S&P Global
Market Intelligence

The Hanover Insurance Group, Inc. NYSE:THG

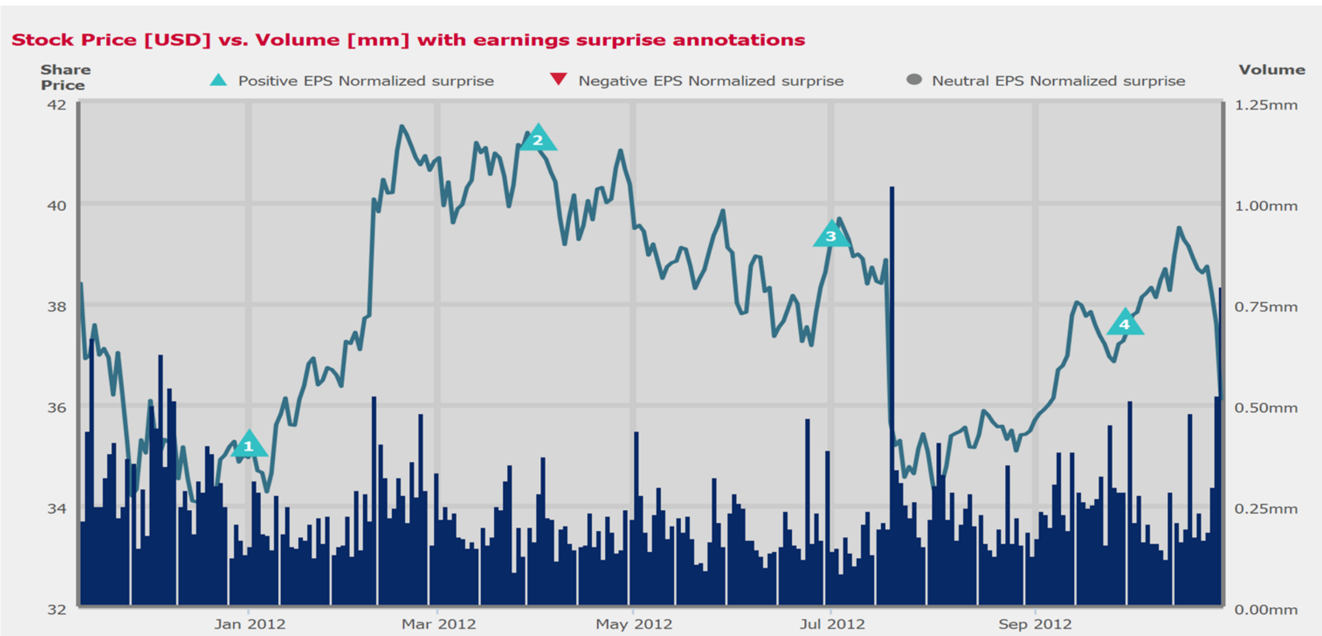
FQ4 2012 Earnings Call Transcripts

Thursday, February 07, 2013 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2012-			-FQ1 2013-	-FY 2012-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	(1.80)	(1.65)	NM	0.95	0.19	0.33
Revenue (mm)	1058.72	1033.90	▲(2.34 %)	1126.85	4400.19	4368.40

Currency: USD
Consensus as of Feb-07-2013 7:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2011	0.81	1.00	▲1 23.46 %
FQ1 2012	0.95	1.01	▲2 6.32 %
FQ2 2012	0.19	0.22	▲3 15.79 %
FQ3 2012	0.68	0.72	▲4 5.88 %

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Call Participants

EXECUTIVES

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Oksana Lukasheva
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ANALYSTS

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Sterne Agee & Leach Inc., Research Division

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Macquarie Research

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q4 The Hanover Insurance Group Inc. Earnings Conference Call. My name is Andrew and I will be your operator for today. [Operator Instructions] As a reminder, this call is being recorded for replay purposes.

I would now like to turn this call over to Oksana Lukasheva, AVP, Investor Relations. Please proceed, ma'am.

Oksana Lukasheva
Vice President, Investor Relations

Thank you, Andrew. Good morning, and thank you for joining us for our fourth quarter conference call. We will begin today's call with prepared remarks from Fred Eppinger, our President and Chief Executive Officer and David Greenfield, our Executive Vice President and CFO. Also in the room and available to answer your questions after our prepared remarks are Marita Zuraitis, President, Property & Casualty Companies and Andrew Robinson, President of Specialty Lines. Bob Stuchbery, President of International Operations and Chief Executive Officer of Chaucer, is in the line from London.

