Q3 2019 Earnings Call

Company Participants

- Jeremy A. Noble, Senior Vice President and Chief Financial Officer
- Richard R. Whitt, Co-Chief Executive Officer
- Thomas S. Gayner, Co-Chief Executive Officer

Other Participants

- Charles Gold, Analyst
- Jeff Schmitt, Analyst
- Mark Dwelle, Analyst
- Philip Stefano, Analyst

Presentation

Operator

Good morning, and welcome to the Markel Corporation Third Quarter 2019 Conference Call. (Operator Instructions)

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 the most directly comparable GAAP measure and a reconciliation to GAAP for these measures in our Form 10-Q, which can be found on our website at www.markel.com in the Investor Relations 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.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you, Carrie, and good morning. This is Tom Gayner. I'm joined this morning by my Co-CEO, Richie Whitt and our CFO, Jeremy Noble, and it's our pleasure to welcome you to the Markel Corporation Third Quarter Year-to-Date 2019 Financial Update Call. The purpose of this call is to connect with you, our owners and to provide you with an update on our financial performance through the first nine months of 2019. We'll also offer some commentary about current events and circumstances around Markel. We also look forward to any and all questions you'd like to ask us about your business.

We're pleased to report positive results through the first nine months of 2019. Over the years, we've spoken about the three engines we have at Markel, namely Insurance, Investments and our diverse Markel Ventures operations. Each of those engines provided positive thrust for the first nine months, that is always fun to see and report.

Now, sustainability is a word one hears a lot these days. We've been saying it for years. We believe that sustainability stems from our values of treating our customers, our associates and our shareholders the best way we know how each and every day with no exceptions. We believe that the sustainability of Markel stems from our diverse and successful three-engine architecture, which provides multiple ways to be resilient and robust through all sorts of economic environments and individual business unit challenges. There are always external and internal business challenges, always have been, always will be. At Markel, we've always risen to those challenges and we always will.

To meet those continuous challenges, we remain dedicated to the proposition that two and two equal four. We also believe that it is a good idea to be able to count to 100. We regularly observe occasions in financial markets where others seem to forget those principles. Some folks seem to have the ability to suspend them for a while. I can jump and suspend the effects of gravity for a while, not very long, but I'm under no illusion that gravity doesn't apply. Rest assured, that we at Markel, always remember that two and two does equal four, gravity applies, and it's a good idea to possess the ability to count to 100. At Markel, you want to see us stop counting before we get to 100, and you know that if we go beyond that, something is wrong.

Years like 2019 so far, and more importantly, three decades as a successful public company, demonstrate the sustainability and resilience created by adherence to these numbers and the principles behind them. At this point. Jeremy, will update you on our numbers through the first nine months. Richie will then pick up with some comments on our Insurance, Reinsurance and insurance-linked securities operations, and then I will update you on our investment and ventures operations. We will then take your questions.

With that as intro, I will turn the call over to my friend and colleague, Jeremy Noble.

Jeremy A. Noble {BIO 20687803 <GO>}

Thank you, Tom and good morning, everyone. As you just heard from Tom, the third quarter was really a continuation of the themes discussed a quarter ago, as all three of our operating engines made meaningful contribution to our results in the first nine months of 2019. We produced a meaningful underwriting profit despite catastrophe losses during the period and we're seeing profitable growth in both our Underwriting and Markel Ventures operation. Investment performance through the first nine months of 2019 was excellent and our investment portfolio continued to make meaningful contributions to both net income and comprehensive income.

For the first nine months of 2019, total operating revenues grew 20% to $6.9 billion compared to a year ago. The increase was driven by just over $1 billion of net investment gains primarily due to the increase in the market value of our equity portfolio during the year. Additionally, revenues from Markel Ventures segment increased 9% year-over-year and earned premiums across our underwriting segment increased 6%.

Looking at our underwriting results, gross written premiums were $4.9 billion for the first nine months of 2019 compared to $4.5 billion in 2018, an increase of 10%, which was attributable to higher gross premium volume in both our Insurance and Reinsurance segments. Retention of gross written premiums increased 1 point from 83% in 2018 to 84% in 2019. This increase was driven by an increase in net retention within the insurance segment resulting from recent changes in our outwards reinsurance treaty structures. In late 2018, we shifted from buying proportional reinsurance coverages towards excess of loss coverages for our general liability and professional liability product lines, which resulted in higher retentions. These increases in net retention were partially offset by lower retention on our personal lines business.

