Assurant, Inc. NYSE:AIZ

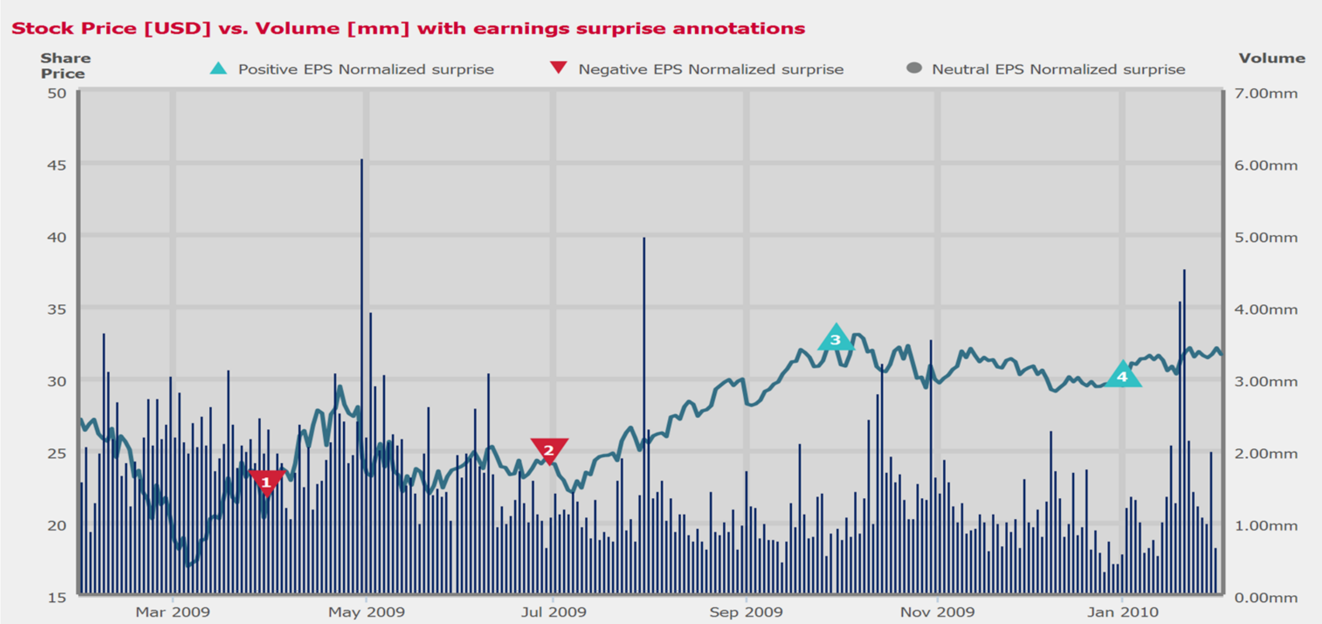
FQ1 2010 Earnings Call Transcripts

Thursday, April 29, 2010 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.04	1.32	▲25.71	1.09	4.24	4.51
Revenue	-	-	▲5.87	-	-	-
Revenue (mm)	2047.70	2167.86	-	2057.53	8289.83	8083.47

Currency: USD
Consensus as of Apr-29-2010 12:48 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	1.43	1.17	▼1 (18.18 %)
FQ2 2009	1.19	0.84	▼2 (29.41 %)
FQ3 2009	0.93	1.07	▲3 15.05 %
FQ4 2009	1.00	1.16	▲4 16.00 %

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Call Participants

EXECUTIVES

Christopher John Pagano
Executive VP & Chief Risk Officer

Melissa Kivett

Mike Peninger

Rob Pollock

ANALYSTS

Ed Spehar
Bank of America-Merrill Lynch

John Nadel
Sterne, Agee

Mark Finkelstein
Macquarie

Mark Hughes
SunTrust

Sam Hoffman
Lincoln Square Capital

Steven Schwartz
Raymond James & Associates

Presentation

Operator

Good day, everyone, and welcome to the Assurant first quarter 2010 financial results conference call. Today's call is being recorded. All lines will be in a listen-only mode for the duration of the call and there will be an opportunity to ask questions following the prepared remarks.

I would now like to turn the call over to Ms. Melissa Kivett, Senior Vice President, Investor Relations. Please go ahead, Ms. Kivett.

Melissa Kivett

Great. Thanks so much. Welcome to Assurant's 2010 First Quarter Earnings Conference Call. Joining me with prepared remarks are Rob Pollock, our President and Chief Executive Officer, Mike Peninger, our Chief Financial Officer. Prepared remarks will last about 20 minutes and then we will open the call to questions. Chris Pagano, our Chief Investment Officer and Treasurer, is also here for questions.

Yesterday, we issued a news release announcing our first quarter 2010 financial results. The news release as well as the corresponding supplemental financial information is available on our Web site at assurant.com.

Some of the statements we make during today's call may contain forward-looking information and our actual results may differ materially from those projected in these forward-looking statements. We caution you about relying on these forward-looking statements and direct you to consider the discussions of risks and uncertainties associated with our business and results of operations contained in our 2009 Form 10-K and subsequently filed forms 10-Q and 8-K, which also can be found on our Web site.

The Company undertakes no obligation to update or revise any forward-looking statements. Additionally, this presentation will contain non-GAAP financial measures, which we believe are meaningful in evaluating the Company's performance. For more detailed disclosures on these non-GAAP measures, the most comparable GAAP measures, and a reconciliation of the two, please refer to yesterday's earnings release and the supplementary financial information that we posted on our Web site.

Now, I'd like to turn the call over to Rob Pollock.

