S&P Global
Market Intelligence

W. R. Berkley Corporation NYSE:WRB

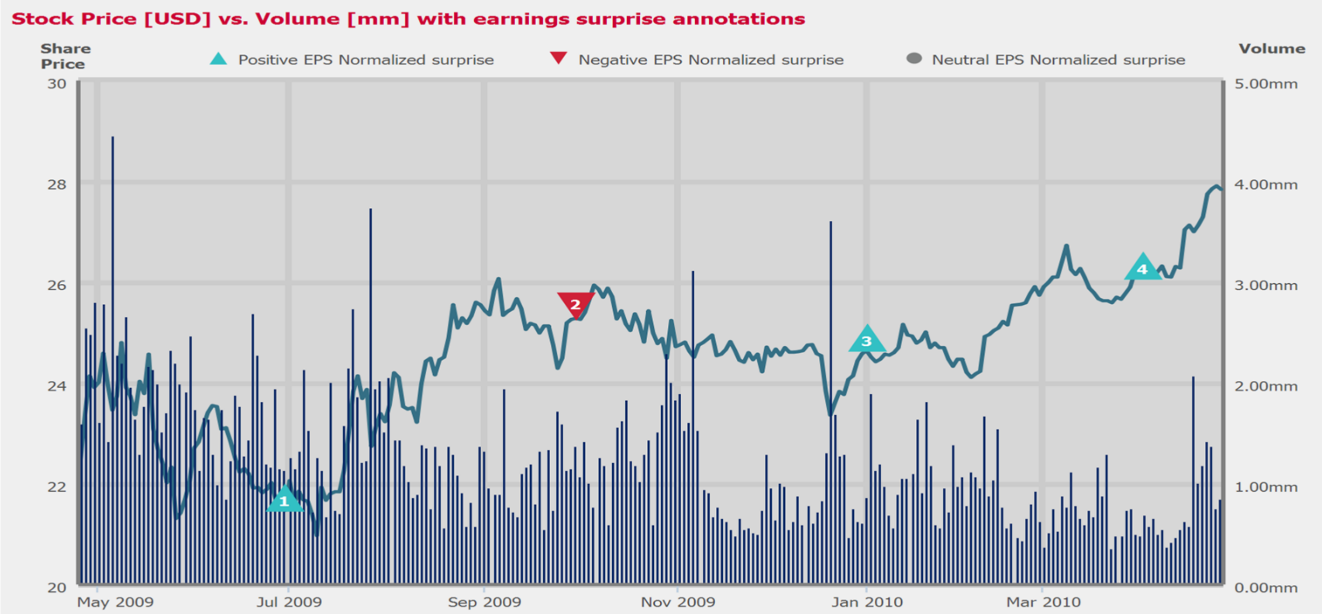
FQ2 2010 Earnings Call Transcripts

Tuesday, July 27, 2010 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.62	0.65	▲4.84	0.63	2.64	2.63
Revenue (mm)	1127.15	1163.07	▲3.19	1137.21	4503.17	4603.58

Currency: USD
Consensus as of Jul-27-2010 12:11 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	0.58	0.60	▲1 3.45 %
FQ3 2009	0.65	0.57	▼2 (12.31 %)
FQ4 2009	0.67	0.71	▲3 5.97 %
FQ1 2010	0.65	0.70	▲4 7.69 %

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Call Participants

EXECUTIVES

Gene Ballard

Rob Berkley

William Berkley

ANALYSTS

Brian Meredith
UBS

Dan Johnson
Citadel

Doug McGregor
RBC Capital Markets

Greg Locraft
Morgan Stanley

Howard Schlenker
Schlenker & Company

Jay Cohen
Bank of America Merrill Lynch

Josh Shanker
Deutsche Bank

Keith Walsh
Citi

Larry Greenberg
Langen McAlenney

Meyer Shields
Stifel Nicolaus

Michael Nannizzi
Oppenheimer

Mike Grasher
Piper Jaffray

Robert Barnum
KBW

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day and welcome to the W.R. Berkley Corporation's Second Quarter 2010 Earnings Conference Call.

Today's conference is being recorded. </TAG>

The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words including without limitation, believes, expects, or estimates.