Earned premiums increased 6% to $3.7 billion for the first nine months of 2019, due to higher written premium volume in our Insurance segment, partially offset by lower earnings in our Reinsurance segment. Our consolidated combined ratio for the first nine months of 2019 was a 95% compared to 94% last year. The increase in the consolidated combined ratio was primarily driven by lower benefit from favorable development on prior year's loss reserves partially offset by lower underwriting losses arising from the catastrophes. Our 2019 combined ratio included $43 million or 1 point of underwriting losses from Hurricane Dorian and Typhoon Faxai, compared to 2018 combined ratio, which included $76 million or 2 points of underwriting losses from Hurricane Florence and Typhoon Jebi.

Now, I'll cover the results of our Markel Ventures segment. Revenues from Markel Ventures increased to $1.6 billion year-to-date compared to $1.4 billion a year ago. The increased revenues reflected higher revenues across our product businesses, driven in part by our fourth quarter 2018 acquisition of Brahmin Leather Works. EBITDA for Markel Ventures was $219 million for the first nine months of 2019, compared to $128 million last year. Our strong EBITDA, thus far in 2019, has benefited from improved operating results within our consumer and building products businesses.

Turning to our Investment results, net investment income increased from $320 million for the first nine months of 2018 to $339 million this year. The increase was driven by higher dividend income due to increased equity holdings and dividend rates, and higher short-term investment income due to higher short-term interest rates compared to the same period of 2018. Net investment gains included in net income were $1.1 billion for the first nine months of 2019 compared to $408 million last year.

As I mentioned earlier, substantially all of our net investment gains in 2019 were attributable to the increase in the fair value of our equity portfolio during the period. Net unrealized investment gains increased $330 million, net of taxes during the first nine months of 2019, reflecting an increase in the fair value of our fixed maturity portfolio, resulting from declines in interest rates over the same period. Given our long-term focus, variability, and the timing of investment gains and losses is to be expected.

Looking at our consolidated results for the year, our effective tax rate was at 22% for the first nine months of 2019 compared to 32% in the comparable period a year ago. As I've mentioned previously, the impact of management's decision to elect to treat two of our UK subsidiaries as US taxpayers beginning in 2018, added $102 million or 11% to the 2018 effective tax rate. Our estimated annual effective tax rate, which excludes this impact in 2018, as well as certain other items that are infrequent or unusual in nature was 21% in 2019 and 20% in 2018.

We reported net income to shareholders of $1.3 billion for the first nine months of 2019, compared to $623 million a year ago and comprehensive income to shareholders for the period was $1.6 billion compared to $305 million a year ago.

Finally, I'll make a few comments on cash flows, capital, and our balance sheet. Net cash provided by operating activities was $712 million for the first nine months of 2019, compared to $763 million for the same period of 2018. Operating cash flows for 2019 reflected higher claims settlement activity and higher income tax payments compared to 2018. Also reflected in net cash provided by operating activities for 2019 were higher premiums in our Insurance segment.

Invested assets at the holding company were $3.3 billion at September 30th, 2019 compared to $2.6 million at December 31st, 2018. The increase in the holding company invested assets was due to financing activity this year including the issuance of $1.4 billion in unsecured senior notes, $800 million of which occurred in the third quarter. We used a portion of these proceeds to repay $235 million of unsecured senior notes that matured in September. We also purchased $223 million of principal amount of our 2020 and 2021 unsecured senior notes via a tender offering and subsequent to the quarter close, in early October, redeemed the remaining outstanding balances on these series. The net effect of these various finance activities will position the Company to maintain a debt-to-total capital position in the mid 20%s while meaningfully extending the duration of our debt maturities, all at historically low interest levels.

Total shareholders' equity stood at $10.6 billion at September 30, 2019 and increase of 17% from year-end. We repurchased 78,000 shares in the first nine months of the year, pursuant to our share repurchase programs. With that, I'll turn it over to Richie to talk more about our underwriting and ILS results.

Richard R. Whitt {BIO 7084125 <GO>}

Thanks, Jeremy and good morning to everyone. Today, I'll focus my comments on our underwriting operations and I'll also provide brief updates on our State National program services and insurance-linked securities operations. Headlines for the first nine months include solid underwriting results combined with strong premium growth, resulting from a combination of organic growth and improving price momentum. We also continue to be pleased with the progress we're seeing from our State National and Nephila operations.