Rob Pollock

Thanks, Melissa, and good morning, everyone. 2010 is off to a good start for Assurant. We reported solid results for the first quarter across our mix of businesses. Specific actions initiated in 2009 are gaining traction and improving profitability. We continue to create opportunities for growth instead of waiting for economic recovery. Our strong financial position allows us to deploy corporate capital. At the same time we remain mindful of the challenges that the sluggish economy in many parts of the world and health care reform legislation that was recently enacted.

Let me begin by providing some financial highlights on the quarter as well as our 2010 business outlook. In the first quarter we generated an annualized operating return on equity of 12.9%. Results were driven by strong performance at Assurant's Specialty property and favorable operating results at Assurant benefits. We grew our book value per diluted share by 3% from year-end. This excludes the impact of accumulated other comprehensive income for AOCI.

We have repurchased shares of what we believe are very attractive prices and below book value per share. Through last Friday, April, 23, we have repurchased 4.8 million shares for about a $157 million. These actions are consistent with our capital management strategy and highlight the free cash flow we're able to generate.

Now, let me make a few comments on the businesses. Specialty Property had a terrific quarter. We achieved an excellent combined ratio driven by both favorable expense and mass ratios. Although our top line results were good we continue to expect pressure on our revenues looking ahead for three reasons.

First, the overall number of mortgage loans number of mortgage loans outstanding is declining, particularly, subprime since new loan originations are at low levels. Second, we expect placement rates to peak soon and return to more normal levels in the years ahead. And finally, portfolio consolidation will tighten margins requiring us to be even more vigilant in managing expenses. The team at Specialty Property continues to execute at a high level and maintains its leading position in the credit replace business.

At Assurant Solutions, we were satisfied with our growth in target areas under difficult market conditions. Our business continues to be impacted by high unemployment in the UK. In addition, the European economy is struggling to recover. We were pleased to see sequential improvement in the international combined ratio. We have made solid progress in reshaping our European business during the past several months and we expect international combined ratios to continue to improve on average by 100 basis points to 200 basis points per quarter for the rest of the year.

In the U.S. Assurant Solutions continues to create opportunities to grow rather than wait for economic recovery. We were pleased to enter into a contract with Lowe's the home improvement retailer which will be later this year.

Our strategy to partner with original equipment manufacturers is also gaining traction and we are benefiting from our preneed partnership with SCI which continues to add new funeral homes.

We are on track to offset revenues that will last from prime bankruptcies and a slowdown in consumer spending. Assurant's employees' benefits provided a good example of how we're creating our growth opportunities as well. Our top-line benefited from the block of business we acquired from Shenandoah Life as well as new clients at Disability RMS, our turnkey distribution channel.

High levels of unemployment continue to limit small employer payrolls which drive premiums. Expense management and continued improvement of dental results will remain key elements of our efforts ahead.

At Assurant Health, it was good to see quarter results improve in line with our expectations. Of course, the issue at the forefront of everyone's mind is the impact of Healthcare Reform. The legislation signed by President Obama on May 23rd reshapes the health insurance industry. Since detailed implementation regulations have not yet been issued the full extent of the impact on our business is still being assessed. However, we know modifications in how we operate will be necessary. In particular, we will need to operate with a lower expense structure at both the business unit and enterprise level.

As we prepare for the future we have begun a comprehensive review of all the options for Assurant Health. A Steering Committee co-chaired by our CFO, Mike Peninger, and Assurant Health CEO, Don Hamm, is leading the effort.

We are completing a thorough evaluation of our auctions in the individual medical market. We're also assessing the impact on the enterprise, including all intangible assets on our balance sheet. The analysis is well underway and we expect to present our findings and made recommendations to our Board of Directors this summer.

Assurant has a long history of successfully adapting the changes in the marketplace. And this legislation will test our ability to do so again. We will take the best course of action to benefit our shareholders and our customers.

And now, I would like to turn things over to Mike who will give a more in-depth review of the businesses. Mike?

Mike Peninger

Thanks, Rob. Let's now take a more in-depth look at the results for each of our businesses. I'll begin with Assurant Health which is continuing to take corrective actions to improve the underlying business results in the near-term.

For the quarter net operating income decreased significantly versus as reported in the first quarter of 2009, however, as we discussed on several calls last year, first quarter 2009 results did not fully reflect the increased medical benefit utilization that began in late 2008.

First quarter 2010 results developed consistent with our assumption and reflect pricing and benefit design changes as well as expense reduction initiatives we implemented. Sales of both individual medical and small employer group policies increased versus 2009. Sales growth continue to come primarily from our affordable healthcare plans that provide more first dollar coverage, but continued high elapse rates offset sales growth waiting to address of about 1% in net earned premiums for the quarter.

In summary, the changes we made to pricing and plan designs over the past year have us on track to return our book to a 4% after-tax margin by the fourth quarter. So of course, this may be impacted by changes made in response to healthcare reform. The team at Assurant Health continues to work towards that goal even as they began to make the changes necessary for future success.

I'll turn next to Assurant Employee Benefits where net operating income was at its highest level since third quarter of 2008. Very favorable disability incidence and life mortality rates drove the improved earnings. In addition, just is in medical, pricing and plan design actions are producing improvement to dental loss ratios.

Net earned premium growth was driven by the block of business acquired last year from Shenandoah Life and two new clients at Disability RMS. These additions brought an additional $35 million in net earned premiums in the quarter and we expect their full year 2010 contribution to be around $100 million. Although overall sales were flat voluntary product sales continue to be a bright spot, increasing by 21% to $21.8 million for the quarter.

While we are pleased with the first quarter results, remember, the low frequency high severity nature of our life and disability products can cause loss ratios to vary from quarter-to-quarter. Also, organic growth in small employer payrolls will require job creation. Until then we will continue to work to increase voluntary product sales.

Now, I'll turn to Assurant Solutions where overall earnings were down about 5% versus the first quarter of 2009, but where they were also several times of improvement. The decline was primarily due to a one-time tax charge of $2.8 million resulting from the restructuring of the European business and a $4 million after-tax change in the value of assets used to protect against inflation risk in our preneed business.

