S&P Global
Market Intelligence

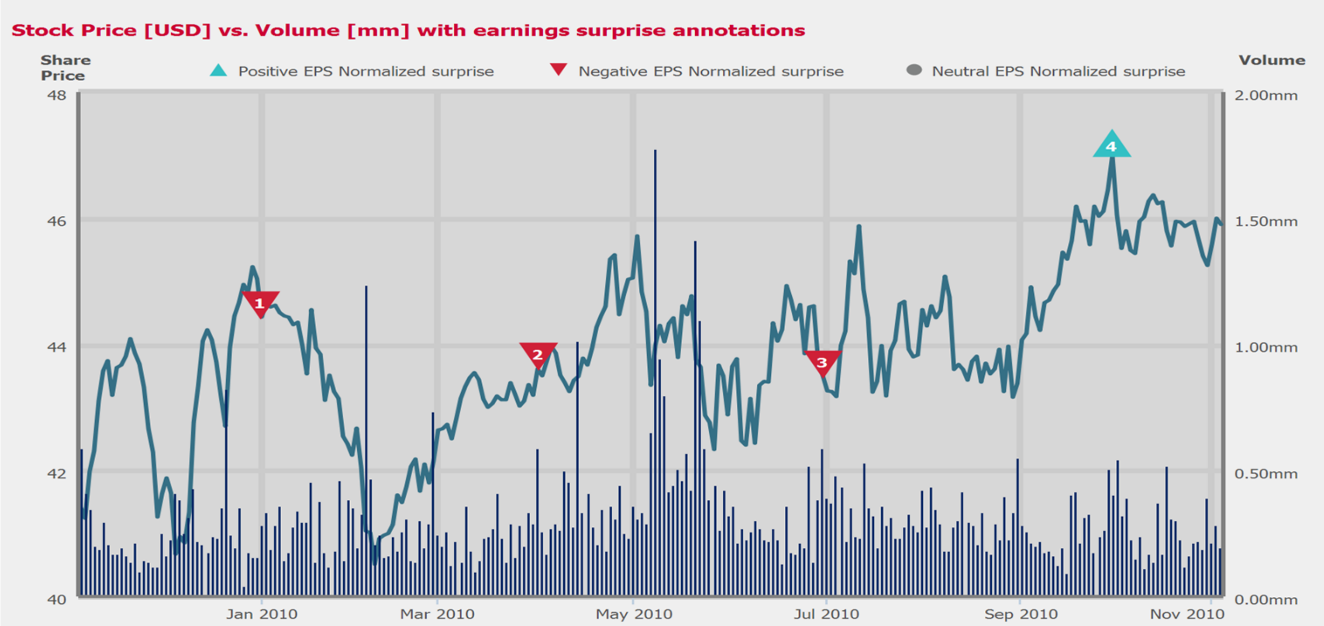
The Hanover Insurance Group, Inc.
NYSE:THG
FQ4 2010 Earnings Call Transcripts

Thursday, February 10, 2011 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.05	0.95	(9.52 %)	0.97	2.75	2.64
Revenue (mm)	740.36	717.10	(3.14 %)	770.43	3052.59	3048.00

Currency: USD
Consensus as of Feb-10-2011 2:14 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	1.01	0.83	(17.82 %)
FQ1 2010	0.77	0.66	(14.29 %)
FQ2 2010	0.20	0.04	(80.00 %)
FQ3 2010	0.93	0.98	5.38 %

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Call Participants

EXECUTIVES

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Oksana Lukasheva
Vice President, Investor Relations

Steve Bensinger

ANALYSTS

Cliff Gallant
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Marisa
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Sarah DeWitt
Barclays Capital

Presentation

Operator

Good day and welcome to the Hanover Insurance Group Incorporated Fourth Quarter Earnings conference call and webcast. All participants will be in a listen only mode (Operator Instructions) After today's presentation there will be an opportunity to ask questions. (Operator Instructions) Please note this event is being recorded. I will now like to turn the conference to Oksana Lukasheva, AVP, Investor Relations. Ms. Lukasheva the floor is your ma'am.

Oksana Lukasheva
Vice President, Investor Relations

Thank you operator. Good morning and thank you for joining us for our fourth quarter conference call. Participating in today's call are Fred Eppinger, our President and Chief Executive Officer; Marita Zuraitis, President of Property and Casualty Companies; and Steve Bensinger, our Executive Vice President and CFO. Also with us today is David Greenfield who will assume the role of CFO with Steve's departure in March.

Before I turn the call over to Fred for a discussion of our results, let me note that our earnings press release, statistical supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com. After the presentation, we will answer questions in the Q&A session.

Our prepared remarks and responses to your questions today, other than statements of historical facts, include forward-looking statements. These include statements regarding expectations of pre-tax segment income, after-tax operating earnings per share, segment earnings, pricing, accident year loss ratio, premiums, expenses, development of loss and LAE reserves, estimates of winter weather losses and their impact on quarterly earnings, estimate of excess capital, returns on equity and other projections for 2011 or beyond.

There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and in this respect refer you to the forward-looking statement section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as total segment income, after-tax earnings per share, segment results excluding the impact of catastrophes and development, ex-CAT loss ratios and accident year loss ratios among others.

A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release or the statistical supplement, which are posted on our website as I mentioned earlier.