We caution you that such forward-looking statements should not be regarded as the representation by us that the future plans, estimates, or expectations, contemplated by us will in fact be achieved.

Please refer to our Annual Report on Form 10-K for the year ended December 31st, 2009 and our other filings made with the SEC for a description of the business environment in which we operate and the important factors that may materially affect our results.

W.R. Berkley Corporation is not under any obligation and expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of a new information, future events, or otherwise.

I would now like to turn the call over to Mr. William R. Berkley. Please go ahead, sir.

William Berkley

Good morning, everyone. First, we got to all let you know that this is a celebratory day, because it's Gene Ballard. And, therefore, after this call, we'll be all out on a birthday party for Gene.

Before I give you my views or whatever, we're going to with Rob, talking about the operating units and Gene is going to talk about the finances and then I'm going to give you my overview of where we stand and then take questions.

With that, I'll start and turn this over to Rob Berkley.

Rob Berkley

Thank you, good morning, everyone. Overall, the market conditions during the quarter remained challenging due to the headwinds that continued to exist, coming from both the general economy as well as in overall competitive marketplace.

Having said this, the good news is, that it appears as though pricing has generally bottomed out, payrolls and receipts are not eroding at the same rate they were in the past quarters, and consequently, the pace of written premiums is slowing. Additionally, there seems to be a glowing recognition amongst both carriers as well as the distribution system that the status quo is not sustainable.

Our price monitoring indicated that are our rates were down a modest 0.8% for the quarter. Furthermore, it is worth mentioning there are growing number of areas where we are achieving rate increases. Finally, for the first six months of the year, our renewal retention was running at about 80%.

Our net written premium for the quarter was $961 million, an increase of 5.8%, which was the first time that our net written premium has grown in almost four years. The growth came about predominantly from our startup. The international segment, led by our Lloyd's operation in particular stands out, but also, our companies in Brazil, Argentina, Norway, Hong Kong, Australia, and Canada has performed well.

The alternative markets division also contributed handsomely to the Group's growth over the three months. Our specialty and reinsurance business remains relatively flat with our regional business shrinking somewhat.

It is worth noting that while the net results of a segment maybe flat or negative, one should not misinterpret that. There may in fact be companies in those segments that are growing. Obviously, seeing this type of growth in parts of our business, given the environment, raises our antenna. However, it is worth commenting that we have a high level of confidence in the people managing these businesses and we remain comfortable with their risk selection and pricing.

Additionally, our rate monitoring and underwriting audits provide all interested parties with additional peace of mind. We strongly believe our growth has come about as a result of our customer focus team, their relationships and the financial strength and stability of the Group. Finally, I would remind you that we have started 19 businesses over the past few years. So this level of growth should not be surprising.

And, for the combined ratio for the quarter, which was a 94.4, which was comprised at a 60.2 loss ratio and a 34.2 expense ratio. The loss ratio was adversely impacted by storms as well as our exposure to Transocean, which in the aggregate added 3.4 points. The expense ratio improved by almost a point compared with Q1 and we expect this trend to continue.

Now, Gene, will take you through the details regarding the numbers. One additional comment from me on this topic is when he cuts through all of the moving pieces back and forth, it is our belief that we are currently running at a current accident year combined ratio of a 98. And if you add storms into that, it brings you to approximately at 101.

Having said this, it is certainly possible that we will outperform these numbers, given our ongoing philosophy of cautiously reserving the current year. As we observe the current market conditions, we can’t help but notice there are many parallels that are present between the existing environment and the market conditions the industry experienced in 2000. Obviously, one noticeable difference is available investment returns, which may very well apply additional pressure to the situations impact.

The Group continued to remain focused on maintaining underwriting discipline while simultaneously positioning ourselves with the inevitable change in the market. Finally, I would suggest that the growth the Group experienced in the second quarter is a fraction of what we expect under improved market condition.

Thank you.

William Berkley

Thanks Rob. Now, Gene, you want to take us through the numbers quickly. And, then, I’ll add probably two sentences.

Gene Ballard

Okay, thank you. And, thank you, for not mentioning which birthday this is as well. Good morning, everyone.

William Berkley

65.