Before I turn the call over to Fred, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investor 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 fact include forward-looking statements, such as our guidance for segment income per share and underlying assumptions for 2013.

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 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 and accident year loss and combined ratios excluding catastrophes, 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

Good morning, everyone, and thank you for joining our fourth quarter call. While the fourth quarter results are dominated by the impact of Superstorm Sandy, I am pleased with the continuing progress we've been making addressing some of the financial challenges and advancing our strategic priorities, improving our portfolio and long-term business and financial position.

We entered 2013 with momentum in the market and a strong, balanced portfolio with improved pricing trends. Our industry was tested again with Superstorm Sandy, which was the driver of our operating loss in the quarter. However, we believe we passed this test by providing strong claim service to our agents and policyholders, but also demonstrating the effectiveness of our ongoing exposure management initiatives.

Despite experiencing nearly twice the level of normal annual catastrophes and a prolonged low interest rate environment, we produced net income of $56 million or $1.23 per share and grew book value per share by 5% to $58.59. For the fourth quarter, we reported a net loss of $55 million or $1.24 per share which included the after-tax impact of Sandy losses of $129 million.

While our financial results reflect the challenges we encountered in 2012, we continue to make important progress in advancing our market and business strategy. And so we enter 2013 with confidence as our competitive position, product portfolio and distribution capabilities are stronger than ever.

In addition, we go into this year with the benefit of several quarters of strong rate increases and successful actions taken to reposition our portfolio mix. I will discuss our outlook as well as my thoughts on the current market environment with you shortly. But first, I would like David to review our financial results and business trends.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Thank you, Fred, and good morning to everyone. Superstorm Sandy was clearly the most significant driver affecting our fourth quarter results, causing a net loss of $55 million or $1.24 per diluted share compared with net income of $50 million or $1.09 per diluted share in the prior-year quarter.

For the year, we reported net income of $56 million or $1.23 per diluted share, compared to $37 million or $0.80 per diluted share in 2011. On an after-tax segment income basis, our net loss for the quarter was $73.4 million or $1.65 per diluted share, compared to segment income of $45.5 million or $1 per diluted share in the prior year quarter. For the year, segment income was $15.1 million or $0.33 per diluted share, compared to $14.2 million or $0.31 per diluted share in 2011.

I'd like to begin my review of the results by commenting on the components of our underwriting results, starting with catastrophe losses and prior-year loss reserve changes. Our fourth quarter pre-tax catastrophe losses were $203 million or 19 points on our combined ratio, represented almost entirely by Superstorm Sandy losses of $198 million. Domestically, the losses were $170 million, with $125 million in commercial lines and $45 million in personal lines. Chaucer's catastrophe losses from Sandy are estimated to be approximately $28 million.

Overall, favorable prior-year reserve development for the quarter was $8 million or one point of the combined ratio. Chaucer generated favorable reserve development of $29 million this quarter as a result of positive loss experience in energy, as well as marine and aviation. Additionally, we continue to see favorable reserve development in our domestic, CMP and workers' compensation lines.

Partially offsetting the favorable prior-year reserve development were increases to reserves for domestic auto coverages which impacted personal and commercial auto, as well as other commercial lines. We believe these reserve additions were prudent, given the persistency of severity trends that we in the industry have experienced.

Overall, surety has performed in line with our expectations and previous comments. During the quarter, we settled a large loss that also triggered a reinstatement premium on our reinsurance program which impacted our current accident year results. We continue to see the benefit of the underwriting and account management initiatives we've undertaken in surety with significantly improved trends in the run-off book. And whereas you would never expect loss-free performance for surety business in general, we believe we've effectively addressed the challenges we experienced in this line.

Moving on to a discussion of our accident year performance, excluding catastrophes by segment. In Commercial Lines, our accident year combined ratio, excluding catastrophes, was 102.5% for the current quarter compared to 98.3% in the prior year quarter. Given our previous comments on the auto and surety trends, it's more effective to focus on the full year performance rather than quarterly comparison. The full year combined ratio improved modestly to 99.9% from 100.3% last year. Within that, our expense ratio declined to 37.7% from 39.0%, reflecting our gross leverage while our loss ratio remained relatively flat.