So I'll kick off by starting with our Insurance segment. Gross written premiums for the quarter were up $170 million or 14% compared to the third quarter of 2018. For the first nine months, premiums are up $404 million or 11%. Premium growth for both the quarter and the first nine months was driven by continued organic growth across several product lines, most notably, our general liability, professional liability and personal line products. Also, there was obviously price increases involved in that. Earned premiums for the segment are up 10% for the quarter and 9% for the first nine months with similar drivers as the gross written premium increases.

The combined ratio for the Insurance segment was 92% for the third quarter of 2019 compared to 96% last year. The 4 point decrease in the combined ratio was driven by lower catastrophe losses in the quarter compared to 2018 and more favorable development on prior accident year loss reserves. The increase in favorable development on prior accident year's losses was primarily driven by more favorable development in our professional liability, and general liability lines. Higher earned premiums in the quarter had a favorable impact on our expense ratio and an unfavorable impact on our prior year's loss ratio.

The combined ratio for the first nine months for the Insurance segment was 94% compared to 92% for the same period a year ago with the increases driven by less favorable development on prior accident year losses. This was partially offset by lower catastrophe losses in 2019 compared to 2018. The decrease in favorable prior-year loss reserve development was driven by our marine and energy specialty programs and property product lines. Similar to the quarter, higher earned premiums for the first nine months had a favorable impact on our expense ratio and an unfavorable impact on the prior year's loss ratio.

Next to talk a little bit about the Reinsurance segment. Gross written premiums for the quarter are down $8 million or 3% compared to the third quarter of 2018. On a year-to-date basis, premiums are up $28 million or 3%. The premium decline in the quarter was driven by non-renewals and lower gross written premiums on multi-year contracts primarily in our product -- property product lines, partially offset by growth in our workers' compensation line due to favorable premium adjustments on a significant treaty.

Premium growth for the year was driven by our workers' compensation line due to the favorable premium adjustments I just mentioned, and by our general liability lines due to a favorable impact from timing of renewals. Significant volatility in gross written premium volume can be expected in our Reinsurance segment due to individually significant deals and the timing of renewals on multi-year contracts.

Earned premiums for the segment increased 7% for the quarter and decreased 3% for the first nine months. The increase in the quarter was due to gross written premium increases in our workers' compensation line, partially offset by higher ceded earned premiums resulting from changes in our outwards property reinsurance structures. The decrease in earned premium for the year was due to the runoff of earned premium from two large specialty quota-share treaty that were non-renewed and higher ceded earned premiums resulting from changes in our outward property reinsurance.

The combined ratio for the Reinsurance segment was 103% for the third quarter this year compared to 115% last year. The 12 point decrease was driven by lower current accident year loss ratio and expense ratio. The decrease in the current accident year loss ratio was primarily driven by more favorable premium adjustments this year and lower catastrophe losses than in 2018. The decrease in the expense ratio was driven by lower G&A cost and profit-sharing expenses, and the favorable impact of higher earned premiums in the current year. The combined ratio for the first nine months for this segment was 99% versus 100% for the same period last year. The 1 point decrease was driven by lower current accident year loss ratios, partially offset by our higher expense ratio. The decrease in the current year's loss ratio was due to lower catastrophe losses. The increase in the expense ratio was driven by higher ceded earned premiums, resulting from changes in our outward reinsurance.

Next, I'll touch on our program services operations. Gross written premium volume from our State National program services operations were up 11% and 15%, respectively from the same periods last year, driven by organic growth across several existing programs. As a reminder, almost all of this gross written premium is ceded to third parties. Ceding fee revenues were up 26% and 18% on the quarter and nine-month basis from last year due to continued growth in premium volumes over multiple quarters. We're very pleased with State National's continued strong operating performance. In addition, and as we expected, State National continues to prove strategically important to Nephila and our overall ILS strategy.

Next, I'll discuss ILS operations. With the completion of the Nephila acquisition in November 2018, we significantly increased Markel's ILS operations. With Nephila and Markel CATCo operations, we have approximately $13.5 billion of net assets under management as of September 30th, 2019. Total revenues from our ILS operations were $55 million in the quarter and $159 million for the first nine months of 2019 versus $18 million and $53 million for the same periods last year. The increase in revenues in both periods is due to the contribution in revenues from the Nephila acquisition, partially offset by lower revenues from Markel CATCo due to lower AUM and a reduction in management fees charged on sidepocket shares.