Gene Ballard

Rob already took us through the change in premiums for the quarter. The only further details I have to add on that are the actual numbers for the startup company. The net premiums written for the companies, the recently started companies, by that, we mean the companies we started since 2006, were a $162 million in the quarter and that’s up 81% from $89 million in the prior year quarter. Most of that growth was - more than half of that growth was in the international segment. Startups overall now represents 17% of our premium volume for the quarter.

With regard to losses, our overall loss ratio was 60.2%, down 2.5 points from the second quarter of ’09. Favorable reserve development was $67 million or 7 loss ratio points in this quarter. That compares to 3.5

points in the prior year quarter. The majority of that favorable reserve development in 2010 was related to the specialty and regional segment and to the 2006 through 2009 accident years.

Storm losses were $30 million or 3 loss ratio points compared to 2.5 points in the prior year period. In addition, we incurred a net loss including reinstatement premiums of approximately $5 million for our share of the Deepwater Horizon loss. The expense ratio was 34.2, up 1.7 points from a year-ago. About seven-tenths of the expense ratio in a quarter was related to startup companies that for which the earned premiums have yet to reach sufficient scale to cover their fixed expenses. And, for the international segment, the impact of startup companies was actually 2.8 points.

On a calendar year basis, the overall combined ratio was 94.4, down one point from a year-ago. And, as Rob mentioned, on an accident year basis, the combined ratio was 101.5, including storms and 98.5 before the adds.

Net investment income was a $128 million, down $4 million from a year-ago. The decline was due to lower earnings from the arbitrage account which reported a profit of $1 million this quarter, compared to $7 million in the prior period. As a result, the annualized yield on the overall portfolio was 4.0% in the quarter compared to 4.3% in the prior period. Investment funds reported a small profit in the quarter.

State municipal bonds represents 41% of our overall portfolio at June 30th. We included a schedule of our state municipal bond portfolio in the earnings release this quarter that illustrates our continued focus on pre-refunded bonds, revenue bonds, and non-state general obligation bonds. As you can see on the schedule state obligation bonds, for the six dates that we presented, represent just 3% of the overall tax exempt portfolio.

As we've planned all along, we used all of our earnings in the first half of the year of $229 million to buyback treasury stocks, we bought back 5.1 million shares in the quarter and almost 9 million shares year-to-date, and that's nearly 6% of our outstanding shares at the beginning of the year. We also set aside cash at the holding company to repay a 150 million of debt that's maturing this September.

Our operating cash flow exceeded our earnings. Operating cash flow was a $130 million in the quarter. Our overall tax rate after giving effect to our tax exempt income was 24%. And the impact of foreign exchange rates on the quarter was not significant. Altogether, that gives us operating earnings of $0.65 per share and net income per share of $0.70. In addition, unrealized investment gains were $505 million at June 30th, which is up a $105 million in the quarter and a $170 million for the first six months. With that, our book value per share was $24.81 at June 30th, up 4.2% for the quarter and 8% year-to-date.

William Berkley

Thank you, Gene. We were pleased with the fact that the quarter came out as it did. It's interesting, lots of you on the phone think I'm an optimist, but rather I'm a realist, not an optimist. A realist in that, I look at the facts, I look at where things are and how the marketplace is and I see it as it is. Many of the people who we compete with, in fact, are optimists. They see the world as they'd like it to be. The result of that is, I may have anticipated a market change sooner than they do, that's because of realism.

Looking out ahead, we're pleased with our results. We started this 19 odd new operating units over the past four years and candidly they got off to a slower start than we expected, that's one of the reasons our expense ration was crapped up. And this slight increase in volume is that they're finally gaining fraction just over time being there, using their long-term relationships and the discipline of maintaining with pricing has kept them from growing very quickly, but we're getting business slowly overtime.

And, as Gene mentioned, they represent almost 20% of our total business. And that's because our historic business is down so much. We've been able to maintain some resemblance of our continuous level of volume because of those new units. And, now with those new units continuing to grow, and our established businesses no longer losing volume, we're starting to see that growth.

We don't think we're going to grow particularly rapidly, but we will continue to get traction, especially in the international segments and a couple of other pieces. We do believe that we're now in the final stages of the market turning around. April and May, prices were basically flat. In June, prices were down. In fact, the entire quarter, we thought we're going to be flat until June came along and the entire eight-tenths of a percent declined and pricing took place in June basically. I expect a sign of aggressive competitors trying to achieve certain volume gains.