In response to auto severity trends, we accelerated pricing increases over the last several quarters and notably, we finished the year with an average of 7%. We plan to seek additional rates going forward which will drive improved performance in the future. We continue to be pleased with rate increases achieved in the CMP line along with the success of our ongoing property exposure management actions aimed to deliver margin growth and lower volatility. We believe these actions will drive improved profitability in this line in 2013.

Our Commercial Lines margins should be helped again by additional operating efficiencies and growth leverage that we expect will translate into a modestly improved expense ratio compared to 2012. However, mix changes towards Specialty Businesses will act to partially offset the underlying improvement in the expense ratio.

Turning to Personal Lines, our accident year combined ratio, excluding catastrophes for the fourth quarter of 2012, was 96.4%, consistent with the prior-year quarter. For the year, the ratio improved to 92.8% from 95.2% as we benefited from significantly improved profitability in the homeowners line driven by both rate increases and more normal weather compared to 2011. We would expect these underlying trends in Personal Lines to continue, resulting in modestly improved accident year performance in 2013.

Chaucer continued its 2012 trend of positive results. The accident year combined ratio of 90.1% in the current quarter compares favorably to 93.6% in the fourth quarter of 2011. During the fourth quarter, much like the full year, we experienced lower attritional and large losses, which primarily drove the positive results. 2012 was an exceptionally strong year for Chaucer, with low loss activity, and we could not be more pleased with the outcome.

However, we go into 2013 expecting loss activity will return to more normal levels that are consistent with our planning assumptions. Chaucer's expense ratio was 39.1% this quarter. This ratio is slightly above normal due to higher performance-based expense accruals in the current quarter. Our expectation for a normal expense ratio for this business remains at around 38% over the year with some quarter-to-quarter variation based on business mix and normal activity.

Moving on to a discussion of our investment portfolio. At December 31, 2012, cash and invested assets reached $8 billion with fixed income securities and cash representing 93% of the total. Roughly 95% of our fixed income securities are investment grade and the average duration of the portfolio is 4.1 years.

Net investment income was $70.1 million for the quarter compared to $69 million in the prior year quarter. The increase is primarily driven by investments of Chaucer's cash into fixed maturities throughout the past year, but of course, offset by persistently low new money yields.

Net investment income also benefited from special dividends in our high dividend yielding equities portfolio. Additionally, we recognized $19 million of realized investment gains in the fourth quarter of 2012.

In the fourth quarter, our overall earned yield on the fixed maturity portfolio was 4.1%, with new money rates at 1.9% in the quarter; the lowest we've experienced in many years. This compares to 4.5% and 2.8% respectively for the fourth quarter of 2011.

Last quarter we talked with you -- we talked you through an example of how the current yield environment would put downward pressure on our net investment income. Taking that into consideration, we believe the persistently low new money yield will continue to be a headwind for us in 2013.

While we believe our portfolio has high resiliency, we still estimate our net investment income will decline by 5% or approximately $15 million in 2013 compared to 2012. Of course, the actual impact to net investment income will be based on timing of cash flows and new money rates available at the time the assets are reinvested.

Moving on to a discussion of our balance sheet and capital. Our capital position remains strong. We ended the year with $2.6 billion in shareholders' equity, after delivering $55 million in shareholders' dividend and repurchasing approximately 543,000 shares of common stock for $20 million during the year.

Our book value per share at December 31, 2012 stood at $58.59, up 5.2% from $55.67 over the year. We maintain strong financial flexibility and liquidity. Our holding company cash and investments was $164 million at December 31, representing approximately 1.5x our external interest and dividend requirements.

In addition to a well-laddered investment portfolio, we also maintain a $200 million credit facility that provides additional support and flexibility. In the quarter, we continue to be proactive and opportunistic in optimizing our capital structure. This quarter, we retired debt that had been assumed in prior acquisitions, lowering our debt to capital ratio from 25.4% in the third quarter to 24.7% at the end of the year.

Additionally, in January, we repaid $46 million of FHLB advances that were related to a development project completed and sold in December. That repayment further reduced our year-end ratio on a pro forma basis to 23.7%.

