - Richie Whitt {BIO 7084125 <GO>}

I don't think -- this is Richie. I don't think we're seeing anything significant, but trend continues to move out there, although I think it's fair to say, and I think most people would say it's probably been more benign than we would have expected over the last several years, but there clearly is some trend out there, just not to the level it's been in some historical periods.

So we still need to get price increases to deal with the trend that is there, and I will get on the soapbox a little bit and say the whole market needs some rate to continue -- rates to continue to move to get to a good level across the various lines. And I will add that we were very disciplined, Gerry Albanese and his team, very disciplined in getting rates in 2012, and we expect them to operate exactly the same way in 2013.

Q - Doug Mewhirter {BIO 7026139 <GO>}

So would it be fair to say that you are at or maybe slightly above loss cost trends with the ratings right now?

A - Richie Whitt {BIO 7084125 <GO>}

You know, every line is going to be a little bit different, but certainly our contention is to set our pricing to be above the loss cost trends, because we want to set each one to an underwriting profit. But each one of our products is in a different place, we've got over 100 of them, and we have to do sort of portfolio management, as you would expect.

Q - Doug Mewhirter {BIO 7026139 <GO>}

Okay. Thanks a lot for your answers to all my questions.

Operator

Thanks.

(Operator Instructions).

There are no further questions in queue at this time. I would like to turn the call back over to Mr. Gayner for closing comments.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you, very much for joining us. We look forward to chatting with you again soon. Goodbye.

Operator

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