From our point of view, we're out there seeing in our standard business less competition. The most competitive areas are in large risks, which we've basically already lost almost all of them. And our excess [inaudible] business and our regional business are the two businesses that have the most pressure today for volume or low. We see that at least in the E&S business, as we've lost our largest risks there, that pressure is not quite so great.

Looking out ahead, we do think our investment income will recover. The downturn in investment income in this quarter came primarily as a result of the reducing spreads in our arbitraging panel which caused a decline from quarter-to-quarter of $7 million and that was the big change. Other than that, yields and so forth are relatively unchanged.

So we're optimist, we see a good year ahead, still very competitive. We continue to seem to establish our current accident years on a more cautious basis than some of our competitors. We probably are giving where inflation is, have been continually more cautious than maybe warranted. That will only mean that our reserves continue to have a comfortable margin should inflation in fact returns. We're not suggesting it will or it won't, we're just suggesting that we have taken a more cautious approach at the moment.
So, with that, I'm happy to take questions.

Question and Answer

Operator

Thank you. (Operator Instructions). And our first question comes from Dan Johnson from Citadel.

Dan Johnson
Citadel

Great, thank you very much. Couple of questions; maybe first just a few simple ones. The FX impact on the top line, if you could, please?

William Berkley

Not significant. It's immaterial. Less than $1 million.

Gene Ballard

Yes, right.

Dan Johnson
Citadel

Okay. Just another simple one on the new money deals, where you're investing today, you had some comments about maybe not going out quite on the duration level you had before. So can you tell us little bit about when you're putting money to work sort of roughly what are you putting it to work at?

William Berkley

First, I don't think I said that. I think - what I said is, we had spoken in our last quarterly call about extending our duration. And, in fact, several people asked about that. And as we got into this quarter, we concluded that extending our duration was not the thing we wanted to do. So we try to maintain our duration as it is right now.

And with that, that really means, we're probably buying things in the 10 years or under area other than a few Build America Bonds that are out a little bit longer, but not much. I would say that the duration of our investments is still probably matching the duration of our long - slightly longer slide of our portfolios of, if I would have guessed, it's probably in the four to seven-year area is what we're buying now.

Dan Johnson
Citadel

And the yield to drive off of that?

William Berkley

Our target yields are still trying to match our current portfolio yield, which is give or take little better than 4%.

Dan Johnson
Citadel

4%, okay. And then -

William Berkley

And, in fact, we've been able to do that.

Dan Johnson
Citadel

Yes, great. And then, lastly, on the price monitoring you talked about, can you just give us a little background on the process and how you do that, especially when you look at things like exposure changes maybe if you have any views on exposure changes as well and whether or not this focus is on new business as well?

William Berkley

It - go ahead, Rob.

Rob Berkley

The answer is that, lots of people call it price monitoring. But, what in our opinion is, is it's really weight monitoring. It's a number of dollars you collect for a unit of exposure. And, certainly, as we've discussed in the past size monitoring is, is not a perfect science. But we believe at this stage that there is some precision to it.

Clearly, with the renewal book, where we're able to keep track reasonably, carefully of the - of exposures we're able to understand the change in exposures with new business it can become a bit more challenging depending on the line of business. So, generally speaking, we think there is a reasonable level of precision in it. There's probably a bit more with the window [inaudible].

Dan Johnson
Citadel

So your number includes new business as well.

Rob Berkley

The answer is that we - my point is, it includes new business, but we track them with a fair bit of granularity, so we're able to dissect it to see what the rate changes are. But the 0.8% includes new business as well as the renewal booked.

William Berkley

It has coincidently, for renewal business, it's 0.8. And then, we examine new business to see if it's pricing on a par with our existing business. And so the conclusion is, we're tracking the same.

Dan Johnson
Citadel

Good. I've got more questions, but I better - I'll jump back in line. Thank you.

Operator

Our next question comes from Josh Shanker with Deutsche Bank.

Josh Shanker
Deutsche Bank

Good morning, everyone. I want to follow on Dan's question a little bit. The new Berkley businesses that are generating the top line growth and in terms of the pricing those businesses, how do we confident about your pricing in those markets? So how - where do you base that sort of pricing analysis off of?