Net operating income benefited from favorable domestic service contract loss experience and improved preneed experience. Our domestic combined ratio continued to reflect favorable loss experience from both new business and run-off clients.

Gross written premiums for domestic service contract business increased by about 12% versus 2009, driven mostly by non-recurring items. Absent these items, written premiums were flat which we view as a good thing since first quarter 2009 results included about $20 million of gross written premiums from Circuit City. We saw modest organic growth for several current retail clients as we saw consumer spending showing possible signs of improvement.

As Rob noted, we're pleased to enter into an agreement to provide service contracts for Lowe's which will begin to produce gross written premium in the fourth quarter of this year. Because Lowe's retains most of the risk and performs a service functions under the contract it will add only modestly to our net earned premiums and earnings over the next few years. We hope to expand the relationship overtime as we demonstrate the value we can add to Lowe's.

Despite a positive impact from foreign exchange our first quarter international results are down versus 2009 even prior to the $2.8 million tax charge I mentioned earlier. Going forward, the effective tax rate should decline to normal levels.

Sequentially we saw improvement in our UK underwriting experience that was consistent with our expectations. The international combined ratio decreased by 670 basis points from the fourth quarter of 2009 and was down by about a 180 basis points excluding the impact of the fourth quarter restructuring charges. We continue to expect an average of 100 basis points to 200 basis points per quarter reduction in this ratio over the rest of 2010 as our pricing and underwriting changes take effect.

While overall net earned premiums for Solutions were level with prior year international net earned premiums increased 26% due to favorable impact of foreign exchange rate and growth from new and existing clients in Canada, Brazil, Argentina and Mexico.

International gross written premiums increased by over 30% due to favorable foreign exchange and new client growth in several countries. Our service contract relationship with Whirlpool in Italy will start producing premium in the second quarter and our wireless business with Tim, Brazil's third largest wireless carrier is expected to produce premium by year-end.

We added a new page to our financial supplement this quarter that breaks out our preneed business and shows that steady contribution to Solutions results. The exhibit also illustrate the impact of our CPI caps which are financial instruments purchased several years ago to protect against inflation risk on certain preneed policies.

These caps which were valued at about $8.5 million at quarter end are important parts of our risk management strategy for the preneed products, but they are mark-to-market each quarter and thus create some variability in earnings.

Preneed earnings grew for the quarter despite a negative impact from the cap and sales were up sequentially. We expect further growth as the funeral homes acquired in 2009 by SCI, our sales partner; begin to sell our preneed policies.

In summary, Solutions is adding new clients and growing in key target areas such as wireless service contracts and preneed while looking for new niche market opportunities. We need to see continued improvement in the UK results and to reach revenue and profit targets in our developing countries.

Our domestic combined ratios are likely to drift back toward our target in the high 90s over time but sales are improving and we believe that our growth expense, control and risk management initiatives are beginning to take hold.

I’ll now turn to Assurant Specialty Property which produced another very strong quarter and drove our overall financial results. The business benefited from a $7.6 million after-tax adjustment in our credit replaced unearned premium reserves but even absent this item net operating income increased 6% versus 2009 due to lower expense in loss ratios.

Combined ratios were the lowest we’ve reported since the fourth quarter of 2008.

As we stated last quarter we continue to expect earnings to reflect margin compression of $10 million to $20 million from client consolidation. However, due to more favorable contracting and slower run-off of loans lost there was minimal impact on our earnings in the first quarter. We now expect that the impact will begin in the second quarter but will not be fully realized until the middle of 2011.

Our net earned premiums rose by 3% primarily due to the change in unearned premium reserves which increased earned premiums by $13.6 million. Excluding this item, net earned premiums were flat with last year.

Real estate owned premiums declined from 20% of credit replaced premiums in 2009 to 12% in 2010. However, premiums from non-REO of business kept total earned premiums level.

We benefited from the fact that the policies on the 230,000 subprime loan lost in January 2010 that we mentioned on our year-end call were not canceled upon client termination. The premium on existing policies is therefore running off more slowly which favorably impacted both earned premiums and earnings in the first quarter.

In the short run it appears that REO premiums have stabilized as loan services have developed more programs to modify loans and hopefully avoid for closures. Placement rates have continued to increase and based on our analysis of delinquent loans we anticipate that they will continue to see near the current levels for the remainder of this year.

75,000 new subprime loans that we gained through consolidation modestly raise written premiums in the first quarter. We will see further growth beginning in the third quarter of this year from a previously disclosed new 80,000 subprime loan account.

Specialty Property continues to manage expenses in capital level carefully, while also looking for new growth opportunities in the creditor placed market and increasing sales of adjacency products such as (inaudible) and creditor placed flood insurance.

Turning now to our investment portfolio on balance sheet. Our investment portfolio continues to perform well. At the end of the first quarter net after-tax unrealized gains were $267 million, an increase of $89 million since year-end. During the quarter we realized $4.5 million in pretax gains from the portfolio despite a $6.7 million increase in our mortgage reserve and under $1 million in other-than-temporary impairments.

Since we took minimal dividends from the businesses during the quarter our holding company capital position declined from $710 million at year-end to about $480 million at March 31 or about $230 million of deployable capital after subtracting our $250 million buffer.

Our debt-to-capital ratio was a low 16.9% down from 18% a year ago. These metrics and the free cash flows our businesses generate are all indicative of our solid financial position, a position that continues to provide us with capital management flexibility.

So in summary, we’re pleased with our first quarter results and continue to remain focused on the macroeconomic challenges and post Healthcare Reform market ahead of us.
And with that, I’d like to open the floor for questions. Operator, we’re ready for questions.

Question and Answer

Operator

Thank you. (Operator instructions) Our first question today comes from Ed Spehar of Bank of America-Merrill Lynch.

