S&P Global
Market Intelligence

Markel Corporation NYSE:MKL

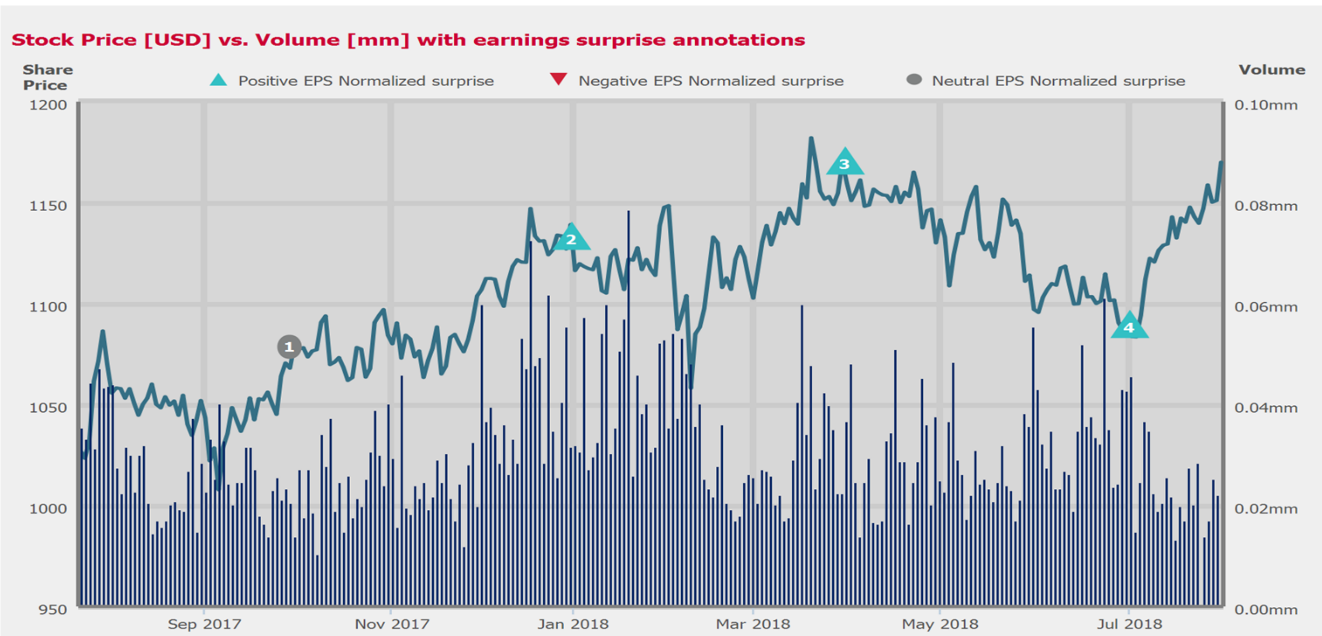
FQ3 2018 Earnings Call Transcripts

Wednesday, October 31, 2018 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2018-			-FQ4 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	7.05	5.20	(26.24 %)	10.38	36.79	39.79
Revenue (mm)	1721.24	2235.95	29.90	1727.94	6988.24	7303.52

Currency: USD
Consensus as of Oct-22-2018 11:59 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2017	(16.97)	(16.74)	NM
FQ4 2017	4.15	6.34	1 52.77 %
FQ1 2018	8.97	11.03	2 22.97 %
FQ2 2018	8.52	9.11	3 6.92 %

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Call Participants

EXECUTIVES

Jeremy Andrew Noble
Senior VP & CFO

Richard Reeves Whitt
Co-CEO & Director

Thomas S. Gayner
Co-CEO & Director

ANALYSTS

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

John D. Fox
Fenimore Asset Management, Inc.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good morning, and welcome to the Markel Corporation Third Quarter 2018 Conference Call. [Operator Instructions]

During the call today, we may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may differ materially from those contained in or suggested by such forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is included under the captions Risk Factors and Safe Harbor and Cautionary Statement in our most recent annual report on Form 10-K and quarterly report on Form 10-Q. We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures in the Form 10-Q, which can be found on our website at www.markelcorp.com in the Investor Information section. Please note, this event is being recorded.

I would now like to turn the conference over to Tom Gayner, Co-Chief Executive Officer. Please go ahead.

Thomas S. Gayner
Co-CEO & Director

Good morning. My name is Tom Gayner, Co-CEO of Markel. And it's my pleasure to welcome you to our third quarter 2018 year-to-date conference call. Along with my co-CEO, Richie Whitt, joining us today is our Chief Financial Officer, Jeremy Noble, in his first conference call in his new position. Richie and I are pleased to welcome Jeremy in his new role with Markel, as he returns to Richmond following his stint in an operating role in our U.K. operations. Richie and I are both delighted with the perspective and operating experience that Jeremy brings to the CFO role, and we hope that this is his first conference call among many.