We will continue to look at ways to efficiently deploy capital to the opportunities available to us with an ultimate goal of providing improved returns to shareholders. Overall, we feel good about our financial strength and underlying indicators for our financial performance. We are confident that we will be able to leverage our position to deliver improved returns in 2013.

And with that, I’d like to turn the call back to Fred.

Frederick Henry Eppinger
Former President & CEO

Thank you, David. Operationally and strategically, as we look back at 2012, we believe we have accomplished much of what we planned to do.

At our Investor Day meeting going into '12, we shared with you that our areas of focus and plans centered around 4 items: First, modifying our business mix to address volatility and property concentration in certain geographies; second, obtaining stronger rate increases and implementing mix improvement beyond exposure management; third, building out our newer specialty businesses and positioning our contract surety business for better profitability; and lastly, aligning Chaucer Operations with our priorities while benefiting from this acquisition and the diversity of the earnings that it provides.

When we step back and reflect on the past year, while our performance didn't meet our financial expectations, it’s clear that we successfully accomplished our strategic objectives and created a clear path for improving financial performance.

First, we achieved a more attractive geographic and product mix that is more resilient to weather events. With the recent growth of commercial and specialty lines, our mix is now more casualty oriented. In addition, we actively broadened our geographic footprint. We now have a much more balanced portfolio. Roughly a third of our premium is coming from our 4 legacy states, down from over 70% only a few years ago.

In 2012, we continued to focus on actively managing our property concentrations, reducing our portfolio in a targeted way in both our commercial and personal property lines. We also executed a renewal rights transaction in the second quarter that discontinued relationships with about 80 legacy agents in New York, New Jersey and Connecticut that didn’t fit our partnership strategy. This resulted in approximately a 1% lower premium growth in personal lines in 2012, but more importantly served to reduce our Northeast property concentration.

Additionally, as we discussed in our calls earlier in 2012, we continued to pursue rate increases and to change policy terms and conditions to mitigate exposure to property risks. In commercial lines, we remained cautious about the property-centric business classes, while writing more casualty business. Our loss ratio improvement in both homeowners and CMP lines reflects the underwriting actions we have taken.

The effectiveness of our exposure management efforts was also tested in earnest by Superstorm Sandy. With upwards of $20 billion in estimated insured losses for the industry, Sandy is likely to be the second costliest loss event in U.S. history. More importantly, Sandy’s impact was centered in the heart of the 2 states where we have significant penetration. In spite of the magnitude of Sandy, our estimated losses were within our catastrophe program retention and substantially lower than our cat models and our market share would indicate.

Clearly, our exposure management initiatives and efforts to balance our portfolio helped mitigate the ultimate cost of this event. And we plan to continue to actively manage the portfolio this coming year, especially in personal lines. While it may put some pressure on our growth, the trade-off makes economic sense.

Pricing was another focal point in 2012. Our objective was to maximize value in our partner agent strategy to gain pricing momentum and achieve a higher quality mix. As the market started to change, it was very important for us to approach price increases in a thoughtful and targeted manner so we could minimize disruption and improve the overall quality of our book. Our focus was on balancing between achieving rate and not leaving margin on the table while at the same time ensuring we were maintaining and improving the quality of our business mix. Assisted by a number of very effective pricing tools we've developed, we believe we struck the right balance, as evidenced by our strong rate increases and our healthy retention levels.

In Commercial Lines, overall price increases in the core lines were over 8% in the fourth quarter, a point higher than reported last quarter and over 9% in middle market. Retention in core lines continues to be strong at 83% and we are confident that our distribution strategy will enable us to seek additional rate increases this year.

In Specialty, we achieved price gains of 11% in the quarter, and plan to pursue similar rate increases in 2013 while continuing to grow. In Personal Lines, the pricing momentum was also strong. We finished the year with a solid rate increase of 8% in the fourth quarter, up from 7% in Q3, with 7% in Auto and almost 10% in Home, both with solid retention trends. We see this trend continuing into the early part of 2013.

What's key to our outlook is, pricing gains we experienced in the domestic business last year clearly outpaced loss cost trends we are observing, which provides us with confidence we can deliver improved underwriting results going forward as rate increases are earned. As importantly, the quality of the new business we are writing today has never been better. It is coming from our best partner agents who understand the importance of our pricing and mix management strategies and appreciate the value-added approach that Hanover brings to the table.