With those comments, I will turn the call over to Fred.

Frederick Henry Eppinger
Former President & CEO

Thank you Oksana, good morning everyone and thank you for joining us today. Overall we are very pleased with our fourth quarter results, they represent a meaningful improvement from last year but more importantly they indicate that we are well positioned for future success. Today I'll begin our call by reviewing our 2010 performance. Marita will then share more insight into our fourth quarter results and discuss on some Q trends. Steve will then follow and provide and update on our financials including our capital activities and then I'll come back to outline our priorities and our financial outlook for 2011.

Fourth quarter results improved with net income of $1.27 per share up 11% over last year and operating income of $0.95 per share was up 15%. While we had more weather related losses in personal lines than we expected our accident year loss ratio for personal lines excluding cash improved three points over the prior year quarter. The commercial lines results were fundamentally as we expected and reflect significant investments we made in the latter part of 2009 and into 2010. We had significant growth about 37% and continue to improve the quality and mix of our business. While the expense ratio improved slightly due to our growth in operating model improvements we continue to invest in the quarter including a successful launch of our technology and healthcare products in the third and fourth quarter.

The fourth quarter was a strong close to an important and successful year for the Hanover. As you know over the year and a half we aggressively invested in our business to accelerate our journey to build a more distinctive company, a company that could deliver strong results throughout cycle. Since 2004 we've focused on creating a company that combines the financial strength, talent and product capability has impressed national companies with a local market knowledge, responsiveness and franchise value of the best regional.

To create value from the vision, the focus of our efforts have been on three critical areas, improving our financial strength and earnings power, enhancing quality and distinctiveness of our product mix and strengthening our position in shelf space with winning agents. During 2010 we made meaningful progress in all three areas and have created momentum for 2011 and beyond.

In 2010 we made good progress on improving our financial strength and earnings power, our core operating results continue to improve during the year with 2010 marking our best reported accident year loss performance in four years. We also continue to lever above industry growth increasing our net written premiums by 17%. In 2010 we significantly strengthen our position in our two core business. Our personal lines pricing action continue to improve the earnings and power of that and our product enhancements with Think Hanover and our increased account penetration in geographic diversification gives us confidence we can build and sustain a high return business in personal lines.

Our ability to deliver increases and improve retention in 2010 is a good indicator we can continue to deliver improved earnings in 2011. You will see us continue to manage our core mature stage for profit versus growth but our better geographic diversification of earnings will strengthen the long term prospects of our business. For the first time in our nearly 160 years history our written premium volume past the $3 billion mark driven by strong growth in commercial lines in fact this was also the first year our commercial premium accounted for more than 50% of our overall business reflecting our diversification efforts.

One beneficiary of our growth is our small commercial business where we now have a strong $500 million business with significant scale. Like our personal lines business our broad product capability and our improved operating model have allowed us to receive 3% price increases while we continue to growth and improve retention. As we've finished the conversion of the One Beacon small accounts book we believe the momentum of improved earnings will continue on this business through 2011. In 2010 we also maintained a strong balance sheet and capital position and increased our book value per share by 10% to 54.74 even with a 33% increase in our dividend. This is the highest year end book value our P&C Company has had in 160 year history.

And we continue to be thoughtful about capital management, in March we completed a $100 accelerated stock repurchase additionally in an effort to lower our cost of capital. We continue to be opportunistic repurchasing high interest debt giving us more flexibility in the future. Earlier in the year we also issued a $200 million of senior debt at favorable terms. As validation of our strong financial condition over the past nine months both Standard & Poor and Fitch have placed our ratings on positive outlook which obviously follows our upgrades from 2008 and 2009.

In 2010 we also made significant progress in improving the quality and distinctiveness of our product portfolio. Over the last two years we've had improved and significantly enhanced the quality of our business mix along with the efforts to enhance our product distinctiveness and earnings power in our core small commercial and personal lines offering we've created a much more distinctive portfolio in our commercial offering. Over the last couple of years we have been building out our industry focused niche business as well as building out our specialty and program business.

In 2010 the portfolio we brought to market was materially enhanced. These businesses which we expect to have a higher margin and now above $800 million of our written premium or roughly 25% of our business up from 3% in 2004. The first area of product investment and opportunity is our industry solution as winning agents continue to focus on growth opportunities in specific industry segments and area of specialization within their agencies. We ramped up our product segmentation capabilities making our product portfolio much more relevant to them. Through our renewal transaction with One Beacon we added ten segments and approximately 20 affinity groups to our core product mix.

Separately we continue to develop additional products and enhancement including our exciting new technology offering. We now have a full array of industry solutions which is on par or better than the market leaders in this area. We've also continue to grow and expand our specialty lines of business. In 2010 we've successfully completed three acquisitions further expanding our portfolio to include healthcare and architects and engineers within our specialty offering and establishing a national platform with our surety business through the acquisition of ICW Group surety business in July. We also continue to grow our program business as well as our management professional liability line. As a result our specialty business now represents 19% of our total business.

Finally we've materially strengthen our position with winning agents in 2010. With our enhanced product set and recently completed national network we are solidifying our position with some of the most successful agents in the country but more work needs to be done. Our promise to agents to provide franchise value through limited appointments, product innovation and local response professionals continues to get significant traction. Our west for example we ended the year at over $200 million of premium with some of the best agents in the country. They continue to build their book of business with us through attractive season business to solidify our partnership.