The purpose of these calls is to share with you the results we just reported and to provide you with some commentary about the state of our underlying business at Markel. We hope to convey some sense of how we're doing, our prospects and our outlook. Also, we hope these calls provide a forum to answer your questions and to respond to whatever issues are on your mind.

As to highlight some headlines, I'd like to start off by updating a statement I made in our 2017 annual report letter. In that letter, I stated that 2017 stands as a transformative and watershed year for Markel. Let me update that statement to say that the transformation and watershedding we referred to in 2017 continue in 2018.

Our announced acquisitions of Nephila, to our growing and market-leading insurance-linked securities activities; and Brahmin to our Markel Ventures operations, along with the growth and continuous retooling and refinement of our existing operations, all stand as examples of how we continue to work towards our goal of building one of the world's great companies.

Jeremy will share the numbers with you in a minute, but qualitatively, I will assert that they were good, and that they reflect substantive economic progress with your company. Everything happening at Markel is pointed in the same direction. Our 3 diversified engines of insurance operations, investments and Markel Ventures would graph out as up and to the right, and we're excited about our ability to do even more.

At this point, I'll turn the call over to Jeremy to review the financial results. Richie will follow with some comments about our insurance operations and then I'll return to cover our investment activities in Markel Ventures, followed by your questions. With that, Jeremy?

Jeremy Andrew Noble
Senior VP & CFO

Thank you, Tom, and good morning, everyone. Our comprehensive income for the first 9 months of 2018 reflects contributions from all 3 of our engines and demonstrates the value of having diversified operations. Our underwriting operations produced an underwriting profit despite catastrophe losses during the period. Our Markel Ventures operations continue to make significant contributions to our overall results. With our investment portfolio, 2018 reflects strong performance in our equity portfolio year-to-date, while our fixed income portfolio was unfavorably impacted by rising interest rates.

Total operating revenues grew 32% to $5.8 billion in 2018. The increase was primarily attributable to a 54% increase in revenues from our Markel Ventures segment, a 12% increase in earned premiums from our underwriting operations and $408 million of net investment gains for the first 9 months of 2018.

Starting with our underwriting results. Gross written premiums were $4.5 billion for the first 9 months of 2018 compared to $4.1 billion in 2017, an increase of 9%. The increase in gross premium volume was attributable to the contribution of premium from our new collateral protection business, which we acquired in November of last year and our new surety business acquired in May of 2017. We also saw organic growth across most lines within our insurance segment.

Year-to-date, retention of gross written premiums decreased from 84% in 2017 to 83% in 2018. This decrease was driven by lower retention on our personal lines business within the insurance segment and our property product lines within the Reinsurance segment. Earned premiums increased 12% to $3.5 billion for the first 9 months of 2018 due to higher written premiums in our insurance segment.

Our consolidated combined ratio for the first 9 months of 2018 was a 94% compared to a 108% last year. The 2018 combined ratio included underwriting losses of $76 million, net of reinstatement premiums, from Hurricane Florence and Typhoon Jebi or 2 points on a consolidated combined ratio. The 2017 combined ratio included underwriting losses of $503 million, net of reinstatement premiums from Hurricanes Harvey, Irma, Maria and the earthquakes in Mexico or 16 points on a consolidated combined ratio. Excluding the impact of catastrophe losses in both 2018 and 2017, our combined ratio was flat to prior year.

Next, I'll cover the results of our Markel Ventures segment. Revenues for Markel Ventures for the first 9 months of 2018 increased to $1.4 billion compared to $933 million a year ago. The increased revenues were primarily attributable to Costa Farms, which we acquired in August of 2017 as well as higher sales volume in both our products and services businesses.

Operating income for Markel Ventures was $60 million for the first 9 months of 2018 compared to $71 million last year. EBITDA was $128 million for the first 9 months of 2018 compared to $121 million last year. In 2018, operating income and EBITDA were both impacted by expenses related to an investigation and remediation associated with the manufacture of products of one of our businesses and impairment charge related to intangible assets of this reporting unit. These expenses were partially offset by the contributions of operating income and EBITDA attributable to Costa Farms in 2018.

Turning to our investment results. Net investment income increased from $304 million for the first 9 months of 2017 to $320 million this year. The increase was driven by short-term investment income, primarily due to higher short-term interest rates. Net investment gains included in that income were $408 million for the first 9 months of 2018 compared to net investment losses of just under $2 million in 2017. Net investment gains for 2018 included $417 million of pretax gains attributable to the increase in the fair value of our equity portfolio.