Our limited distribution strategy, supplemented with local expertise and a thoughtful approach to pricing, helps agents navigate through the changing and dynamic market conditions. At the same time, our distinctive industry-specific product offerings, which is an important competitive advantage, help us and our agents write the most desirable business, thus achieving improved economics for both.

In Personal Lines, our partners are writing account business while deemphasizing monoline property. Only 5% of new business is written as monoline home. In Commercial Lines, we are targeting smaller account sizes and industry-specific liability-oriented mix. As a result, the majority of our growth in Q4 came from small commercial accounts with that growth heavily focused in our target classes, industries and geographies.

We also made significant progress during 2012 in maturing our newer specialty businesses and adjusting mix in some places. Our Specialty Products and ability to offer them direct to the retail partners is one of the cornerstones of our distribution strategy. In this respect, continued penetration of Specialty business and gaining traction with agents remains an important priority.

We remain excited and confident about our progress and profitability gains in this business going forward based on the following drivers. First, our domestic specialty business matured and continued to grow last year, reaching over $800 million in annual direct written premium. Most of these businesses now are established enough in terms of scale and operating model to contribute to the bottom line.

Second, as we discussed a few moments ago, we introduced strong price increases in our Specialty Lines including AIX, our largest specialty business which we achieved pricing increases of 13% in the fourth quarter. These rate actions should positively impact earnings in 2013.

Third, we took significant portfolio and underwriting actions in contract surety and Auto. We are seeing indications of improving trends in these areas as expected. Overall, we made significant progress in 2012 and we believe we are better positioned to deliver improved returns in the domestic specialty business going forward.

Moving to our international specialty business. In its first full calendar year as part of the company, Chaucer delivered a meaningful contribution, generating $136 million in pre-tax earnings and a combined ratio of 90.3%, including catastrophes. Chaucer's quality underwriting and diversified portfolio has settled in nicely to our overall organization. The strong performance by Chaucer helped to provide diversification of earnings and geographic exposure.

Looking ahead in 2013, we will increase our economic interest in Syndicate 1084 to 98% from 84%, absorbing the gross underwriting capacity previously provided by Flagstone Re. This allows us to recapture the long-term profit potential without expanding our operations.

In the short term, however, our assumptions for reinsurance and other associated costs will moderate the immediate earnings impact of this additional capacity. Additionally, following up a very profitable year, we expect market conditions and rates in international specialties to remain flat and even soften in some places, which will limit growth in the syndicate during 2013.

Overall, we are very excited about our current position in the market, the capabilities we have built and our ability to improve earnings. Our 2012 initiatives and the pricing we are achieving provide us good momentum, making our business portfolio stronger competitively and financially, which gives us confidence in our outlook for 2013 and beyond.

The trends and momentum we've discussed today drive our financial earnings expectation for 2013, which is in the range of $3.60 to $3.90 of after-tax segment income per share. As a basis for this outlook, we assumed cat losses of appropriate -- of approximately 5% of earned premium, a combined ratio excluding catastrophes between 93% and 94% and written premium growth in the mid- to high-single digits.
With that, I would like to open the call for your questions.

Question and Answer

Operator

Thank you. [Operator Instructions] Our first question comes from Vincent DeAugustino, Stifel, Nicolaus.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

If we look at the personal orders full year core loss ratio at about 75% and then for 2011, just at 74.9%, so that's basically flat and with the adverse reserve development that we had seen in 2012, maybe the updated 2011 pick is covering somewhere around 77%. So that would basically imply somewhere around 200 basis points of margin expansion from the updated 2011 pick, if my math and assumptions are right. But I'm assuming that there's probably some disparate trends between the liability and property coverages. And so any color you could provide there just -- I mean, especially on the liabilities side given the severity uptick.