As we end 2010 our potential pipeline with mature business being looped to us is as strong as it's ever been. And so today at the bottom of the soft market our strong results continue to validate our agency focused strategy that we adopted in 2004. I feel very good about all we've accomplished during the year and I believe we've put our company in a very good position to win going forward. I'll now turn the call over to Marita.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Thanks Fred, good morning everyone and I'm glad you could join us today. As Fred mentioned the positive underwriting trends we've seen in recent quarters continued in the fourth quarter. Starting with the discussion on slide 8, our fourth quarter combined ratio was 97.8 all in and 95.6 excluding catastrophes which is point better than our ex-CAT combined ratio in the same period last year. Our ex-CAT ex-development combined ratio which is a stronger indication of the underlying quality of our earnings was 98.4 in the quarter representing a significant improvement from the 108 in the fourth quarter of 2009. And our ex-CAT ex-development loss ratio improved three points over the prior year quarter and year-over-year.

For the full year our ex-CAT combined ratio was consistent with 2009 despite higher investments in our business and lower favorable development. At the same time we increased our net written premium by 14% in the quarter and 17% on a year-to-date basis. Our results continue to validate the agency focused growth strategy we adopted more than seven years ago now making us less vulnerable to the competitiveness of the current market environment. So for each of our businesses I'll give you an update on the underwriting performance and trends and then discuss the drivers of our growth to put it all into perspective starting with commercial lines on slide 9 pre-tax segment income in the fourth quarter of 2010 was impacted by lower favorable development of prior year loss reserves and to a lesser extent higher catastrophe losses.

Excluding catastrophes and favorable development of prior year loss reserves commercial line segment income was $36 million in the current quarter that compares to $30 million in the prior year quarter driven by lower ex-catastrophe accident year losses. Our expense ratio decreased for the third consecutive quarter as we continue to earn in the premiums associated with the renewal rights transaction and our specialty investment. Our expense ratio was also half a point lower than it was in the fourth quarter of last year as we continue to gain scale with our newer business. We should see this continue to translate into a lower expense ratio going forward. Our ex-CAT accident year loss ratio was 47.1% compared to 48.8% in the fourth quarter of 2009.

Our full year accident year loss ratio also shows improvement in every line which we believe is the best indicator of the underlying quality of our commercial lines book. The primary reason we have been able to achieve this results while consistently outperforming the industry and growth is that we have remained disciplined consistent and resourceful in our search for growth opportunities.

As soon on slide 10 our commercial lines written premium grew almost 37% in the fourth quarter of 2010 consistent with prior quarters about 24 points of overall growth came from the renewal rights transaction, six points was driven by specialty business and the remaining six points came from our core commercial lines growth including new business writings from former One Beacon agents.

Slide 11 illustrates sources of our premium growth for the full year of 2010 approximately 60% of our commercial lines new premiums in 2010 are attributable either to the renewal rights agreement, new AIX programs or acquisitions. In all three instances by virtue of extensive upfront underwriting and due diligence we had clear visibility into the historical margins of these business. We also knew what rates we needed to charge considering historical performance and characteristics of this risk. About 30% of our commercial lines new premiums in 2010 came from what we broadly call consolidation activities primarily with partner agents.

Whether it is in our specialty lines, our middle market niches or segments the common theme of our growth strategy is converting business in blocks through our book consolidation efforts. Our agency great value and our strong specialty capabilities as well as our segmented and niche products, our practice of limiting access to these products creating franchise value makes the Hanover an even more attractive chose for our agents. This allows us to access controlled profitable business rather than engaging in aggressive price competition on undifferentiated new business.

As our partner agent strategy gains momentum our pipeline of book consolidation opportunities continues to expand and finally the remaining portion less than 10% of our new premiums in 2010 comes from traditional agents new business activities and support of their premium development efforts. In the context of our overall commercial lines growth this is a rather small component. As you can see most of the business that contributed to our growth this year is not new to our agents in fact the lion share of hat business has remained with the same agent for a long time. This is the principal reason we believe that we’ve been able to consistent overgrow the market without reducing our margins as we work to avoid underpriced new business.

As Fred mentioned as a result of the combination of our organic growth and One Beacon renewals we’ve believed a significant small commercial portfolio of approximately $500 million which we believe will provide future earnings growth and stability. The market in general remained soft in the fourth quarter with larger accounts continuing to experience the most competition however new money in our sweet spot small and middle commercial lines continue to be marginally positive with a slight improvement in December driven by exposure growth.

Our more specialized core commercial product set which now includes a growing suite of industry niche and segment allows us to win business based on value, the strength of our offering, accounts solutions and added services and not principally on price. Moving on to slide 12 for a review of our renewal rights transaction. As we close 2010 I would like to provide a couple of concluding observation of this very successful transaction. From the beginning we aimed to build deeper partnership with winning agents, increased our segmentation focus, accelerate our geographic expansion and build operating efficiency we have delivered on all of those fronts.