As a reminder, effective January 1, 2018, all changes in the fair value of equity portfolio are included in net income rather than in other comprehensive income.

Net unrealized investment gains decreased $384 million during the first 9 months of 2018, reflecting a decrease in the fair value of our fixed maturity portfolio, resulting from rising interest rates. In our long-term focus, variability in the timing of investment gains and losses is to be expected.

Now if we take a look at our total results for the year, our effective tax rate was at 32% in both 2018 and 2017. As previously discussed, the impact of our decision to elect and treat 2 of our U.K. subsidiaries as U.S. taxpayers beginning in 2018 added $102 million or 11% to the 2018 effective tax rate. Our estimated annual effective tax rate, which excludes this impact, was 20% in 2018 compared to 28% in 2017. The decrease in estimated annual effective tax rate was primarily attributable to the decrease in the U.S. corporate tax rate from 35% to 21% as a result of the tax reform legislation enacted in the fourth quarter of 2017.

We reported net income to shareholders of $623 million for the first 9 months of 2018 compared to a loss of $40 million a year ago. Comprehensive income to shareholders for the first 9 months of 2018 was $305 million compared to $546 million a year ago. Comprehensive income for the period was driven by net income, the components of which I just discussed, which was partially offset by the decline in the fair value of fixed maturities since the end of 2017.

Finally, I'll make a few comments on cash flows, capital and our balance sheet. Net cash provided by operating activities was $763 million for the first 9 months of 2018 compared to $599 million for the same period of 2017.

Operating cash flows for 2018 reflected higher net premium collections, lower payments for employee profit sharing and income taxes compared to the same period of 2017. 2018 also included higher claims payments, driven in part by the 2017 catastrophe losses.

Invested assets at the holding company were $3.1 billion at the end of September, up from $2.7 billion at December 31, 2017. The increase in invested assets is primarily due to dividends received from certain of our U.K. subsidiaries. We are well positioned to fund our acquisitions of both Brahmin and Nephila from resources on hand. Total shareholders' equity stood at $9.8 billion at the end of September.

And now I'll turn it over to Richie who will talk more about our underwriting results.

Richard Reeves Whitt
Co-CEO & Director

Thanks, Jeremy. Good morning, everyone. Today, I'll focus my comments on the underwriting operations. I will also provide brief updates on State National and our Markel CATCo operations and provide a little bit of color on our pending acquisition of Nephila.

First, I'll start with our insurance segment. Gross return premiums for the quarter were up $150 million or 14% compared to third quarter of 2017. On a year-to-date basis, writings are up to $454 million or 15%.

The -- as Jeremy said, the acquisition of Markel surety and the State National collateral protection line added $51 million of premiums in the quarter and $171 million of premiums on a year-to-date basis. Premium growth for both the quarter and on a year-to-date basis, excluding these newly acquired product lines, was driven by organic growth in our general liability, professional liability and personal lines, product lines.

Earned premiums for the segment were up 14% for the quarter and 16% on a year-to-date basis for similar reasons to the gross written premium increases. The combined ratio for the insurance segment was 96% for the third quarter of 2018 compared to 119% last year. The 23 point decrease in the combined ratio was largely driven by lower cat losses in 2018 compared to 2017. Cat events added 4 points to the 2018 year-to-date combined ratio compared to 31 points in 2017. The remaining change in the combined ratio was due to a decrease in favorable development on prior accident year losses and a slightly lower expense ratio. The prior accident year loss ratio was also unfavorably impacted by the growth in earned premiums.

The expense ratio decreased due to benefiting from growth in earned premiums, partially offset by higher profit-sharing expense. The year-to-date combined ratio for the insurance segment was 92% versus 101% for the same period last year. A 9-point decrease in the combined ratio was again largely driven by lower cat losses in '18 versus '17. Cat events added 1 point year-to-date for 2018 compared to 11 points in 2017. The remaining change in the combined ratio was due to slightly higher favorable development on prior accident year losses and a decrease in the attritional loss ratio.

The decrease in the attritional loss ratio was attributed to decreases across multiple lines, including the impact of our recent acquisitions. Those lines of business carry a lower overall loss ratio than our average portfolio loss ratio, partially offset by higher attributable losses in our marine and energy product line. The benefit from the increase in favorable development on prior accident year losses was reduced due to the impact of higher earned premiums.

Next, talk about the Reinsurance segment a bit. Gross written premiums for the quarter were up $4 million or 2% compared to third quarter of 2017. On a year-to-date basis, writings are down $90 million or 9%. The increase in gross written premium in the quarter was due to higher premium volumes in our general liability product line due to timing of renewals on multiyear contracts and that was offset by the impact of higher assumed reinstatement premiums on the cats in 2017.