Rob Pollock

Morning, Ed.

Ed Spehar
Bank of America-Merrill Lynch

Thank you. Good morning, everyone. A couple questions. First, when we look at Specialty Property, the fact that there maybe things or not reverting to normal as quickly as at least as I had thought, but I am still struggling with how to think about what is normal revenue for this business? And I think specifically on the subprime loans I guess you're saying you added 75,000 new loans in the first quarter and another 80,000 in the second, is that correct?

Mike Peninger

I think it's 75,000 in the first quarter and 80,000 in the third, Ed.

Ed Spehar
Bank of America-Merrill Lynch

Oh, in the third, okay. I guess -

Mike Peninger

They will start producing in the third quarter, sorry.

Ed Spehar
Bank of America-Merrill Lynch

Okay. I guess the question though is it how do we look at this, given the replacement rates are so high on subprime with no originations how quickly does this number go to zero? And if it does, does that mean we should start thinking about higher placement rates on a normal basis for prime because some of that stuffs somehow ends up in the prime category. How do we think about sort of a normalized revenue level?

Rob Pollock

There's couple different things that first, I think if you go back and we provided a history that that's splits the business out over time, subprime has always been a portion of the marketplace and maybe it grew more than the market did in particular, vintage years, probably '06, '07, '08 years, okay. But some primes always been 10%, 15% of the overall market. Now, remember what's reported to us by our clients, they classify the loans. And we have some suspicion that prime loans may get reclassified to subprime when they started to having problems with the loan.

But I think if you go back and look at placement rates in an '06 timeframe, you can get a feel for what more normal subprime placement rates are and then the real issue is when is there going to be new loan originations coming back in the market. I think the key for us is Gene and his team has continued to find opportunities to grow, when we can get clients in RFP situations we typically do very well and we're aligned with market leaders who as the consolidation takes place has us well positioned as portfolios move around. When I look at the overall revenues I very much look at it as placement rates and some estimate of what's going on in the overall number of loan.

Ed Spehar
Bank of America-Merrill Lynch

So when we look at over the long-term you said there is still going to be something that is subprime in terms of loans outstanding, whatever that maybe.

Rob Pollock

Yes.

Ed Spehar
Bank of America-Merrill Lynch

Okay. And then on capital. I think the ordinary dividend capacity this year is 560 million from your subs. Can you tell us how much you took so far if any?

Rob Pollock

First, we have a strong capital position we generate a lot of free cash flow out of the businesses is one of the things we really like. Actually, I'll let Chris run through and just give you an update on where the capital was at year-end and where we're at the end of the first quarter?

Christopher John Pagano
Executive VP & Chief Risk Officer

Sure. Hi, Ed. Just to get us from the 715 I guess to the 480 roughly, so 235 million of reconciliation, 127 of that again was returned to shareholders to repurchase plus the dividend, we had an interest expense, February and August are debt payments, that's about 30 million. About 50 million on a net basis plus or minus was put back into the segment, half of that was in Health in response to the increase in litigation reserve and the other half went back into solutions due to point growth. And then the balance of it was what I would call normal course operating expenses for the company. The inc operating expenses are front loaded in the first quarter and a lot of that just related to compensation expense we pay our year-end bonus in the first quarter of the following year. And then we have a 401(k) matched out.

First off we did not take any dividends of consequence from the subs in the first quarter. We will look to be taking the dividends in the second quarter going forward. I think that gives you an example of the advantage of being in such a strong capital position. We're able to go out repurchase shares at attractive levels both relative to current market and as a percent of book, without having significant upstreaming of dividends from the segments and above average operating expenses at the corporate level.

Ed Spehar
Bank of America-Merrill Lynch

What's the total for the year expected in terms of interest expense and operating expense?

Christopher John Pagano
Executive VP & Chief Risk Officer

We kind of given you, and again, the difference between cash in and out we think about interest expense, for example, we would tell you, it's roughly 40 million, that's an after-tax number. But the dollars that go up the door though in the first and third quarters are pretax numbers that comes back later on. Operating expenses typically run around 50 million and then the other piece of it is recurring dividends, which run rate right now is about 70 million.

Ed Spehar
Bank of America-Merrill Lynch

Okay, thank you very much.

Operator

And our next question comes from John Nadel of Sterne, Agee.

Rob Pollock

Good morning, John.

John Nadel
Sterne, Agee

Good morning, everyone. How are you doing? So Rob I guess the question for you is understanding from your opening remarks that rakes of yet to be sort to determine under Healthcare Reform, but can you dive into that a little bit more deeply in terms of what the Steering Committee, Mike and Don, and their team are coming up with at this point, sort of maybe walk through what, the range of potential options or outcomes might look like?

Rob Pollock

Sure. Again, I'd almost put a little bit of a discontinuous change to the business. We have a history of adapting to changes when they occur, John. And I'm going to let Mike comment on this a little bit too, but we kind of gone to the team and said, look, it's a new world, we want you to look at all the possible considerations in evaluating things, but remember we're looking at a set of legislation that is probably as comprehensive as anything that's going on in history, John, it's long, we're finding places where we're generating a lot of questions, we're interacting with the NAIC, HHS to get clarity around how things work that are unknown. At the same time we have some things that are known that we need to respond to and start dealing with such as covering shoulder and update etc., so there's a lot of detail here that devil is in the detail on how they operate. And I think the team is looking at all the potential options that are out there. Mike, you will be able to give comments?

Mike Peninger

Yes, I had to say that exact thing it's hard to talk about all the options we're looking at or trying to take a very comprehensive look, our fundamental we've a long history, we've been in this business for over 100 years, we have 750,000 I think customers and 600,000 plus of individual health customers so they have vested interest in this and we're trying to look at as Rob said, the details of healthcare reform, the regs there are not written yet, however, MLR calculation actually work, etc., And some of the answers are those really, say, what kind of opportunities are going to be available. We know that the business will look different; we know that certain strengths of ours that have benefited us historically. Underwriting, for example, would be less important, but other things that we have will be usable in other ways. So we don't want to take any options off the table at this point.