As of yearend out of the $400 million former One Beacon business we considered we renewed approximately $300 million in direct written premium with $66 million renewed in the fourth quarter. This equates to an overall retention of 79% which is very high for a renewal rights transaction. We appointed fewer than 300 agents and also strengthen the relationship with many of our existing agents resulting in about $30 million of additional new business premium. Through the transaction as Fred mentioned we added 10 industry segments and roughly 20 affinity groups and over 75% of the renewed premium was with these new products consistent with our small and middle market strategic focus. We strengthen our talent pool adding 165 professionals across the country. We now have over 100 employees in our new western region.

In the West we renewed nearly $100 million in premium jump starting our expansion in the region. We achieved renewal rates which we were relatively in line with those that we achieved on our legacy commercial lines renewal and we will continue to gain scale and expense leverage for this transaction in 2011 and beyond. We continue to believe this transaction was extremely successful. We received overwhelming agency support and we are very pleased with both the quality of the business we wrote and the partnership we build and enhanced through this initiative. Simply put the transaction has achieved the strategic benefits that we had anticipated. We believe our commitment to invest in product capabilities; our agent partners continue to need is the best part of our strategy and will help us generate an increasing flow of quality commercial lines business going forward.

Turning now to personal lines on slide 13, our pre-tax segment income excluding catastrophe was $47 million in the quarter compared to $26 million in the fourth quarter of last year. This improvement was driven by higher favorable development of loss reserves as well as better underlying loss ratios in both the auto and home owner lines. The ex-CAT personal lines accident year loss ratio improved by three points compared to the fourth quarter of last year driven by continued rate increases and actions to improve our mix of business. That being said our accident year loss ratio was adversely affected this quarter by a higher incident of large home owner losses and weather related losses and personal auto.

Large losses can be lumpy in any given quarter, our large loss experience was favorable over the first three quarters of 2010 and we are expected to come back to more normal levels going forward although this is admittedly hard to predict. In auto book we saw an uptick in physical damage losses which is typical for the fourth quarter considering the amount of snow and sled we saw in many of our geographies. For the full year of 2010 our accident year loss ratio improved by two points in auto and over six points in home. For an overall four point improvement in personal lines.

We attribute this improvement to our continued rate activity and actions to improve our mix of business as well as more normal non catastrophe weather in 2010. Moving on expenses, other underwriting expenses were higher during the fourth quarter when compared to the fourth quarter of 2009 this increase was driven by higher agency contingent commissions as a result of improved agency performance in 2010. For the full year of 2010 the personal lines expense ratio declined half a point compared to the full year of 2009.

Overall we have good line of sight towards achieving our return targets in personal lines through our rate and business mix improvement strategies which I'll discuss using slide 14. Our personal lines net written premium declined by 2.4% quarter-over-quarter with 1.5 points of that decline attributable to our exposure management initiative in Louisiana. Putting aside the impact of our Louisiana actions personal line net written premium in the quarter would have declined by less than 1% which is essentially in line with the flattish growth trends we saw most of the year. As we've said before given our significant market position in our four core states, we manage these states with a focus on margin not growth. Net written premium in these states declined by approximately 3% and reflected continued auto pip contraction as we remained focused on writing new business at profitable rate levels.

In our growth states, we continue to gain positive momentum with premiums increasing approximately 7% in the quarter and for the full year. As we've said in prior calls as 2010 progressed we took increased level of rate in both auto and home across our personal lines footprint. In the fourth quarter alone written premium reflected applied rate increases of 6% in auto and 7% in home. We also planned and have filed additional rate increases in both lines in 2011. Also our overall retention improved slightly on a year-over-year basis excluding our Louisiana actions retention actually improved by almost 1%. This significant increase reflects the shift to more account business in our mix which tends to have a higher retention rate.

We have confidence that our pricing discipline, business mix improvement and our partner agent strategy will continue to drive future profitability in personal lines. In summary 2010 was a very successful year for our organization. In commercial lines we capitalized on the renewal rights transaction controlled business conversion opportunities and product innovation. In personal lines we continued to improve the quality of our business and margins through a rate and non-rates actions. And overall with strong support from our partner agents we continue to produce strong and improving results and with that I'll now turn the call over to Steve.

Steve Bensinger

Thanks Marita and good morning everyone. Today I'll review the company's financial results referencing the slide presentation and starting with slide 16. Our solid underwriting performance already noted by Fred and Marita combined with stable net investment income and the strong balance sheet drove improved operating earnings in the quarter. These trends were consistent throughout the year although they were undermined by significant catastrophe activity in the first half of 2010 which lead to lower segment income results for the full year compared to 2009.

For the fourth quarter favorable development of prior year loss reserves amounted to $20.7 million or 2.8 points of the combined ratio compared to $26.5 million or 4.1 points in 2009. Favorable development for the full year of 2010 totaled $88.5 million or 3.1 points of the combined ratio compared to $133.1 million or 5.2 points last year. Fourth quarter net income also benefited from pre-tax net realized investment gains of $12.9 million.

Turning to slide 17, I would like to touch briefly on our investment portfolio and yield. As of December 31st we held $5.4 billion in cash and invested assets. The composition of our portfolio remains largely unchanged from the third quarter of 2010, cash and fixed maturities represent 97% of our total invested asset at the end of the quarter roughly 92% of our fixed income security are investment grade. The average duration of the portfolio is 4.5 years. Fourth quarter net investment income was $63 million relatively in line with $63.8 million in the prior year quarter.