The decrease in gross written premium on a year-to-date basis was driven by a large specialty quota share entered into in the first quarter of '17 that did not renew in 2018, along with a decrease in our property lines due primarily to nonrenewals.

We've nonrenewed marginal property business where rates and/or terms did not improve sufficiently to meet our profitability targets. As mentioned in previous quarters, significant volatility in gross written premium volume can be expected in our Reinsurance segment due to individually significant deals and timing of renewals on multiyear contracts.

Earned premiums for the segment decreased by 13% for the quarter and 2% on a year-to-date basis due to the impact of assumed reinstatement premiums in the third quarter of '17. The combined ratio for the Reinsurance segment was 115% for the third quarter of '18 compared to 183% for the same period last year. The 68-point decrease in the combined ratio was driven by lower cat losses in '18 compared to 17.

Cat events added 16 points in the third quarter of '18 compared to 95 points in '17. The decrease in losses from cat events was partially offset by a higher attritional loss ratio due to higher losses in our whole account product line, less favorable development on prior year losses in our property and general liability product lines and higher expense ratio, largely due to reinstatement premiums from the 2017 cat events.

The year-to-date combined ratio for the Reinsurance segment was 100% compared to 135% last year. 35-point decrease in the combined ratio was primarily driven, again, by lower cat losses in '18 compared to '17. Cat events added 5 points year-to-date compared to 34 points in 2017.

The Reinsurance segment's 2017 results also included $85 million or 12 points on a year-to-date segment combined ratio of adverse development on prior year loss reserves due to the decrease in the Ogden rate. Excluding the impact of Ogden, the segment had less favorable development in '18 compared to '17 due to adverse development on our property reinsurance lines compared to favorable development in these lines last year. This went along with less favorable development in our whole account and general liability lines this year.

The adverse property experience in '18 was driven by $18 million of adverse development on the 2017 cat events. Year-to-date in total between our insurance and reinsurance segments, we've had to increase reserves for the 2017 cat events by only about $1.7 million.

Next I'll make a few comments about State National. As a reminder, the State National business is comprised of 2 products, the collateral protection insurance coverage, results for which are included in our insurance segment; and a fronting platform, which provides insurance licenses, rated paper and services for a fee. We refer to this business as our program services business. This business is almost entirely nonrisk bearing to Markel and is reported separately from our underwriting operations.

The collateral protection insurance, acquired as part of State National, contributed $51 million of earned premiums in the quarter and $138 million on a year-to-date basis, and those are included in the insurance segment operating results -- excuse me, those are gross written premium numbers.

The program service business added $561 million of gross written premium in the quarter and $1.6 billion in the first 9 months. The business -- this business is a fee business and contributed ceding commission fee revenue of $23 million in the quarter and $67 million during the first 9 months of 2018. These amounts are reported in other revenues within our operating results. We are very pleased with our year-to-date results at State National. They are bang on the forecast they gave us back at the time of the acquisition.

Next, I'll talk a little bit about Markel CATCo. Assets under management, including funds held that would be used to settle claims for incurred losses, increased to $6.6 billion at September 30, 2018. This was up from $6.1 billion at the end of '17.

Markel CATCo's third quarter '18 total revenues were $18.3 million compared to $1.2 million in the third quarter of '17. The third quarter of '17 had to be adjusted for performance fees that were forfeited as a result of cats in 2017.

For the 9 months of 2018, total revenues were $53 million compared to $19.9 million in 2017. In terms of Markel CATCo's progression, management fees are well ahead of whatever expectations would have been at the time of acquisition, obviously, as a result of this significant growth in AUM that we've had over the 3 years since the acquisition.

As of September 2018, Markel's investment in the Markel CATCo funds was approximately $134 million. We recognized the gain of $2 million in the quarter and a loss of $49 million on a year-to-date basis due to decreases in the net asset value of the funds due to adverse development on the 2017 cat events.

Our investment in the CATCo funds, we largely look at that. It's pure cat risk. And then, we think of it in terms of our overall cat aggregate as opposed to -- while it shows up in the investment lines, you should think of it as part of our cat underwriting results. The adverse development was primarily related to Hurricane Irma, as a result of significant reported increases in loss adjustment expense, late claims reporting and increased Caribbean loss estimates.

Next, I'll discuss our pending Nephila acquisition. Over the decades at Markel, we built both organically and by adding talented teams to enhance our specialist capabilities. Continuing this transition, we look forward to closing the Nephila acquisition hopefully before the end of the year and quite honestly hopefully well before the end of the year.