John Nadel
Sterne, Agee

Understood. And just as a quick follow-up. The medical loss ratio sort of the 80% MLR. Obviously, at this point, very lose in terms of what goes into that ratio, but is there some timing, I thought I might have read something somewhere recently that there is some timing on when the definition of what goes in the numerator and the denominator is going to come out?

Mike Peninger

Yes, HHS has requested I believe from the NAIC that the NAIC gives them some recommendations in the June timeframe I think maybe June 1st,which was earlier than it was originally they were until the end of the year but HHS has some to move that out and so the NAIC is developing and I've seen I think some list of questions they're starting to ask and raise so I think by in the second quarter we'll start to hopefully get a little more clarity on this.

Rob Pollock

But one of the things we do note, John, is that it's not an apples to apples comparison against our loss ratio today -

John Nadel
Sterne, Agee

Yes, that’s a point, right?

Rob Pollock

So they’ve already made some statements about things that can be excluded such as income taxes, premium taxes, assessments, etc., so again, there’s lots of details here. We’re in the midst of trying to get answers to all those things. Again, the details will help us formulate what the best option is and we’re not pre-disposed toward any option today. We're going to add them all.

John Nadel
Sterne, Agee

Got it. And in the meantime feel comfortable that pricing actions and lapse rates and the various other expense initiatives, etc., Have you on track for your targeted margin improvement?

Mike Peninger

Yes, we took those actions starting in middle of last year. They continue to roll through the block as I said the development in the first quarter was consistent with what we expect. So in the absence of any healthcare reform unusual impact we definitely feel like we’re on track for those actions that have the desired results.

Rob Pollock

If we just look at, John, all of that was assumption-based when we took all the actions and that’s the end of each quarter we’ve reported out. We’re getting a pretty good line aside that our actions are doing just what we’d expect.

John Nadel
Sterne, Agee

Excellent. Thank you very much. I'll get back in the queue.

Mike Peninger

Okay.

Operator

Our next question comes from Steven Schwartz of Raymond James & Associates.

Rob Pollock

Good morning, Steve.

Steven Schwartz
Raymond James & Associates

Hey, good morning, everybody. Both Ed and John got to some of the questions I wanted to ask. Just one of the possibilities here with the health business is the sale. That is not off the table, right?

Rob Pollock

We’re looking at everything and so obviously we’ll consider all the actions, as I said, we’re not pre-disposed toward anyone particular option.

Steven Schwartz
Raymond James & Associates

Okay. Just making sure that everything was everything. The balance sheet has a GAAP equity there, 300 million in that business. Would that be I guess accurate on a statutory basis, things are different obviously with health insurance and they now with life insurance?

Rob Pollock

The question I think you're raising is, is our staff capital similar to our GAAP equity? I believe they are in this business. So there's some intangibles that are also associated with the health business. Again that will all be part of the analysis as we look at things, Steve.

Steven Schwartz
Raymond James & Associates

Okay. Like I said John got most of what I wanted to ask. That's really all I wanted to add there. Thanks

Rob Pollock

Sure.

Operator

(Operator instructions). And our next question comes from Mark Hughes of SunTrust.

Rob Pollock

Hi, Mark.

Mark Hughes
SunTrust

Thank you. Any perspective you can share on the typical duration of the policies in the Specialty Property business, say, Q1 versus this time last year?

Rob Pollock

When you look at what characterizes our policyholder groups, Mark, I tended to put this into some different buckets. And obviously, the duration has gone up we believe a little bit. It's largely related to people who run into problems, making payments on their homes.

Mark Hughes
SunTrust

Right. I guess the typical time that your policies are in force under those circumstances, when you say up a little bit, is that what you're suggesting?

Rob Pollock

Yes, absolutely. I guess I put our customers into three different buckets, those who stay with us for a long time because they tend to get a policy from us and just keep it in force, people who get the policy (inaudible) from us and decide they're going to pursue another option and they're with us a short period of time. And then there's group who come about really because they run into problem, making payments and that's the one we're seeing a movement out and how long the policies held.

Mark Hughes
SunTrust

All right. The Lowe's business, could you talk about what your experience has been historically with taking a big retailer like that and moving it potentially fully on to your platform? And if you did so, how meaningful would that be?

Rob Pollock

Well, I think we've got a long track record in this business, Mark, working with large clients and we try to do is our offerings in the service contract business we have the full range we kind of cover the full gamut of the value chain in that business from issuing it to doing the administration to take in the underwriting risk, etc., So we got kind of the full package and I'd say it's fairly typical in this business that we start with a piece, sometimes a fairly small piece of that total value chain and what I think we've been able to do typically is work with the retail customer, show how we can add value and them improve their own business and that makes them over time get increasingly receptive to giving more of that value chain toward us and we'd certainly hope that we can demonstrate or make that case to Lowe's, we're excited to have start of the relationship and hopefully, over time will increase it.

Mark Hughes
SunTrust

Thank you.

Operator

Our next question comes from Mark Finkelstein of Macquarie

Mark Finkelstein
Macquarie

Hi, good morning. Couple of questions, I guess Ed brought up the question on capital and you talked about the $560 million of dividend capacity for 2010. I guess how should we think about free cash flow generation overall for 2010 going into 2011 for dividends? And I guess what I'm getting at is you got Specialty Property that theoretically is going to kind of shrink in size, you probably get capital release from that. Is there any way of thinking about this? I mean should we assume that kind of free cash flow should be somewhat close to operating earnings for 2010?