For the full year of 2010 net investment income amounted to $247.2 million also just marginally lower than last year. The earned yield on our fixed income portfolio of 5.37% this quarter was just slightly lower than the fourth quarter of last year. Fixed income new money yields were about 3.7% in the fourth quarter compared to 4.9% last year. We believe the lower interest rate environment will continue to pressure new money yields however growth in our invested assets coupled with our well laddered portfolio should help elevate the effects of lower yields on net investment income going forward.

About 10% of our portfolio is projected to mature in each of the next two years so we will take a relative long term for our installed book yield to decrease materially and given the relatively small amount of liquidity we have to reinvest at any given time we have been finding pockets of opportunities with attractive risk reward characteristics in the fixed income area.

Turning to slide 20 I would like to highlights a few points about our investment in municipal bonds as this area of the market has recently become a general point of concern for investors. As of December 31st we held $965.6 million or approximately 18% of our total investment portfolio in municipal bonds. Taxable bonds represent approximately 84% of the portfolio. Specific revenue bonds represents 60% of the portfolio and the total portfolio has an average rating of AA. Our portfolio is actively managed with an emphasis on the quality of the underlying credit. It is well diversified both by geographic region and by sources of payment whether it's on the state level, by municipality or by project type.

On average our exposure to a single issuer is about $3 million and no single state represents more than 5.8% of the municipal portfolio. Overall we are quite comfortable with the quality and composition of this portfolio. Turning to slide 21 pre-tax net unrealized investment gains on portfolio decreased $123 million during the fourth quarter almost entirely driven by an increase in interest rate. For the full year however unrealized gains increased by over $100 million. Our portfolio will continue to be subject to market fluctuation driven by changes in interest rates and spread however we are confident we have a balanced and well laddered asset mix which gives us flexibility as unexpected cash needs arise yet provides a stable stream of income in the current challenging yield environment.

As you can see on slide 22, our balance sheet remains very strong book value per share declined about 1% this quarter driven by a decrease in net unrealized investment gains. For the full year however book value per share increased by 10% to $54.74. As of December 31st book value per share included a benefit of $2.03 per share related to a release of deferred tax valuation allowance as a result of the implementation of certain tax planning strategies. These are essentially permanent benefits that are currently recorded and cumulative other comprehensive income on the balance sheet and will be reflected as a tax benefit in non-segment income over the course of future period. Statutory surplus totaled over $1.7 billion at year end and at about 1.75 to 1 our premium to surplus ratio remains quite acceptable for our current mix of business which is heavily weighted towards a shorter tail line. We believe we have continuing capital flexibility at the operating company level based on rating agencies and regulators risk based capital models as well as our own economic capital assessment.

Holding company cash and investment securities were approximately $448 million at December 31st including a dividend of $75 million paid from the insurance subsidiaries to the holding company in December. We feel it is prudent to hold liquidity at the holding level for coverage of interest, dividends and potential operating contingencies. However a portion of our holding company investments also represents excess capital. We didn’t repurchase stock in the fourth. We did however take advantage of an opportunity to repurchase a portion of our higher cost debt. During the fourth quarter we retired $36 million par value of our junior subordinated debentures with an 8.2% coupon. As a result of this transaction at the end of December our total debt decreased to $605.9 million and our debt to capital ratio decline to 19.8%.

We are also in the midst of another transaction that could result in the additional repurchase of $48 million par value of the same issue in the first quarter. Before turning the call back to Fred I just wanted to note that this will be my last earnings call with the Hanover. The CFO transition to David Greenfield is going seamlessly and I’m confident that the financials affairs of the company will be in good hand. I would like to wish Fred, Marita and all of my other colleagues at the company all the best for much continued success. I believe the company is extremely well positioned for the future and thanks to all of you I look forward to seeing you again soon. Fred?

Frederick Henry Eppinger
Former President & CEO

Thanks Steve and I would just like to express my appreciation for your service to the Hanover during the past years and we all wish you the best in your future endeavors. Let me turn to 2011 and give you both set of priorities and our guidance. We will essentially continue to focus our energy and resources on the same strategic priorities we have over the course of our journey. As I mentioned 2010 efforts have given us tremendous momentum across our business and should allow us to improve the company’s position regardless of the market environment in the coming year.

As we continue to drive our strategy forward this year, you will see us focus on three critical areas as I mentioned earlier. First we will have an intense focus on capitalizing on our investments and increasing the earnings power of our business. Given the investment and improvements we’ve made we believe we can drive for improved performance in several areas. In personal lines we will continue to focus on improved accident year result, our pricing and retention trends gives us confidence in continuing this improvement trends. In commercial lines we should see significant improvement in our expense ratios. As 2010 net written premium growth is earned in and as a result of our investments in technology and improvements in our operating model. And overall our mix should continue to improve through growth in a higher margin specialty business with partner agents. Not only should we able to increase the percentage of our business from more attractive segments many of our start off business we invested in the last two or three years should have more normal expense load as they mature into their established operating model.