Nephila is the preeminent insurance-linked securities manager in the world. They bring deep and long-term investor relationships, energy, creativity and innovation in matching investor risk appetites with client needs. Nephila has over $12 billion of assets under management for over 300 geographically diverse investors.

We believe that adding Nephila's unique capabilities and scale to our specialty insurance and Reinsurance, State National and Markel CATCo capabilities is a game changer. We look forward to working with Frank Majors, Greg Hagood and the entire Nephila team to bring an even broader range of solutions to our insureds and production partners. We also look forward to bringing new, attractive investment opportunities to our Nephila and Markel CATCo investors. This is only the very beginning. Please stay tuned.

Last, just some brief market commentary. There is really not a whole lot new to talk about in the last 3 months. The market remains competitive. But we are -- we continue to achieve modest single-digit rate increases in many of our lines of business. It will be interesting to see if this year's catastrophe losses has any impact on the rating environment. Even with lower catastrophe losses this year, 2018 is still shaping up to be another unprofitable year for most property writers, and this is due to poor attritional results.

2018, at least to this point, has not been a particularly heavy cat year. In fact, it probably would be a little bit below average at this point, and yet, I would suggest most people are probably very disappointed with the property results. We continue to push for rates where needed and have shed business we believe do not meet our profitability goals.

With that, I'd like to turn it over to Tom. Thank you.

Thomas S. Gayner
Co-CEO & Director

Thank you, Richie. Good morning. I'm pleased with our investment results for the first 9 months of 2019. In our equity portfolio, we earned 9%; and in fixed income, we were down 0.4%. Our total return, after all FX adjustments as well as the returns from the ILS activities were -- are included in our investment results, was a positive 2.1% through September 30.

My main takeaway from our investment activities is that we continued our steady as she goes approach and process in our investment choices. We stick -- stuck to our guns of our 4-part strategy of investing in profitable businesses with good returns on capital and modest debt, with management teams with equal measures of talent and integrity, with reinvestment opportunities and fair prices.

Our total publicly traded equity portfolio now stands at 66% of shareholders' equity compared to 63% at year-end and that reflects our steady methodical purchasing throughout the year of equities that met our 4-part test. That ratio also moved up a bit due to the decline in the valuation of the fixed income portfolio. At a 66% exposure, we continue to participate in the long-term economics and growth of the underlying businesses our common stock portfolio represents, but we also have ample liquidity and a margin of safety to absorb normal market volatility and keep buying.

As we've all seen in the trick-or-treat month of October, we've had the trick part of lower overall stock prices, and we've been able to enjoy the treat part of continuing to invest in quality companies at lower and more attractive prices. That volatility and our behavior in the face of that are nothing new. Our consistency amidst the varying conditions helps us to earn the significant returns that we've earned over the years. We will continue to act in a disciplined and consistent manner.

On the fixed income side, I'm pleased to report that the decline in market valuation was entirely attributable to the increase of interest rates and mark-to-market map. There were no credit issues in the portfolio. As we've said before, we keep our duration roughly matched to the duration of our insurance liabilities and between 4 and 5 years. Including cash, the duration is roughly 4.25 years, and we don't expect it to get too much lower than that.

With rising interest rates, recurring interest income is starting to increase. Additionally, growing dividend streams from our high-quality equity portfolio continue to drive increases in recurring investment income. For the first 9 months of 2019, net investment income rose from $304 million to $319 million, as a result of these factors.

At Markel Ventures, total revenues grew to $1.4 billion compared to $936 million a year ago. While reported EBITDA grew only modestly to about $130 million compared to about $128 million a year ago, there were approximately $62 million of nonrecurring charges in the 2018 number from the unpleasant factor of goodwill write-offs and charges and the good factor of payments of performance-based earn-out agreement.

In aggregate, the Markel Ventures companies continued to perform in line with our expectations, and the recurring EBITDA margins for 2017 and 2018 for the group stood steady at slightly more than 13%. While that percentage will change in different environments, I think that the stability in that percentage year-over-year begins to describe the normalized earnings power of the Markel Ventures groups of companies.

I'm also pleased to report that we did indeed close on our Brahmin acquisition on October 1, and we're excited to welcome the Brahmin group into the Markel family. Brahmin's stance is a great entrepreneurial success story, and we look forward to their continuing growth and buildup of the Brahmin brand and product line. I hope you'll head the brahmin.com yourself, shop and purchase a quality bag. They have products for men and women. And I'll share with you that my wife and I are both happy customers, and that we paid full retail price for our purchases after the October 1 close.
With that, I'd like to open the floor for questions. Allison?

Question and Answer

Operator

[Operator Instructions] Our first question today will come from Mark Hughes of SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

The attritional losses in Reinsurance, I think, they were up a little bit in the quarter. Would you expect them to continue at the kind of the higher end of the recent range?