Frederick Henry Eppinger
Former President & CEO

Yes, sure. Obviously, the issues we've had -- and you rightly said it, have been the '11-year accident year; that's really been the issue. What we've tried to do, Vincent, is reflect -- and you saw it in the fourth quarter, right? -- the '12 -- the implications on '12 of what trends we're seeing in '11. So we've tried to incorporate what we see. Now there's a couple of differences from '11 to '12. One is obviously we've gotten 4 quarters of pricing in this year, so there's some earn-in price. The other thing I would tell you -- and it's the ex-cat weather, and it's an odd thing about our industry, right? So ex-cat weather, when you have a big cat year like this is a tad better than typical. So there's a couple of moving pieces. But your point is that there is an improvement given some of the rate we're seeing and some of the underwriting action we've taken. But it's probably -- it looks greater to you than it is in our models and how we're thinking about it.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. Perfect. And then obviously, we've heard you and the industry talk about the severity upticks. But I guess I'm just curious if there's anything or any studies that you've done or looked at that more specifically say exactly real world cause and effect. What -- is it driving behavior, is it cost? I mean, what have you seen that you could maybe add some color in terms of whether or not this is a phenomenon where we're going to have the adjustment and then this isn't going to be an issue in a year? Or is there anything that you're seeing that points to a more long-term inflation issue with the severity side?

Frederick Henry Eppinger
Former President & CEO

Yes, obviously, a lot of people have talked about it. I do not see anything definitive in our numbers. It is not as direct. I've seen people talk about deaths per 100,000 miles. But when you look at it, that's a minor -- when you work through the numbers, particularly in personal lines, that's a minor impact. So -- our view by the way is that for us, it was a combination of some of these industry trends, which I think is real. But we also probably were too aggressive in our '11 pick. We had a very attractive trend in '09 and '10 and our mix was improving. And so to us, I think part of our issue was that our '11 pick was probably too optimistic as well as the industry trend. So I don't see anything in our trends that we can't get ahead of with pricing. I don't think there's anything outsized. When we look at the quality of our business, it's quite good. We got off with very little of it. So I actually think we could get ahead of it pretty straightforward with rate. And I do think part of it was a self-inflicted overreacting to some good trends that we thought were going to continue in 2011 which made ours probably a little bit larger than they should have been.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. Perfect. That's really helpful. And then just one last one, if I may. Were there any changes significant changes, to the reinsurance program at the January 1 renewal? I know that the other portion of it's going to renew later this year, but, curious --

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. Vincent, it's David. Really no substantive change in our renewals. It was very clean. We were very pleased with the outcome of the renewal.

Operator

Your next question comes from Dan Farrell, Sterne Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Just thinking about the rate that you're currently achieving and I believe you said that you do feel you're ahead of loss costs. Can you sort of quantify that? And the reason I'm asking is, we've been seeing healthy rate for little over a year now, I would say, and obviously accelerating and I realize that needs to earn. But it hasn't seemed to really have an offsetting impact on the accident year picks as of yet. So I'm trying to think about how that will flow through given where we are in loss trends.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. You know, Dan, I think we are seeing, obviously, the benefit of the rate in the book as we've talked about. You rightly point out, it takes a while for that to earn in. But I think from the commentary you've heard Fred and I both say, I mean, we're very positive about our going forward trends and will begin to see even more of that benefit start to come through in our next year.

Frederick Henry Eppinger
Former President & CEO

And again, it's a Tale of Two Cities. This year, obviously we had the surety problem, which was a drag on us and the severity auto mess. If you look at our outlook, we have about 3.5 points of improvement that we're showing. Obviously, Chaucer goes the opposite way as they go to more normal, but the underlying improvement in our core business is pretty much every other business is improving. And you're going to see it in the loss ratios in a pretty significant way to get to this outlook. We did -- we are conservative about our forward pick for this year in auto, though, because we have baked in our thinking of what we saw in '11 and what we believe we're going to see in '12 into '13. But you're absolutely right, you are starting to see that mix because the historical problem of surety is kind of behind us now and so you're going to start seeing it in those accident years and in those lines. The other thing I would say is, what gives us confidence more than probably any year that we've been doing this is that this is the first year we've had where we're not buying a company, integrating a company, growing new geographies. We've got our portfolio established. It's matured. We've been at this now 3, 4, 5 quarters now where it's really about rate mix. Rate mix. Right? And the growth is obviously more moderated and more of the growth is priced. All of that gives you greater confidence that you're going to now see it in the accident year improvement. It's easier to kind of plan and have line of sight.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Okay. And just -- reserve actions in the quarter. Can you talk about how much the additions this quarter were due to sort of changes you saw in the data versus 2Q and 3Q or how much of it was just, "We're seeing the same stuff, but let's take an even more conservative approach to where we are." Can you just kind of talk a little bit more about the thought process?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I think it's mostly the latter point you're making, Dan. I mean, I think there's really not been much change in the underlying trends that we've seen in the quarter. But they've continued and so we decided in this quarter to take a position on the reserves that we feel is a strong position to take going forward and neutralize any further impact we would hope to see coming out of that business, those lines.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Okay. And then I just want to make sure I'm clear on the guidance. The 93 to 94, is it ex-cat, ex-development combined ratio? Or is it just ex-cat?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Just ex-cat, Dan.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Okay. So that would be whatever you think are going to be the reserve trends for next year as well?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

That's correct.