The second strategy area of focus will continuing to enhance our distinctiveness of our product set while 2011 is more about digesting and delivering our many new products like our healthcare and technology business launches we will continue to expand our specialty offering in select areas for example we expect to soon launch a sports and recreation offering. Because we continue to believe that there will be continued market disruption we will be opportunistic to build our product capabilities and diversification of our business mix through additional investment as well through strategic acquisitions over renewal rights transactions if there is strategic fit and if the price is right. We’ve demonstrated our ability over the past three years to successfully integrated acquired organization in our own organization and successfully execute a relative large renewal rights transaction and we will do it again given the right opportunities.

This will obviously require some capital flexibility which brings to our discussion of capital management whether stock repurchase or through refinancing of debt we've been disciplined about identifying and acting on capital management opportunities. Having said that given the current market environment we believe it makes sense to maintain capital flexibility in order to take advantage of structural changes in the industry and to continue to grow our capabilities for the long term but obviously we will continue to evaluate our capital management decisions throughout the year.

My third area of focus is to continue on improving our position with winning agents. The momentum from our product and geographic expansion as well as our new agents that came with the One Beacon transaction give us confidence we will continue to profitably grow in 2011. Our focus will be to deepen partnership and develop preferred shelf space with winning agent. In commercial lines we will continue to growth across our business but we expect those to predominately from our specialties lines and our segmented and niche offering. We believe by delivering more specialty business directly to retail agents we will strength our position and earnings power with them. In personal lines we aim to continue to show momentum in expanding our growth states while at the same time managing our core states with the focus on profitability so overall we expect commercial lines will be the main impetus for growth in 2011. Based on this driver we believe we will achieve pre-tax segment income of $300 million to $320 million or after-tax operating earnings per share of $3.70 to $4 in 2011.

Underlying this estimate are the following assumptions mid to high single digit net written premium growth in commercial lines, relative flat growth in personal lines, Cat activity in the range of 3.5% to 4% of net [inaudible] premium. Lower prior year favorable development compared to 2010, net investment income relatively flat as decline in yields are expected to be substantially offset by growth in our invested asset space. Aggressive improvement in expense ratio by approximately 0.5 point for the year somewhat dependent on business mix as improvements in commercial lines of two plus points are expected to be partially offset by a shift in business mix to commercial lines. An effective tax rate of 34% and weighted average share outstanding of 46 million share.
Relative to the first quarter 2011 clearly the winter has been a harsh one. As you know our loss patterns are relative of our geographic footprint. We've talked about in the past that our fourth and first quarter earnings power is lower due to winter weather impacting both catastrophe and non-Cat losses. This quarter as you would expect given the number of voracity of the winter storms has started out to be challenging while desirably it seems likely that the first quarter weather related will be heavier than a typical fourth quarter due to potential range of outcome for the first quarter. We have included a range of Cat ratios in our full year estimates overall I'm very excited about our company's prospectus and now I look forward to answering your questions.

Question and Answer

Operator

Thank you sir, we will now begin the question and answer session. (Operator Instructions) at this time we will pause momentarily to assemble our roaster. The first question we have comes from Sarah DeWitt of Barclays Capital. Please go ahead.

Sarah DeWitt
Barclays Capital

Hi, good morning.

Frederick Henry Eppinger
Former President & CEO

Good morning Sarah.

Sarah DeWitt
Barclays Capital

Your guidance for 2011 seems to imply an ROE of roughly 7% so I was wondering if you could update us on your long term ROE guidance and how fast you can get there.

Frederick Henry Eppinger
Former President & CEO

Yes it does, it implies to your mid portfolio 7.5% ROE and as I have been saying obviously next year there is a pattern of improvement that's quite significant. If you look at the earned in rate for the year our expense aggression will be significant in addition obviously the rate we are earning both in small commercial and in personal lines will enable us to enhance actions here throughout the year. And so what we see is a progression to improvement and so you will see the fourth quarter a lot [inaudible] than the first quarter obviously. My view on this as you know I talk about this probably more than any CEO I believe very strongly that we are building we are trying to build a world class company which means top quarter performance which is a 11 to 13 through the cycle. After our upgrade couple of years or 18 plus months ago we knew that we had an opportunity here to structurally enhance both our mix and our long term prospects for sustainable earnings and so we brought five companies in the last 18 months. We also did geographic expansion to a full network with that comes an additional amount of historical cost.

What you are seeing is a very steady and very manageable progression to those targets. Will we get there by the end of the year? Probably not it will probably go into next year but what I know is we will be counter cyclical to the industry. What I know is as the industry is the king in action here is the way we've set this up I can pretty much have visibility to improving profitability next year because of the leverage of our expense and improvement of our mix and so I feel very good about where we going and what we are doing and how much book value we will grow and then how much value we will create. I rather have do this in a great price market sure but if you look at our business over $2 billion of our business are small accounts that will get plenty.

And our mix is improving and we got expense leverage so in my view we are in a very position and so we will continue to be focused on this goal over the next 4 to 6 quarters and we will keep moving in that direction. One of the thing I would tell you to and we don't use this as an excuse obviously I could be more precise and I could talk about margin over risk [ph] rate. We have decreased our data as a company more than any significant insurance company over the last three years and so our cost of capital to all our work has also reduced so I feel good about that as well so our returns are getting better our cost of capital is getting better and therefore we are going to create significant shareholder value.