Richard Reeves Whitt
Co-CEO & Director

Mark, I think some of that is mix. If you kind of parsed my comments, we've been shrinking property business just given kind of the rate environment this year, and we've been -- actually been growing some in professional and general liability, and those 2 would carry a higher loss ratio than the property loss ratio. So I think most of that would be mix. And if we continue kind of on that path, which, at least, at the moment I think it's probably the path we would be on. Yes, we probably be a little bit higher in terms of the attritional.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And also on Reinsurance, I think you had some adverse in the general liability product line, that's clearly offset elsewhere. But anything going on there? Any commentary on inflation, anything like that?

Richard Reeves Whitt
Co-CEO & Director

Well, I think we've seen some development, actually some of it going all the way back to the credit crisis in GL. So GL is very long tail, and we never like to have adverse development, but I guess, it wouldn't be surprising to see it. We're working hard to make sure we're on top of that. In terms of commentary on GL trends today, I think I said it last quarter, I mean, I think we're starting to see the evidence of potential inflation in the overall economy that will find its way through to losses -- cash with the professional losses. And we're also seeing over the years some rollback in terms of tort reform. So we are planning for -- in terms of our business plans, we're planning on seeing more trend -- more claims trend in the lines.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then finally, how should we model the tax rate going forward? I know the U.K. impacted brought the number into the low 30s. On a go-forward basis, what sort of number should we use?

Jeremy Andrew Noble
Senior VP & CFO

Yes. Actually, post-tax reform and some of the elections that we made with regards to our U.K. subsidiaries and treating those as U.S. taxpayers for U.S. tax purposes kind of simplifies a lot of that tax rate differential associated with one operation. So Mark, I would really suggest, take the effective tax rate at 21% -- sorry, take the U.S. statutory tax rate at 21%, and you should think of the normalized period, our effective tax rate will come in slightly lower than that. Some of that differential being linked to things like tax-exempt investment income, but slightly under 21%, the U.S. statutory tax rate.

Operator

Our next question today will come from Jeff Schmidt of William Blair.

Jeffrey Paul Schmitt

William Blair & Company L.L.C., Research Division

Looking at the State National program services business, it looks like fronted premiums there are up about 25% year-to-date, 26%. Where are you seeing that growth? And how sustainable is that?

Richard Reeves Whitt
Co-CEO & Director

Some of its growth in existing programs, Jeff, and then some of it's the pipeline of programs that they're constantly working on to bring on to the platform. So yes, they -- I don't have papers in front of me to -- 25%. I know it's pretty solid growth. We would hope to continue to grow. The pipeline remains full. It's State National. The model -- I think the need for the model is strong, particularly with the growth of ILS and other models in terms of accessing insurance risk. So I don't know if 25% is the right number, but we believe growth should continue to be strong.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And then, looking at the ceding fees there. I guess, historically, they looked to be about 5% to 6%. But since the deal, I guess, year-to-date, it looks to be like it's in the low 4s. Is there -- is that right? And what may be driving that?

Richard Reeves Whitt
Co-CEO & Director

Again, I don't have the numbers right in front of me. Yes, I think the fees can range anywhere from probably 4% to 6%. Obviously, the bigger the program become, we have some flexibility to offer some discount for scale or some -- but in terms of -- it might just be the growth and the onlining of new programs that would be depressing that number a little bit at this point.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And one last one on Nephila. It sounds like that should close fairly soon. Would that be integrated with CATCo? I mean, are there some benefits there? Would that be run separately?

Richard Reeves Whitt
Co-CEO & Director

They will be run separately. The products are different enough and the teams are very -- are focused -- their investor bases are actually pretty different as well. So they will continue to be run separately. There will be strong collaboration between our insurance and Reinsurance operations, CATCo, Nephila and State National. And in fact, there are already quite a bit of business happening between those various entities even before the acquisition of Nephila. We would expect that to increase after we close the deal.

Operator

Our next question will come from John Fox of Fenimore Asset Management.

John D. Fox
Fenimore Asset Management, Inc.

I have a number of questions. First for Jeremy, expense ratio was up a little bit and that was also up in the June quarter. Is there anything going on there interesting? Or is that just cost of business going up?

Jeremy Andrew Noble
Senior VP & CFO

Yes. Some of that could be down to mix, and we still have some of -- the sort of the way the acquisition costs come through in the expense ratio. Profit sharing is more significant component of the expenses in 2018 versus 2017. That creates some of the variability particularly in the quarter year-over-year because clearly we have the impact of the catastrophes last year. So there's not a lot of additional sort of news, if you will, in the expense ratio. I kind of link it to mix, acquisition cost and profit-sharing movements.