Rob Pollock

I think that's a good way to think about it, Mark. And in addition to that we've talked about we're going to try and free capital in the Solutions business we can do that to the tune of $75 million to $150 million over really 10 or 11 timeframe, when property comes on then, it hasn't, but if it were, we'd have a little bit of additional capital that would free up there as well. But I think thinking about our earnings plus that amount within Solutions is a good way to think about things

Mark Finkelstein
Macquarie

Okay.

Christopher John Pagano
Executive VP & Chief Risk Officer

Let me, Mark, if I could, this is Chris, maybe just make a couple other comments. I just want to make a clarification, I think and I could be wrong, but I believe your net dividend capacity is 525 million. I do want to point out that that is a regulatory number and does not necessarily indicate what we can or cannot take out of the businesses. When I think about dividend capacity I think about earnings plus minus. The minuses would be held back for growth and as we have seen in years past sometimes the portfolio effect will cause us to, we'll have to retain more capital and not be able to access it from the operating companies. And, of course, on the plus side you mentioned potential shrinking of the business on the property side, again, also our efforts to take some excess capital solutions over the next 12 months to 18 months.

The other thing I would point out again, Ed asked the question I provided reconciliation. Some of the infusions and taking dividends out of the subs are timing issues. This past quarter we did put some money into Solutions (inaudible) to some additional client growth that doesn't change the fact that over time we'd like, we think we can get out the earnings and then from the Solutions segment over the next several years. The other thing you've got to keep in mind in a variable that we've talked about in the past is the cap, the AM Best capital requirement; we do capitalize the best to the extent that those change from one year to the next that might have some effect. We're in regular dialogue with the rating agencies, have not gotten any indication of the material changes there, but will know that as the year progresses.

Mark Finkelstein
Macquarie

Okay. And then one other question on benefits. Clearly, a very good quarter. I think you highlighted low mortality. I'm curious what the dental block is doing. Are you starting to see kind of incidents come down at all or are the results kind of even without the trend improvement in the incidents?

Mike Peninger

Yes, I think what we're seeing is sort of an interesting comparison with the medical business where we had some changes in incidents and costs that happened in, started in late 2008 timeframe and those have sort of maintained at that level and so we have done has gone into the block and instituted the pricing plan design changes very much like the both the and our health business have done and medical. And so what we're seeing now is those changes working through the block. So I'd say that improvement that we're seeing really reflects the actions that we're taking rather than some sort of reversion, the incidents have kind of stayed at the more elevated level and we're pricing accordingly.

Mark Finkelstein
Macquarie

Okay, all right, thank you.

Operator

And our next question comes from Sam Hoffman of Lincoln Square Capital.

Sam Hoffman
Lincoln Square Capital

Hi, good morning. I have a couple of questions. First in Specialty Property, gross earned premiums exceeded our expectations because they were about 100% of the trailing four quarters gross written premiums. And that's something that hasn't happened since about 2007. The ratio dropped to 95% last year in '08. So I guess can you help us out in terms of how to best model earned premium to the ratio to written premiums, understanding that you have some new policies coming on that improve that ratio going forward?

Rob Pollock

Sure. To me again I start, Sam, looking at placement rates on loans and if you think about the written premium representing the annual premium on a policy, okay, a placement rate times the number of loans, times an average amount of the policy gets you to a written premium originates back to the date their coverage start. So I think the earned premium numbers perhaps a better way to model. We provided the written, there's a lot of movements in the written over time caused by that. But I think it's just a big part of it is how our model operates in that is looking in arrears to know what our coverage comes into a fact. Then if you look at the number of portfolios that have moved around over the last couple of years, which are unprecedented, those exacerbated all the numbers as well. So I'd be more focused on the earned premium number.

Sam Hoffman
Lincoln Square Capital

Okay, then also on Specialty Property. Can you comment on your reinsurance policy this year? It looks like you issued some kept ons and just generally should it have the same impact on the financials as it did last year?

Rob Pollock

Sure, this is a big part of our risk management program at the enterprise level. Cap risk is something we're quite focused on. We typically buy our program in pieces and we place part of it in January, part of it in June, it involves the Florida Hurricane Cat Fund as well. Several years ago we said we were also going to look at different pools of capital other than just the reinsurance market, we looked at a cap bond transaction and placed one last year, we have recently just entered into another cap fund arrangement. Chris, do you want to comment on that a little bit?

Christopher John Pagano
Executive VP & Chief Risk Officer

Sure, I think a couple of things. Again, the apples to apples comparison versus last year is probably best done by looking at last year's cap on and where it's trading in the secondary market. The two tranches we placed last year are somewhere between 5% and 6% lower in terms of spread. And we saw that comparable pricing validated in our second issue this year. We're very pleased with the results, clear evidence of available capacity and more attractive pricing versus prior year.

The flip side though is that it's not apples to apples, the other thing we have to keep in mind is how the reinsurance program has changed, the exposures have changed from a geographic perspective, and also the tower has grown; the reinsurance needs have grown since last year. So I think what we typically do is provide you with an update sometime around mid-June once we place the balance of the traditional program were out in the market right now with our reinsurers.

Sam Hoffman
Lincoln Square Capital

Okay. And then on the Health business, can you just frame what the minimum return on equity would be in order for you to retain that business and in what timeframe you would need to achieve that ROE?

Rob Pollock

Sure. Again, if we look historically, the healthcare business has produced very strong ROE. A lot of that driven, Sam, by the fact that there's not a high equity requirement in the business and you can write premium to equity at 6:1, 7:1. So, we have had a history of returns that have been in the 20% and 30% range, obviously, we look and I'd say we'd want to be at 15% or better in this business. Obviously we would look at what are the issues to deal with that. We didn't have those returns last year but we have with the corrective actions we implemented last year they're all paying off. We see us returning, as Mike mentioned, to a 4% after-tax margin by the fourth quarter absent healthcare reform and that will put us well in excess of that.