So I'm not at all backing away from this trend it is still the cornerstone of our long term rewards to our executives which is a three year average between 11% and 13% is how they are rewarded on their performance shares and so that we are very, very focused on this and we will get there. I feel very, very confident about our ability to get there. I would tell you that it's going to happen over the next 4 or 6, 7 quarters depending on how things unfold as far as our growth in our incremental investments.

Sarah DeWitt
Barclays Capital

So if you think you can reach it in 4 to 7 quarters I mean that would imply in 2012 if you are around 11% ROE over $6 in earnings is that?

To what extend -

Frederick Henry Eppinger
Former President & CEO

It is going to depend on our mix right and what the business looks like at that time, it depends on you know think about this way our business all things being equal needs about 94 to 95 combined ratio to get that kind of earnings power depending on kind of mix inline and that's what we are moving to. What exactly those earnings are obviously has a hell of lot to do with our growth over this period and what kind of capital we retain and how much of that capital we apply to the growth but [inaudible] significant improvement in earnings you can get on the math will tell you that. But I mean the precision of that has a lot of do with the mix and how much we grow.

Sarah DeWitt
Barclays Capital

Okay, great and then if I could just ask a follow-up on your comments on capital management you said you wanted to maintain some flexibility in the current environment based on that how should we be thinking about how fast you could finish the $157 million share repurchase authorization.

Frederick Henry Eppinger
Former President & CEO

Yes, so I did in the guidance. I essentially guided to zero share buybacks because at this point we don't as Steve mentioned we are opportunistically doing some stuff on debt repurchase which I think is a smart thing to do because of the attractiveness of the debt market right now and the flexibility we would have if we needed to. And on the buyback I have kind of put it on hold as I see what's going to happen now I watched that all the time but right now my view is our growth opportunities could be very attractive over this year. I think we are at a point where some of our region competitors and smaller competitors are tremendously straining which could create some opportunities for us that we are trying to pay attention to and I don't want to get caught short on capital.

I would tell even with our extensive growth in One Beacon which remember our estimate when we first came out we said 225. We way surpassed that that required some capital alright so we did some shifting but we still have significant excess capital. I would say probably couple of hundred of millions of excess capital so we have it. What I'm trying to do is right now keeping my powder dry and being flexible particularly in the first half of the year as I see how everything unfolds because remember you guys all follow the large guys and people have big reserve release and stuff. But there is no question in restrain in the system, there is no question and if you look at the folks that we compete with which does do mostly under $50,000 in average size in commercial the strain is unbelievable so what you've got is a lot of potential disruption that could occur as this year unfold and I just want to make sure that we have enough powder to make sure we could capitalize on it if it occurs. So that's what I mean by that.

Now every quarter we will give you an update of that and I'll give insight to that but right now that's what it means.

Sarah DeWitt
Barclays Capital

Alright thanks for the answers.

Operator

The next question we have comes from Michael Paisan of Stifel Nicolaus.

Marisa
Stifel Nicolaus

Hi this is actually Marisa for Mike. I actually have a couple of few questions. In your commercial book premium growth for 2010 ex-One Beacon looks like it grew about 10% if I'm doing my math correctly I think workers comp grew about 8% for the year ex-One Beacon. Since it looks like multi parallel and it was about flat ex-One Beacon so can you kind of tell us where are you seeing the opportunity for the worker comp growth out there?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Well first of all in the quarter worker comp grew pretty consistently with the rest of the commercial lines as we will total accounts consistent with our strategy. For the total year 2009 worker comp represented about 10% of our commercial lines portfolio and year end 2010 it was the exact percentage about 10% of our portfolio. We remain relative conservative in the line as we've talked before we've got good underwriting DNA in the line but we are also pretty caution of think conservative with the line. So it's pretty consistent with our strategy overall in the growth you saw in the fourth quarter was really total account growth with package being up 55% and comp being up 60% that's pretty consistent with a total account approach to business.

Marisa
Stifel Nicolaus

Okay, could you touch a little bit on the contingent commission going forward I mean what can we expect coming out of that.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, they are actually pretty consistent with the exception of a slight uptick in the fourth quarter in personal lines that came from the improvement in the underlying accident year that I discussed in my script. They have been pretty consistent over 2009 and we don't anticipate a significant difference in 2011.

Marisa
Stifel Nicolaus

Okay, and then going back to capital if try to possibly be a little bit more specific on what opportunities for the use of capital you are possibly seeing out there.

Frederick Henry Eppinger
Former President & CEO

Well again its growth of our business, I mean if you see what's happening in the last three years we grew this company a billion dollars last four years. And while getting out of a lot of low value places like homeowners in Florida and we are doing in Louisiana and without any new business penalty we've done some extension risk and really with no business penalty. And my personal point of view is that like you've seen buy 5 or 6 small companies before there could be some potential in those areas. It could be potential in some renewal rights areas, it could be some potential in blocks of business moving from partner agents to us based on the disruption.

Again what we see we saw it in personal lines in the mid-west about a year ago and that's kind of continuing, we are seeing it in commercial broadly now again with some of the small company. So for me it's about profitable growth that enhances the book value of this company and that's obviously if I get it and beat our IR hurdles that's a great place to use the capital so what I'm trying to do is make sure that

I'm ready. If you look at the last 0 years every single time the same thing happens we are just like we were in 1999 right now. What people happens - lot of people call the cheating phase right you can see the difference the calendar and accident years getting pretty severe and what's happening it is getting tight and re-underwriting is starting.