Operating expenses for both periods were impacted by costs associated with the internal review of matters at CATCo and related litigation cost. The effects of these were more than offset by lower retention and incentive commission costs in 2019 compared to 2018. There are a number of other items that are creating a complicated picture of ILS results for 2019. Related to Nephila, while the overall operations are profitable, the impact of purchase accounting adjustments on operating expenses and lower-than-anticipated management fees and associated delayed fee recognition on sidepockets arising from the 2018 catastrophes, negatively impacted reporting -- reported performance.

Shifting through the noise caused by these items, Nephila is broadly on top -- on target to meet our expectations from the beginning of the year and continues to take a disciplined approach to long-term value creation. Related to Markel CATCo, the run-off of the business and the associated cost of the internal review and litigation have resulted in a net loss for the first nine months of the year.

Amounts from our program services and ILS operations are reported within Services and Other Revenue Expenses within our operating results.

Next for a few comments on the market conditions, I'm afraid my commentary is going to borrow heavily from what I've said the last couple of quarters. The themes that I have been mentioning throughout the year continued in the third quarter. Market conditions continue to improve in an incremental fashion. We continue to see month-over-month price improvement in most lines. It's very clear that the market is in transition, carriers are reassessing their expectations for cat frequency and severity given the events of the past now three years, and professional and casualty results needing rate increases after several years of decreases. We continue to see month-over-month acceleration in the upward pricing trends. There's been much discussion of increased claims trend. I think recently it's been referred to as social inflation and whether rate increases are keeping pace. Really this is going to be -- it's going to be a different answer depending on the line of business and it's going to take some time to have definitive answers. Our sense is that professional and casualty lines need rate increases to account for increasing claims trend or social inflation. It would be foolish to assume that all price increases are going to fall directly to the bottom line.

One thing I'd just like to say here, social inflation is not some new trend. This has been going on since insurance started, quite honestly, and it tends to go in cycles. We have seen this before. We have to be very vigilant and we understand that. But we also are confident that this cycle that we're currently in, is manageable.

Similar to last quarter, the only major line where pricing is declining is workers' compensation as a result of its good results over the last several years and highly regulated nature. We believe that workers' compensation is still profitable, but obviously with rate decreases, the margins that we've enjoyed in that business over the past several years are shrinking. We remain consciously optimistic that this incremental rating improvement will continue during the rest of this year and during 2020.

So in summary, we're feeling very good about the underlying performance of our underwriting ILS and program services operations for the first nine months. Market conditions continue to improve and we're growing profitably across our business as a whole. We remain intently focused on finding ways to leverage Markel's unique set of capabilities for our customers.

Thank you for your time today. And now, I'd like to turn things to Tom.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you, Richie. We enjoyed wonderful results in both Markel Ventures and in our investment operations during the first nine months of 2019. So far, we're up 20.3% in our equity investments and 6.9% in fixed income. The total return for the portfolio, after subtracting out foreign exchange movements and investment expense was 10.9%. That is a great full-year return and well beyond my expectations for any given nine-month period.

The main message that I wish to share with you is that we continue to be as disciplined as we know how, to follow our long-standing four-part investment philosophy of buying businesses with good returns on capital and not too much debt run by management teams with equal measures of talent and integrity, with reinvestment opportunities and/or capital discipline at fair prices. It's the way we work, always has been, always will be.

In recent days and weeks, headlines featured amazing stories of companies where -- to put it one way, their investors and funders might not have been following the same sort of discipline to make decisions. We do not and have not owned any of the names, which I've -- about which I've read entertaining stories in the last few weeks. In our fixed income operations, we earned a total return of 6.9%, which is well in excess of current coupon rates on offer for high-quality fixed income securities.

We benefited from positive price marks on the bonds we held. We continue to be very wary about investing in long-duration bonds. We continue to build up liquidity and forego some current income, because we think it's more important to protect our balance sheet in the event of rising interest rates or any financial market dislocations.

At Markel Ventures, we set new records in revenues and EBITDA. Revenues equaled about $1.6 billion during the first nine months of 2019 and EBITDA of $219 million gives a vivid picture of the size and scope, as well as the profitability of our Markel Ventures operations. We continue to enjoy strong results from our industrial businesses where we expect cyclicality. Those businesses continue to perform well, both due to their own efforts and management expertise, as well as the continuing favorable economic environment. Our companies that tend not to be as economically sensitive, also continue to grow and perform well and we're gaining ground in some spots where we had ground to gain.