Sam Hoffman
Lincoln Square Capital

And do you currently see any options under healthcare reform that would enable a 15% ROE?

Rob Pollock

Well again, we've got that comprehensive study underway and I am sure that will all be part of the analysis that group provides us.

Sam Hoffman
Lincoln Square Capital

And finally, just at a high level. There were a couple of moving parts in the quarter, but more or less it was a clean quarter. And so would you say that now excluding CATs that you're kind of at the 12% ROE currently and that's kind of where you are for the foreseeable future until any major changes might occur excluding CATs?

Rob Pollock

A couple of different things. I look at there first is the balance sheet drives the enterprise ROE, but the businesses are out and pricing products everyday in the market place. So I think if we're able to grow, business should be written that, is in the target ranges and as we can grow the business that will be at higher ROEs than the 12% on the incremental piece of business. We have the correction actions we took in our business last year that are raising ROEs in a number of our businesses as well.

And as we deploy capital, clearly, we've got deployable capital that today is sitting at the enterprise level earning low rates of return. So we can figure out how to deploy that better, that's another opportunity. Saying all that we're in businesses that have variability associated with them, so the pricing is at levels we think can be higher. It requires that we grow. We've talked about each of the businesses and some of the challenges we're facing in them, but we're trying to move to those higher returns.

Sam Hoffman
Lincoln Square Capital

Okay, so as long as revenue remains flat you should be at least 12% return on equity excluding CATs?

Rob Pollock

Well, that will depend on our business results, Sam.

Sam Hoffman
Lincoln Square Capital

Okay, thank you.

Operator

And we go next to a follow up from John Nadel of Sterne, Agee

John Nadel
Sterne, Agee

Hi, there. So Rob, last quarter, you indicated that buybacks that you would expect to use about half of your existing authorization through the end of 2011.

Rob Pollock

I think (inaudible), John.

John Nadel
Sterne, Agee

You did, you did, I'm sorry. You said at least. In the first four months here, at least what you've reported through the 23rd of April, you've used half of that half.

Rob Pollock

Correct.

John Nadel
Sterne, Agee

I applaud it. I'm just looking for a little bit of help on pace from here. Understanding that I think you guys typically would at least historically you would typically slowdown a little bit in front of hurricane season but?

Rob Pollock

Yes, well let's first start with, and looking at that anything, we start with, we've got to be able to deploy in excess of our cost to capital. We think that somewhere in the 12% range. We try and evaluate that against all alternatives with a couple of cash -

John Nadel
Sterne, Agee

Hi, Rob, I am sorry, I am sorry, can I interject?

Rob Pollock

Sure.

John Nadel

Sterne, Agee

You guys think your cost to capital is around 12%. I am interested in that only because I've got some other companies that I cover who -?

Rob Pollock

I think it's lower than that, John; we're using it as a rough rule of thumb. And also just I'd point out and Chris has done a lot of work in this area. It obviously moves around as capital markets move around. So when we looked at a last year it was higher than that. But again we're just trying to give a rough rule of thumb in terms of how we think about it.

John Nadel
Sterne, Agee

Understood, okay, okay. And one more. If you took your current debt-to-cap, which is very, very low relative to most of my coverage universe anyway at 16% or 17%. If you took that more to a typical single A rated companies debt-to-cap of 25-ish, how much would that take your cost of capital down? Your weighted average cost of capital. If you were talking about 12%, I would assume that would take it down to 10% to 11%.

Rob Pollock

Right, it's a blend, it's a blend of equity and debt and it would take it down. Again, I think it just reinforces our strong financial position that we're in. We certainly realize we have the capability to structure the balance sheet differently. Chris and his team are looking at that in-depth. But if we go back to how do we evaluate things it's relatively, first, we got to invest, as Chris mentioned, in the business to generate and deal with organic growth and we have some of that going on and then we evaluate the alternatives. And I think the first quarter demonstrates we've seen the attractive nature of buying back our share.

John Nadel
Sterne, Agee

And your valuation essentially with the sequential add to book value per share from your net income, your valuation effectively, if I think about the first four months of buyback and, frankly, it's just the last couple months, right, because you were blacked out until February. The valuation hasn't really changed, right?

Mike Peninger

The market to book is that you're referring to, John?

John Nadel
Sterne, Agee

That's exactly what I'm referring to, yes.

Mike Peninger

Yes, again, I mean we can do a lot of different things here, the combination of strong balance sheet to start the year, operating cash flows that we think we will be able to get and then some up in the form of dividends, the share price, we can do a lot of different things with the cash flows that the businesses are generating, and frankly a nice position for us to be in. And we will, we do think the share price continues to be attractive. We expect to be back in the market. Our goal is to be in there consistently, typically in a 10b5-1 structure, we think makes the most long-term sense -

John Nadel
Sterne, Agee

And do you guys have one in place right now? 10b5 or no?

Christopher John Pagano
Executive VP & Chief Risk Officer

Yes, we do, again, the 10b5-1 is typically, we put one in place that allows us to continue to repurchase shares through blackout periods. The fact that we were in the market in this past month suggest that is still in place.

John Nadel
Sterne, Agee

That's fair, all right. And last one for you guys. Just going back to Solutions in the international combined ratio improvement, can you give us a sense for the actions that you've taken in the UK biz, how much maybe in terms of the 180 basis points of combined ratio improvement in international, how much of that was UK improvement driven, if you will?