John D. Fox
Fenimore Asset Management, Inc.

Okay, great. And then, does anyone have any insights on Hurricane Michael versus Florence, if you want to talk about industry-wide? Is it higher, lower, anything you can share with us there?

Richard Reeves Whitt
Co-CEO & Director

Well, John, I don't know if you've had a chance to see the Q yet, but we did put a range in there. It's still pretty early days, and we put a range of $60 million to $120 million net. I think most people would believe, including the modeling firms that Michael is a bigger event than Florence. And Michael is going to be more of a wind event. Whereas, Florence was more of a flood event, not as much flood is covered as wind. So I think in terms of insured losses, Michael will likely be larger. We -- still very early days and it hit as either a 4 or even potentially a 5, I don't know. They've been looking at that. So just given the magnitude of the storm and how deep, I mean, it was still blowing pretty hard when it got to Virginia because it came right over us, so we can tell you that. I think it's going to take a while to get a handle on those numbers.

John D. Fox
Fenimore Asset Management, Inc.

Okay. No, that's great. Richie, since I have you on the line, the program services, you mentioned the amounts and they're in the other display in the Q. Are there expenses that go against that? You gave the revenue figures. Or is that -- because if that's commission, that really just falls to the bottom line?

Richard Reeves Whitt
Co-CEO & Director

No, no. There is definitely expenses. I just was kind of trying to highlight the revenue kind of trajectory there. But clearly, we have expenses that go against those fees, and you can see those in the segment disclosures.

John D. Fox
Fenimore Asset Management, Inc.

Okay. So that's in other, other.

Richard Reeves Whitt
Co-CEO & Director

It's in other, other. Yes.

John D. Fox
Fenimore Asset Management, Inc.

Okay. Got it. And on Nephila, probably for Tom. Tom, business model-wise, should we think about that like an asset management business that goes in the other segment or the fee on the assets and then corresponding expense and we should think about it like that is a multiple of EBITDA-type business. Is that the right way to look at it or not?

Thomas S. Gayner
Co-CEO & Director

Yes.

Richard Reeves Whitt
Co-CEO & Director

Yes.

John D. Fox
Fenimore Asset Management, Inc.

Okay. Thank you for the complete answer. Well, my last question -- yes, go ahead.

Richard Reeves Whitt
Co-CEO & Director

I was just going to -- I'll add to that. I mean, like...

John D. Fox
Fenimore Asset Management, Inc.

There is no need, but go ahead.

Richard Reeves Whitt
Co-CEO & Director

It was pretty clear. Obviously, it's both. I mean, in terms of our economic participation in it, it's a fee business. But what we're doing -- what the business is doing is, I mean, it's selling underwriting acumen for a fee. So I look at it -- while our economics in the business are obviously fees, it's still an underwriting business. And we want to make sure we do a good job underwriting for those investors.

Thomas S. Gayner
Co-CEO & Director

And John...

John D. Fox
Fenimore Asset Management, Inc.

Yes. I mean, when I -- you can confirm or deny this. When I think about your cat exposure, I think about insurance, reinsurance, your investment in CATCo fund and then the stream of income you get from CATCo over time, which is when the cat goes down. Is that the right way to think about it?

Richard Reeves Whitt
Co-CEO & Director

Yes, yes. No, there's 2 components. The management fee does not -- is not as impacted. Performance fees are, obviously, highly impacted by catastrophe.

Thomas S. Gayner
Co-CEO & Director

And John, let me add to Richie's comments both in his early remarks plus his response. As he said, this, along with CATCo and State National and Nephila, I mean, I'd say that's a hat-trick. And the collection of the 3 really is indeed a game changer for Markel. And the addressable market of what it is that we can underwrite is bigger than it used to be. So yes, you think about it like an underwriter, and frankly, we think about our investments the way an underwriter would risk reward. But the addressable market is bigger than what we have previously looked at which is one of the underlying aspects of why we're so excited about this.

John D. Fox
Fenimore Asset Management, Inc.

Okay, great. My last question is with the 2 deals over $1 billion. I know you have a lot of cash to the holding company, but do you anticipate issuing any debt to close these deals?

Thomas S. Gayner
Co-CEO & Director

No, no. There's -- we earlier said, we have access to $3 million at the holding company, after that sitting in sort of cash in short term. We've already closed the Brahmin deal on the 1st of October, and we've got excess capital to -- from resources on hand to close Nephila.

Operator

Our next question will come from Scott Heleniak of RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

First question is just on the Nephila acquisition. Can you talk about the growth opportunities you're going to have there in ILS, once those 2 come together or maybe some of the growth -- I know you mentioned they are kind of standalone and have different business units, but -- or strategies. But could you talk about how they -- how those might kind of work together and the opportunities for growth that you'd have together as opposed to standalone companies?