All-in-all, I just want to thank you, the shareholders, my colleague and our Board of Directors for your patient and confidence that we were indeed making good capital allocation decisions as we work to build Markel Ventures. It's delightful for me to be able to report to you overall, solid organic growth and the double-digit percentage EBITDA profitability.

The environment to add new companies to Markel Ventures remains tough as valuations continue to be high across the marketplace. Fortunately, we continue to enjoy organic growth opportunities within many of the businesses we already own. Also, our track record of financial performance, along with our values-based, long-term approach continues to cause people to seek us out about the possibility of joining the Markel family. We'll keep working diligently on what we have and we will remain open-minded and flexible as we consider growth opportunities.

We believe that our balanced, steady, disciplined and unrelenting approach to build our portfolio of partially-owned businesses, i.e. publicly-traded stocks, alongside building the value of the Markel Ventures majority-owned companies, combined to work as designed to build long-term value for all of us at Markel. And by all of us, I mean our customers, our associates and our shareholders. We continue to strive to build one of the world's great companies and that means running the Company with win, win, win opportunities for all involved. Thank you for your confidence in us and support as we do so.

With that, thank you again for joining us today, and we'd now like to open the floor for your questions. Carrie?

Questions And Answers

Operator

(Operator Instructions) First question will come from Phil Stefano of Deutsche Bank.

Q - Philip Stefano {BIO 20346322 <GO>}

Yeah, thanks and good morning. For the CAT losses, do you have a breakout you could provide between Dorian and Faxai?

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

We didn't put that out in the 10-Q, but it's obviously $43 million in the period and it's a little bit more weighted towards Dorion, but...

Q - Philip Stefano {BIO 20346322 <GO>}

Look, the reason I ask and I saw that in the Q that you have the Hagibis estimate range out there. I realize it's very early days, there is a lot of uncertainty. But it felt like the market share on Hagibis was higher than Faxai. And I was wondering, is there anything inherently different about these exposures or were there aggregate covers tripped or maybe something different in the reserving process? It just felt like they were similar storms with a dissimilar market share and losses that we would expect on your results.

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

I would say probably the biggest difference is just the lack of time to analyze Hagibis and also just the flood component. The flood component there is massive and it's going to -- and I'll just throw out one other thing. Hagibis coming into a relatively similar area right after Faxai. That is going to be a complicated storm to adjust. And so, I think, more than anything, we're just trying to be conservative in terms of what that thing could potentially look like.

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

Yeah, I would add to that. I mean, the preliminary industry loss estimates for Hagibis is certainly greater than Faxai. But both of those are pretty recent events. We have very sort of initial estimates, ourselves as well as across the industry. But as you get into larger-size event, to the extent that we play at higher sort of attachment points at higher layers we could get sort of a higher amount of exposure. But to Richie's point really a broad range to say it's out there. We'll put a finer estimate on that obviously in the fourth quarter.

Q - Philip Stefano {BIO 20346322 <GO>}

Got it. Okay. Thank you. No, I appreciate the forward-looking. Not many companies have given us at least an estimate at this point. So I do appreciate it. Looking at the reinsurance underlying loss ratio, it feels like it has some volatility to it. And commentary in the past I think suggests that the changes in the outwards reinsurance is causing some choppiness. And probably as we get towards the end of this year, we'll get a better idea of what the steady-state is going to look like. Do you feel like you have a sense for what the steady-state is pushing towards at this point?

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

No, I think you're right there, Phil. And I think, as we get a little closer to the end of the year, we'll have a better sense. There has been a lot of moving parts. Obviously, we changed the reinsurance structures. We have been -- pricing for property has gotten better as the year has gone on, but early in the year we were a bit disappointed with property pricing, and so we wrote less. And actually, we wrote -- seeing improvement in casualty, we were shifting a little more towards casualty. So mix is affecting it. The change in the reinsurance is impacting it and also, we've had some movement in the prior years that we've talked about. So it's a little hard to pin right now. I do think towards the end of the year, we'll have a better sense.

Q - Philip Stefano {BIO 20346322 <GO>}

With the full-year '19 number being good, way to think about forward?

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

I think so -- but for prior year we've had a little bit of noise in the prior year. So I think the full-year number would be a better proxy and that would reflect some of that shift from property into the casualty and specialty lines.