Rob Pollock

Yes, I don't have the specific UK piece off the top of my head, John, but I can tell you that our sort of key metric is our overall combined ratio internationally going down by that 100 basis points to 200 basis points per quarter. We've done a variety of things in the UK ranging from exiting certain distribution channels to redesigning products to re-pricing products, etc, etc., And we've got specific metrics on each of those things that we're watching and those are the results of those actions are sort of enfolding in line with our expectations so -

Mike Peninger

No, I was going to say, again, think of the analogy to health, think of the analogy to our demo business, again, we've have taken actions they were assumption based. To me, John, they've unfolded consistent as Mike pointed out with the correction actions we've taken, the caveat we'd add on the UK is where we expose is, if we get an upward spike in unemployment.

John Nadel
Sterne, Agee

Understood, understood, okay. Listen, I applaud, I applaud the progress on all those fronts. I mean they are real very evident this quarter, so thank you.

Rob Pollock

Sure.

Operator

And our next question comes from Ed Spehar of Banc of America-Merrill Lynch with a follow-up.

Ed Spehar
Bank of America-Merrill Lynch

Hi, thanks. I guess, Rob, I just want to go back to this cost of capital thing. When you're saying 12%, are you saying that's what you guys think your weighted average cost of capital is or your equity cost of capital?

Rob Pollock

Yes, again I would say we just are using it as a rough rule of thumb, Ed, think about what we've done with the business is first in pricing products. We want them pricing at 14% to 16% or better returns in the businesses, okay? Where you think this as a rule of thumb as they look at up, hey, maybe we want to go, do a deal, maybe we want to do that, there is obviously inherent risk with it. So we're trying to just be mindful of let's not look at things right on the margin of our cost to capital because there will be unknowns there and we're just using it as a price holder. We have the actual calculation. We look at it regularly. I was going to say the debt component is it's the equity component we look at periodically and it moves around

Ed Spehar
Bank of America-Merrill Lynch

Yes, first of all, I guess I would argue, you found the right use for your capital this quarter and in April. But the second thing I would say is that going back to the point I think Sam was making, you've got a 12% ROE this quarter. Understand this is not a normal quarter from a CAT standpoint. If we spread that out it may be different, but stocks at 80% of book value. So, the question about your equity cost of capital, I guess, I would argue your equity cost of capital is maybe higher than the numbers that you're suggesting just because the stock is trading below your equity value.

Rob Pollock

Absolutely, that's a classic capital market assessment, Ed. Couldn't argue that.

Ed Spehar
Bank of America-Merrill Lynch

And then just real quick one on the health side. When we talk about wanting to get at least 15% ROE or better, two things, how do you sort of think about the importance of the health business from an overall enterprise standpoint of capital relief or credit that you're going to get in either for the rating agencies or the RBC ratio and is that going to change going forward giving the uncertainty about how. And then also just because you point out the unclear nature of exactly how you implement the sweeping legislation and how do you handicap just sort of the risk when you think about somebody decides that something will be included in the MLR or then a year later they say it's not included there is obviously not just the question of how it's interpreted today but how do we get confident and how to be interpreted over the long-term?

Mike Peninger

Well, we certainly, we think about that you're raising great questions out and certainly, there are a lot of uncertainties, that's why we are trying to take time and do a very comprehensive and thorough analysis of all the options because each of the options entails making certain assumptions we're not going to have definitive information for quite some time until all the changes start to work through the system. So we try to make reasonable assumptions about the key drivers of any particular scenario, the modeling capability we have, as part of our enterprise risk management analysis, enables us to look at a range of options depending on see, how sensitive a particular scenario returns might be to changes in the assumption. So we're trying to do that that really comprehensive and thorough. Look all, what the backdrop of, again, this is a business that we've been in a long time, we think we understand that as well or better than anybody else in it, so we've got that going for us, we've got all our customers I mentioned earlier trying to make the best decision as we analyze all these options.

Ed Spehar
Bank of America-Merrill Lynch

Thank you.

Operator

And our last question comes from Mark Finkelstein of Macquarie with a follow-up

Mark Finkelstein
Macquarie

Thanks. This is a little bit of a philosophical question on the health side. And you may defer the question, which is fine. But I guess if you were forced today to kind of underwrite excluding pre-existing conditions, I know that doesn't go into place till 2014, but would you be able to do that without a degree of certainty you're getting at least close to right, knowing the data that we have today, that's my first question? The second question is again, we don't have great transparency around this, but do you think that the penalty that's been put in place or at least discussed on the individual side, not even withstanding whether it gets enforced or not, that's a whole another issue, but do you think that the penalty for non-compliance with the rule is enough to compel the risk group to be a cross section as you'd kind of need it to be?

Rob Pollock

Right, okay, so pre-ex, the two hours length, right, so, pre-ex is not an issue if everyone's in the same and we can deal with that as you point out the real issue comes when people can selectively enter or exit. We know a number of markets, we have history in Maine, Massachusetts, New York, New Jersey to evaluate what happens when people can opt in and out of the market which I think is a whole point you're raising around the penalty. I think it's certainly an issue that continues to be voiced by lots of players and things that if you really want to make things work we're going to have to get tighter here. So we can deal with pre-existing, we're going to have to see how all the regulations ultimately unfold to figure out if the penalty is enough to provide protection there. And we'll do all that. Again, early stages not sure quite how all this works, we do have models to look at in markets, where these kind of practices have been in place. So to me this all just points out that we have the ability to pivot and respond quickly to changes we've done it in the past, we will continue to do so as we move forward.

Mark Finkelstein
Macquarie

Okay, alright, thank you.

Rob Pollock

In closing, while we see encouraging signs in the economy, we are not content to wait for a full recovery. We have initiated actions to create opportunities for growth and to increase profitability. We are pleased with the new business momentum we are building. Our cost saving measures we have implemented will yield benefits in 2010 and going forward. And our strong capital position improves our flexibility to build shareholder value for the long-term. Thanks for your interest today. We look forward to updating you on our Q2 2010 performance.

Operator
This does conclude Assurance Q1 2010 Conference Call. We thank you for your participation. You may now disconnect.