Richard Reeves Whitt
Co-CEO & Director

Sure. One of the things that we're very -- I mean, there's a number of things we're very excited about. And in fact, we started getting the teams together to talk about what the opportunities set might look like in anticipation of the close. We want to be ready to fire off the starting line as soon as it does close. Obviously, we manage for our shareholders roughly $10 billion in capital. And then, through Nephila and Markel CATCo, we manage another almost $20 billion in capital for our investors. There is just so many more opportunities that we can address with $30 billion of capital than we could with $10 billion of capital. And so I think in terms of the solutions we can offer to our insureds and to our production partners, it's just -- it's so much larger. It's a complete game changer in that regard. State National and Nephila already worked together previously. We would expect that relationship to continue to grow and probably grow at a faster rate, now that we're all part of the same family. Distribution, I mean, we can, through our insurance and reinsurance operations, offer access to distribution to both Nephila and CATCo that they might not have previously had. And then, kind of looking at it from the other side of the coin, the investor universe. Both of these companies, CATCo and Nephila, are very adept at going out and raising capital. They present a very appealing investment proposition to investors, and they have penetrated that market very well. But as we all know that is a huge addressable market. So we're looking at it from both sides. There's a lot more risk in this world that can be insured. And there's a lot more investable capital out there that could be put against those risks. So we look at both sides of it and the opportunity, we quite honestly believe, is massive.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. That's good comprehensive answer. One other quick one along those lines, too, is other lines, there's been discussion. I think Willis put out a paper about Iowa shifting to other kind of non-property lines, cyber, liabilities. Could that be in the mix as well?

Richard Reeves Whitt
Co-CEO & Director

Yes. I think that -- I think everybody has been looking for that to happen at some point. Nephila has already moved to primary in terms of property. So they do both reinsurance and primary now. And I think that will go along a continuum. You probably won't see the next thing being excess workers' comp. It would probably be something more closely aligned with property, shorter tail. Cyber, as an example, is something that people are looking at. But I think that will develop over time. And I do believe shorter tail, Casualty will find its way into the ILS markets before too long.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. Just switching gears to the Hurricane Michael, just a couple of quick ones on that. I appreciate the loss guidance. Do you have any sense on where those might split out by unit, the percentage mix, reinsurance versus insurance, where you're going to see kind of a heavier loss total? Or is it sort of split down the middle?

Richard Reeves Whitt
Co-CEO & Director

That's really hard to say right now. We're still polling our divisions for their estimates at this point. So I couldn't give much insight to that.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then, just one last follow-up too on Michael. Was there any significant impact to Costa Farms from Hurricane Michael that might show up in Q4?

Thomas S. Gayner
Co-CEO & Director

No. We're specializing in one-word answers today.

Operator

And our next question today will come from Bob Farnam with Boenning and Scattergood.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

So the Brahmin deal, it sounds like you get a full fourth quarter out of them. So how do you see the revenue playing out in terms of maybe sort of the fourth quarter end for the full year?

Thomas S. Gayner
Co-CEO & Director

Yes. There will be some seasonality, and obviously Christmas is an important time of the year for them, but it's not a massively seasonal business.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Okay. And any ballpark in terms of an annual revenue target?

Thomas S. Gayner
Co-CEO & Director

No, we're not talking of breaking that out separately at the moment. It depends on how much you buy?

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Yes. So it sounds like the collateral protection business is going according to plan. How about the new surety business? Is it too early to tell how that business is performing relative to your expectations?

Richard Reeves Whitt
Co-CEO & Director

No, I probably should have mentioned that. It's -- again, this is kind of strange, all 3 of those are pretty much bang on the projections or forecast they would have given us back at the time of the acquisitions.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Okay. Any impact from the economy? Will that have much of an impact on the surety book, do you see?

Richard Reeves Whitt
Co-CEO & Director

Well, not so far, and I'm going knock on the table. But obviously, when the economy starts to run into headwinds, that tends to show up in the surety market. But our guys are -- they're veterans. They are veterans and they understand the cycle that goes into surety and they understand that very close connection it has to the economy and to the construction market. So they are prepared, I guess, that's what I'd say.

Operator

Ladies and gentlemen, this will conclude our question-and-answer session. At this time, I'd like to turn the conference back over to Tom Gayner for any closing remarks.

Thomas S. Gayner
Co-CEO & Director

Thank you very much. Thank you for joining us, and we'll chat with you next quarter. Thanks.

Operator
The conference has now concluded. We thank you all for attending today's presentation. You may now disconnect your lines.