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

And Phil, this is Tom. I want to jump in. This is not the question you're asking, but I think it's a really important point to make and it relates to our capital allocation framework and those comments I made about counting to 100. I think one of the beautiful things about Markel is the architecture where we have a lot of different things we can do. And reinsurance in and of itself has volatility. There are commodity like aspects to that business. We fully understand that but we're participants in the business. We see flow and I think we have some reasonably good sensitivity that when prices are attractive we are in a position to write more of it. And when they're not, we're in a position to write less and what that does over cycles is it provides us with lumpy but real capital that comes back into the corpus up Markel, which we then make capital allocation decisions, looking around the horn of everything we do to see where the best place to put that capital is. So we're not dependent upon reinsurance, but it is a wonderful arrow to have in the quiver that drives overall returns at Markel.

Q - Philip Stefano {BIO 20346322 <GO>}

Got it. Thanks. And maybe to follow on that. Where are we in the capital allocation process? Is ventures still appealing or have valuations gotten away from you? With pricing that we're getting on the insurance side of the house, does it make sense to allocate capital there? How are you thinking through the current environment and what we've seen in the movement in PE pricing versus insurance pricing?

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

Right. Well, capital allocation process is a continuous process. I mean that's what we do all day every day and what we're looking at is the opportunity set of the things that are already within the house and everything else that we see. So, that diagram [ph] covers the whole world. You're correct in sensing that given what's happening in the insurance market, our favorite thing to do is allocate capital to proven underwriters within the organization who produce profitable books of business because that in and of itself generates capital for everything else at the same time. So, that's the first thing we always look to do and we are experiencing the opportunity to do exactly that right now. You're correct in the commentary I made about pricing to expand Markel Ventures. That's been the case for three, maybe five years now.

We have done one deal a year I think over the last couple of years and those have been inbound calls where somebody called us and there were various reasons beyond just a bidding contest as to why those organizations wanted to be part of Markel and they're working out great. We are not participating in auction processes as bids right now because that would -- prices are just too high. So unless there is some reason somebody wants to be part of Markel, we're not going to succeed in a circumstance such as that. But we are continuing to engage in conversations with people who care about the long-term value creation and future of their business and their unique opportunities and it will be completely (technical difficulty) a lot.

Q - Philip Stefano {BIO 20346322 <GO>}

All right. Thanks, guys.

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

Thank you.

Operator

The next question will come from Jeff Schmitt of William Blair.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi. Good morning, everyone. Looking at growth in the US segment obviously continues to be really good. Can you maybe discuss what type of growth you're seeing in E&S lines in particular or maybe touch on what you're seeing in the market there just given the pullback from some big competitors?

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

Sure. I mean that is where the strongest growth is in our E&S or wholesale side of the business. Without a doubt, there is business that is experiencing dislocation and that is finding its way into the E&S or wholesale market and so that is a big, big driver of our growth right now. We're seeing it in executive risk, we're seeing it in professional liability, we're obviously seeing it in commercial property. So, it's not every line and I think other people have spoken about this. Not every line is going up by the same amount and some are trailing still and we're grow -- so we are growing less in those areas and we are growing more in the areas where we feel like the prices are moving appropriately.

One of the things we look hard at is we triage -- again talking about capital allocation, like Tom just mentioned, we go pretty granular in terms of allocating capital and we look at our product lines in terms of -- we make it simple; green, yellow red. Green is business that's profitable, we want to write more of; yellow is right around the target, we'd like to write more of that, but we need the right price; and red is probably not achieving pricing targets and so we need quite a bit of price and it's not going to be our first priority. Most of our growth is coming in our green line. So, we are focusing our growth and we're focusing our capital on our most profitable lines and we like what we're seeing in terms of the environment.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And just on social inflation and I know you touched on this and have in the past, just looking at your underlying loss trends in the US segment, I mean they appear to be quite a bit better than competitors, I mean, much more stable. Are you just not seeing it as much? I mean, are you surprised with some of the commentary you're hearing? I mean, maybe is it a business mix issue?