Operator

Your next question comes from Ray Iardella, Macquarie.

Raymond Iardella
Macquarie Research

Maybe just to hit back on the reinsurance renewal. Just curious I mean, can you give us a sense of the cost for you guys or the incremental cost year-over-year?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

There was none for us, because...

Frederick Henry Eppinger
Former President & CEO

Yes, we didn't have any incremental cost because -- obviously because we didn't -- if you think about what happened to us, right? One of the biggest storms in history right up our teeth in the Northeast and we didn't hit our reinsurance. So in essence, we didn't have any increase in the insurance and even with a little bit of exposure increase, the price was the same. So we're -- it was a good result for us. But it was because of what we've done over time, I think to manage our exposure, and people saw what we did. And so again we had a good outcome. I don't know...

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

And the same is true on the liability lines. We effectively, on an aggregate basis between our casualty and our professional treaties, we're effectively flat on rate for this year. So really no change.

Raymond Iardella
Macquarie Research

Okay. That's helpful. And maybe just going back -- and I know you guys looked at the debt this past quarter. But maybe talk about the thought process in terms of buying back stock relative to return some of the debt. And kind of how you think about the risk reward or the risk or the reward of either one, I should say.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, certainly, Ray. I think it's important to recognize, the debt buyback that we did was related to debt that had been assumed in acquisitions over time, including more recently with Chaucer. So importantly for us, what we're trying to do is obviously optimize the capital structure where the borrowings are within our capital structure and get the maximum effect of our leverage in our capital models. So this wasn't necessarily a clear case of purchased debt versus a comparison of an equity repurchase. We do favor share repurchase, but we're growing as a company and as I've said previously, we'll continue share repurchase opportunistically as we have the capital to apply to it. But first and foremost, we're trying to maximize our returns through growing our platform and growing our business.

Frederick Henry Eppinger
Former President & CEO

And we -- I think in the call when we bought Chaucer as well as a couple of these other ones, I think you all know that we had our debt level inflated a little bit, when we had Chaucer. And David and I both talked about how this 23 range is a much more normal. So in our minds, we always were going to clean up the capital structure in these acquired acquisitions and get us back to the 23 to give us flexibility going forward. And I echo David, too; it's really about, going forward, how we maximize shareholder value. But again, the cleanup here and I feel like that we're in that range now that's really the way we think about the ongoing capital structure that we clean this up.

Raymond Iardella
Macquarie Research

Okay. That's helpful. And then one more and then I'll re-queue, I guess. Just thinking about workers' compensation. Obviously, a favorable trend on the reserving side. And also you guys have been growing there over the more recent periods. Can you just talk about each one, sort of where you guys are getting the growth? Obviously, I'm assuming rate is a big part of it, but kind of where you're getting the growth and then also some -- the reversing trends.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, you're absolutely right. When you look at quarter-over-quarter, we've got some growth in the line. But when you look at the combination of price, as well as the additional premium at audit, both of those variables actually account for virtually all of the pricing -- all of the premium increase quarter-over-quarter. You saw the PIF increase, but as we've talked about before, that PIF increase is all coming from small commercial and that's by design. Going back and actually capturing the workers' comp on a lot of these small commercial packages that we've written for a long time in our cross-selling effort is starting to come through. So we continue to be conservative in the line, but we like where the growth is coming from.

Raymond Iardella
Macquarie Research

So I mean, I guess the second part was sort of on the reserving side. Anything you guys can talk about, given the favorable development?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

On the workers' compensation side?

Raymond Iardella
Macquarie Research

Yes. Yes.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, there was a little bit of a favorable development in the quarter, but that all came from very early years and it's really more of a true-up. This is a longer tail line, it's a relatively small volume line for us at this point; it wasn't particularly meaningful. But that little bit was coming from earlier years.