And in my view particularly and where we live which is of lot of mid-size agents and mid-size accounts a lot of these regional companies are starting to have problems and what we are going to see is more re-underwriting and disruption that is going to create movement of books. And so for me one of the things what I'm trying to do is make sure that we have the capital to be available to capitalize on that of course as I said it's pretty clear what our pattern is, right. As soon we believe we have excess and I don't have an alternative I get it back in one way or another and we will continue to do that. What I'm saying is that I said in the fourth quarter and I'm saying now I would like to just I'm holding. Now this debt came late to us and as we get to the beginning of the year when that happens when it's obvious if the math works I want to do because it's opportunistic those things don't come along.

So I try to make sure that we capitalize on if it makes sense because we do have excess and the debt market is attractive to us now if we needed to do something. So you will see us continue to focus on growing profitable this company and creating value that way if the availability is there. If it's not get back the money that's what I'm talking about and again I'm not telling that tomorrow I'm going to announce something I'm saying that there is a lot of activity in the marketplace and I think it's prudent for us to have this flexibility for the next couple of 3 months.

Marisa
Stifel Nicolaus

Okay one more; I actually have a couple more. On the investment side your duration obviously is a bit higher than most of the companies we cover at least at four years, about four years. Is that plan to kind of lower that given that interest rates are expected to increase I know you guys are going to manage portfolio very efficiently but losses could start to creep up.

Steve Bensinger

I don't think we have no significant plans to change the composition of the portfolio. I think it's comfortably right now, in a very reasonable range compared to the duration of our liabilities. It's well within the range that we feel is acceptable it's high yielding portfolio relative to the industry. It's very well laddered so even though it's a higher duration it's got liquidity characteristics that are extremely strong so I don't think you are going to see that and I think as our portfolio mix on the business side continues to move more into commercial lines and it has before the duration of those liabilities also increases so you wouldn't necessarily want be going the other direction on investments.

Marisa
Stifel Nicolaus

Okay and just one very minor question can you remind us what is in other personal? I know it's a very small piece of the business.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, most of it would be umbrella.

Marisa
Stifel Nicolaus

Okay, thank you so much.

Operator

The next question we have comes from Cliff Gallant of KBW.

Cliff Gallant

KBW

Good morning, can you talk a little bit about the cash flow of the company just with all the top line growth I just would have thought that asset growth might have led to little bit more investment income growth in 2011 despite the yield environment being weak.

Steve Bensinger

I think you are going to see a delayed effect of that cash flow because of the timing in which those cash flow is coming remember there is cash flow is more or less parallel more closely earned premium than they do written premium because of the way the cash flows are timed. And you also have various cost that Fred described and investments that we've made in the business and also as part of this transactions in 2010. So I think you are going to see the effects of the positive cash flow a little more back ended.

Frederick Henry Eppinger
Former President & CEO

It's a great question Cliff because this whole thing between written and earned right so you are going to see this growth at the tail end of the year except we don't have a lot of months to get the returns but that's why I get excited about our momentum because if you look at the earning its multiplier effect on our earnings as it goes forward and the other thing is these business we are getting in are a little bit longer tail but we don't have kind of that investment portfolio because they are young. As they mature we actually are going to get more leverage if you will so we place it like short tail lines because we don't have that leverage that you would if we've been in this business for quite a while. So it's a very good question and to be and that's why we are more convinced in the improvement overtime. You can kind of see what happens mathematically based on the way we get into this business and set ourselves up.

Cliff Gallant
KBW

Okay, thank you. Another question on the mid to high single digit commercial lines growth how much of that is call it continuation of the One Beacon renewals, I know it's been a full year but I know in the first quarter it was little bit slower in terms of sort of picking up that business and to what degree would it call it organic growth outside of the One Beacon book.

Frederick Henry Eppinger
Former President & CEO

Almost all organic although you are right there is a little bit in the first quarter that's going to be a continuation of the One Beacon not a lot couple of days right so because we've fronted right at the beginning of the year but the vast majority of this is kind of our geographic expansion our specialty business, our niche business that are growing and so that where the vast majority of this growth is going to be. Now again there is a little bit of earning from the healthcare company that we brought in March right so you got pad there and the little surety business which was tiny you get a little bit of that coming into the books. But the vast majority of the business is really kind of what I would call book things book rolls organic.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

And if you refer back to that growth slide that we have in the deck with the exception of the Fred's One Beacon comment I think you could expect the growth to come from similar places that you are seeing on that slide. Book consolidation opportunities with agents and a push in our specialty business but very similar to the percentages that you saw in that breakdown with very little of the growth coming from non-differentiated commercial business.

Cliff Gallant
KBW

Thank you.

Frederick Henry Eppinger
Former President & CEO

Thank you.

Operator

At this time it appears that we have no further questions. We will go ahead and conclude the Q&A session. At this time I would like to hand the conference back over to management for any closing remarks.

Frederick Henry Eppinger
Former President & CEO

We just like to say thank you for everybody's attention and look forward to talking to you next quarter.

Operator
And we thank you sir and to the rest of management for your time. The conference is now concluded. We thank you all for attending today's presentation, at this time you may disconnect your lines. Thank you.