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

It is definitely a business mix issue. There is definitely social inflation out there and like I said, it goes in waves. We had that big spat of tort reform years ago and what's been happening since, tort reform has been slowly but surely chipped away at and you've got other factors such as millennials and jury pools. There is lots of things going on, but social inflation runs in cycles and not all lines are affected equally. Commercial auto has seen it probably the most and larger accounts, the headline verdicts, the big Fortune 1000 sort of stuff. That has probably been hit harder. While we write the Fortune 1000, it's a relatively small part of what we do. We don't do much commercial auto. We tend to be more of a small to middle-sized accounts sort of company. And I don't think those lines are seeing as much of the social inflation as some of the other areas. So -- and also I'll say we are pretty proactive in managing that. We watch -- we don't wait until it's -- and this is not -- this is not easy. I mean, sometimes it can sneak up on you, but we don't wait until it's already on top of us. We've been adjusting our books to sort of guard against social inflation as we've been moving along. So, we're definitely seeing what other people are seeing. We're trying to manage it and our mix has protected us to some extent.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And just one last one on the unrealized gains. Just looking at it for fixed income securities. With $95 million on a pre-tax basis in the quarter which is -- looks like less than half what it was in Q1 and Q2. But looking at interest rates, they actually -- looks like they moved down more in the third quarter than the first two. Is there anything in there why that may be lower? I mean, obviously it's a tough number to predict.

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

It's straight math and the portfolio continues to come in in terms of duration a little bit. So as the duration number gets lower and lower, any given level of change in interest rates will have a smaller dollar effect on things. So, the way in which the fixed income portfolio is invested in terms of absolute highest credit quality stuff we can find is unchanged. The only difference between now and six months or a year ago is the duration is a bit shorter than what it was.

A - Jeremy A. Noble {BIO 20687803 <GO>}

Hey, Jeff. It's Jeremy. There's one other thing depending on how you're looking at this. If you look at it on an after-tax from a change on an AOCI basis, there's a little esoteric sort of US GAAP feature that exists within life insurance. And I can point you to that footnote in our financials, but we have this concept called shadow loss, which essentially is the market yield goes down our investments that exist against our life insurance policy reserves, we essentially have to recognize through the balance sheet an increase in the policy reserves for life insurance and a reduction in AOCI. So, the idea almost being if you were to crystallize the unrealized gains as a result of the decline and put that money back to work and lower yield, they would all of a sudden maybe not be sufficient to match off against your reserves. A sort of funny feature within US GAAP, but that is creating a little bit of that noise potentially in your calculation.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. I'll take a look at that. Thank you.

A - Jeremy A. Noble {BIO 20687803 <GO>}

You can see that in the footnote, yes.

Operator

The next question will come from Mark Dwelle with RBC Capital Markets.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes. Good morning, everyone.

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

Hey, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

A lot of ground has already been covered, but I have a couple I want to hit on. First for Richie, could you talk a little bit about the new Lodgepine business, maybe a little compare and contrast on how that's the same and different from Nephila and/or the former CATCo?

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

Sure. Happy to, Mark. Lodgepine is -- what it really is is a retro reinsurance fund and it's run by people who have run our retro portfolio at Markel reinsurance for the last many, many years. What it does is it really kind of fills out our ILS offering. Nephila focuses on insurance and reinsurance, cat bonds, things of that sort. They really do not -- they do not play in the retro space. So having large bonds, it puts us into the -- and this is traditional retro. This isn't pillared like the CATCo product was. This is sort of your traditional retro, one with a reinstatement.

And so, it gives this kind of product breadth across. And also this is business that we've written for many years and kept it on the Markel balance sheet. There is the opportunity there to put some of that into the fund, obviously, continue to take a large participation in it. But if investors find that return attractive, reduce some of the volatility on Markel's balance sheet, be able to continue to grow in retro and provide exposure -- and hopefully -- to that risk, and hopefully with good returns to investors. So, that's sort of in a nutshell the plan.

Q - Mark Dwelle {BIO 4211726 <GO>}

So it seems pretty timely considering what appears to be going on in the retro market at this point in time with all the trapped capital and whatnot. So, thank you. Thank you for that.

Is there anything to update at all with respect to CATCo? Any further word from regulatory authorities or others as to when or if, or how they might conclude their work?

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

Really no word. The investigations continue and we continue to cooperate. And really there is nothing else to report at this point.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. I think that's all for you, Richie. I'd like to turn over to Tom then. On the investment portfolio, given what we've seen with yields and how those have moved across the market, is there anything that you're doing or contemplating doing with respect to how you're positioning the portfolio? I know you had recently lengthened some of your durations a little bit. Is that something that you're revisiting?

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

No. The expectation, frankly, would be to continue to have the durations come down. So sometimes there are cash flows that come in, and you -- you invest some of that and we want to keep the duration still in the neighborhood of what the duration of the liabilities are. So if we do absolutely nothing, the duration probably comes in a little too far too fast.