Frederick Henry Eppinger
Former President & CEO

Yes, one of the good things, again, comparing us to many in the industry, we have virtually no monoline comp; we have very little middle market comp. Our book is very attractive, mostly all small comp and has come recently as we've grown our small commercial comp -- small commercial business and round -- to the previous point, rounded out, so we feel very good about that line of business for us.

Operator

And your next question comes from Larry Greenberg, Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

I'm wondering if you can just talk about your cat load assumption for '13 given that if you look back over the last few years, certainly the impact from cat has been a decent bit bigger than that. How difficult was that conclusion to come to?

Frederick Henry Eppinger
Former President & CEO

Obviously, it's something we've spent a lot of time on, Larry. We've changed the mix dramatically. So, if you look at this as a percent of property, we've taken the estimate up. And if you look at the rolling -- the 10-year rolling average, we've tried to adjust it. And we can also look at it an actuarial way and look at other wins which has been for us, the biggest driver of the change in it has been the other win category of that, kind of a kitty cat if you will. And so we have, in our view, taken a pretty solid, conservative view of it. But again, one of the things to understand is, we've changed our mix quite a bit from where we were. We were heavy, heavy, property and now we're more balanced. So we believe it's a good solid conservative number and it does reflect -- now, the last -- 3 of the last 5 years have been very, very high in the industry and been for us too, but we really addressed it. The other thing, just to be very specific, at Investor Day I talked about getting off about $200 million of business. Now it's evolved to about $250 million, we've probably got right around about $175 million of that $250 million that we're targeting over time. And a lot of that, the vast majority of that has been all about this. We've very successfully executed that, both in a micro-concentration way to take away volatility because of micro-concentration, but also this Northeast. And it's material; I mean, it's a material change. So not only is our mix better and our spread better, we've actually aggressively taken it. So it's a good -- we feel very good about the cat numbers, probably the best I've felt about that number since I've been here because of all the actions we've taken and the work we've done around it. But we recognize that it's been a pretty volatile last 2 or 3 years. The other point I would make is the ex-cat weather -- and I've mentioned this in a couple of calls, we have built a lot more, probably 4 points more of premium, like in Personal Lines, of ex-cat weather into our numbers. So we have tried to assume all the additional weather we have seen into kind of just the day-to-day weather. And so I feel good about what we're doing on our rate, too, to try to capture this.

Lawrence David Greenberg
Langen McAlenney

Great. Thanks. And then secondly, if I'm hearing you on surety, it sounds like you have a very high level of confidence that we shouldn't see more noise either from an accident year or development standpoint. I'm just wondering, and if I put that level of confidence at 90 or whatever, pick a number, how confident would you be that Auto reserves won't continue to wiggle on you?

Frederick Henry Eppinger

Former President & CEO

So let me go back to the surety point. What I would tell you is, surety will be better in '14 than '13. So while we won't see what we saw this year, and we really do, we do...

Lawrence David Greenberg
Langen McAlenney

'14 better than '13? Or '13 better than...

Frederick Henry Eppinger
Former President & CEO

'14 will be better than '13. And what I mean by that is, we have a lot of confidence in this area that we've gotten a bust [ph] through this. We have a big part of this behind us. But the book is continuing to improve. So we feel good about the results and I'm just telling you that, that mix is getting better and better and better. So you're absolutely right; we have lots of confidence that we've got the big parts of this, as David articulated, behind us. But we also -- we have an improving book there and improving mix as we -- every day. And on Auto, and we've talked about it, we clearly have taken a really hard look at this and what trend, and we believe we reflected a conservative approach to our outlook. And I would tell you that if you ask me what creates some of the variation in that outlook, it is the conservatism around Auto. So I feel like as you think about inclusive of our outlook next year, I think we've captured a very solid view on what's going to happen with Auto. But it is the one that we've been the most aggressive at trying to really get after it and put some numbers up at the end of this year to get it behind us. But it is something that we have reflected additional -- not additional problems but we reflected a conservative view in our outlook next year based on what we see this year.

Operator

You have no questions at this time. [Operator Instructions]

Oksana Lukasheva
Vice President, Investor Relations

Okay. So thank you all for you participation today and we look forward to speaking to you next quarter.

Operator
Thank you for joining today's conference. This concludes the presentation. You may now disconnect and have a good day.