So we do use some of the money to keep the duration within that four-year to five-year bandwidth that is -- that matches the four-year to five-year bandwidth of the liability, and we're closer to four than we are to five. And that's what in this environment, you should expect to continue to be the case.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. And then the last question I had for you, Tom, just -- and this is more of a, I guess, a macro set of comments. I mean, within the Markel Ventures vehicles, you have a pretty good cross section of the US economy between industrial companies, retail companies, consumer companies, et cetera. Is there anything you're reading across with their results that might inform how the broader economy is behaving and whether we're accelerating or slowing, or getting worse or better, or anything of that nature? Just any observations that'd welcome your thoughts.

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

Sure. I would encourage you to get out and move around America a little bit as opposed to just reading the New York Times. Things are better than what is reported in the headlines. I mean, these businesses are doing great. Good order books and plenty to do. And really the number 1 consistent comment that the CEOs that run these businesses would say is, labor and getting people to run the businesses.

So that continues to be the case. There are some of the cyclical businesses where you're getting a bit of a whip of a little bit of economic slowness, but if it continued to operate under the plain level where we are now, you and I would both be delighted. But the ability to operate reasonably well is out there and that's what the businesses are doing. And it's better than what the headlines read.

Q - Mark Dwelle {BIO 4211726 <GO>}

Well, thanks for the comments. I'll stick to reading the Times-Dispatch then.

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

And really for the Pittsburgh Steelers.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yeah.

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

It's better than it looks.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thanks, guys.

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

Thank you, Mark.

Operator

The next question will come from Charles Gold of Scott & Stringfellow.

Q - Charles Gold {BIO 17653874 <GO>}

Thank you. Two questions. Any feeling on the effect of the California fires at this point? And am I correct that the currency was about a $54 million drag in the quarter?

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

I'll take the fires, Charles. it is way too early to have any sense of the fires. And unfortunately, given conditions out there, the ones that are burning could be burning for a while, and there are some possibility of more starting. It's still there. So very much an evolving situation. The one thing I can tell you is, we adapt. And so post the 2017 fires, we made changes to our underwriting approach to reduce our exposure for '18. Post the '18 fires, we made adjustments to reduce our exposures again.

So all things being equal, which unfortunately, they never are, my expectation is our exposure today is less than it was in '18 and more -- and even more or less than it was in '17. So we're just going to have to see and our thoughts are with those folks.

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

Hey, Charles. It's Tom and I'll let Jeremy to chime in on this response too on the FX. Yes, that number is what is there on the face of the statements. So...

A - Jeremy A. Noble {BIO 20687803 <GO>}

Well, Charles, it's Jeremy. It's actually a gain in the period in FX through the income statement. And just to finish it off and then I'll hand it back over to Tom, but some of that's just geography. So really we try to match off assets and liability in currency, and we don't see a lot of movements. But the reality is on the asset side. That mark kind of goes to unrealized is captured through one aspect in the financials. On the liability side, it gets captured in the income statement. So you think -- in the third quarter, dollar was strengthening against kind of sterling and euro. That had the impact of creating kind of losses on the investments and gains on the liabilities. That's what is in the income statement.

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

Right, and economically substantive point I wanted to add to the technical, in geography that Jeremy just mentioned is that, while we do match everything to the best of our abilities, part of that match and while we're always sort of long sterling is, because we have operations that are based out of London and sterling-based payroll and rent costs and things like that. So generally speaking, you can expect that we would be a little heavy in Sterling relative to the pure investment match that we would have against insurance liabilities.

Q - Charles Gold {BIO 17653874 <GO>}

Thank you.

Operator

The next question is a follow-up from Phil Stefano of Deutsche Bank.

Q - Philip Stefano {BIO 20346322 <GO>}

Yeah, thanks. Hopefully, just a quick one on CATCo. Does the creation and ceding of Chard Re in any way accelerate the run-off for the management fees that we would see come through the CATCo business?

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

What it really does is, assist an orderly run-off of the Aquilo Fund, which was before the [ph] CATCo. And that's really the biggest thing we were trying to achieve there. It's just to make sure we do our absolute best to achieve an orderly and efficient run-off for the investors. So in terms of management fees, it really has no impact on the CATCo management fees.

Q - Philip Stefano {BIO 20346322 <GO>}

Great. Thank you.

Operator

And this concludes our question-and-answer session. I would now like to turn the conference back over to Tom Gayner for any closing remarks.

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

Thank you so much for joining us. We look forward to catching up with you after the New Year. Take care.

Operator

Thank you. The conference has now concluded. Thank you all for attending today's presentation. You may now disconnect your lines. Have a great day.