William Berkley

I'll let Rob answer with details. But basically, when we enter any new business, whether startup or whatever, we have a price model, we examine pricing levels. So we have standards that we enter into the business before we get into the business. So it's not that we go into a business and say, "Okay, let's see, what happens." So you enter the business with pricing expectations, with market expectations, having examined it. It's not sort of a random mock theory of pricing. Rob, do you want to?

Rob Berkley

Yes, I - I think you've covered it. But the ones that I would add is, I have suggested, we have a technical rates and - that we derive through a fair bit of work. In addition to that, obviously we're conscious of where the market is.

And, quite frankly, it's - when we look at the pricing that we see in these startups, not only they are both technical rate, but generally speaking, they are the top level or above market. And so, our comfort that you think these folks are doing the right thing in building these businesses. And in addition to that, obviously, we do have other resources within in Group, at sister companies that have expertise and we are able to doing this peer review to there as well.

William Berkley

And, in addition, I might add that, a number of these teams of people wrote hundreds of millions of dollars of business in the places they were at and they're now in our company writing $30 million or $40 million of business, because they understand we mean that we're looking at price discipline. So they understand what they mean. So we're - this has been a very slow start and it's still moving very slowly.

Rob Berkley

Most of these businesses that I think you're referencing are below the budgets that they have put together for themselves, 12 months ago, because of market condition. And to the point that I made earlier about the number of startups combined with the amount of business that these people wrote or managed it by organization, this is really - this is really just a reflection of their skills, expertise, and relationships in our opinion.

Josh Shanker
Deutsche Bank

Would it be a correct statement that most - the vast majority of business that you're receiving is business of a broader - from their former employers at this point? And -

William Berkley

That would not be a correct statement.

Josh Shanker
Deutsche Bank

That would not be.</TAG>

William Berkley

No.

Josh Shanker
Deutsche Bank

Okay. And then the second question will be, why do you think that in the second quarter of 2010, it seems like there's been an acceleration upward?

William Berkley

I just think it takes time. It takes time, it takes time, the relationships. We don't go out and ask people to move business. It takes time, we have relationships with people and they get comfortable doing business with you. And the fact is, they get comfortable that we and they are going to be able to do what they expect and write the business.

Josh Shanker
Deutsche Bank

Okay, thank you very much.

Operator

Our next question comes from the line of Keith Walsh with Citi.

Keith Walsh
Citi

Good morning, gentlemen. First question for Bill. Bill, you've been on the call talking the last several quarters about undisciplined competitors, then you guys put this type of premium growth. So, I guess, my question will be, what would your reaction be if your competition put up your numbers this quarter will be the first question?

William Berkley

Well, first of all, I think you're asking the wrong question, sir. I think the first question I would have asked is probably starting a few years ago was, why is Berkley investing so much money in all these startups and is getting no business out of them. Because, in fact, we started 19 operating units and we still shrank over that whole period of time. But with 19 new operating units, we shrink about 15 quarters. So that's the first question you'll have to ask, because if you want to take a snapshot of one quarter, then you probably shouldn't be investing in the insurance business.

Keith Walsh
Citi

Okay. So -

William Berkley

Let me finish your question, please.

Keith Walsh
Citi

Sure.

William Berkley

Then, second of all, I think the next question if I was out there is, where is the growth and it's mainly in international and places that there are other kinds of opportunities, there are other things going on. And, finally, if you divide that number up off 5.5% which is $50 million amongst 20 operating units, it's not very many dollars from all those teams in that investment. So, I certainly pay attention, I'd look at it, but I wouldn't come to any conclusion right away.

Keith Walsh
Citi

Okay. Then, taking your advice, if we just focus on the new business, my second question would be, doesn't the new growth imply your undercutting existing players in those current markets?

Rob Berkley

No, what it imply - I mean, I guess, in that statement or that question, that assumes that, people make selections as to who they do business with or who they buy insurance from purely on price. I think in that comment, you're suggesting the skill, reputation, relationships, financial strength, ratings, et cetera, are relevant to the decision process.

William Berkley

And I think the long and short of it is, there is a lot of people out there that have relationships, that do business. And, as I said, it's not very much business when you look at it on a per operating unit basis.

Keith Walsh
Citi

Okay. And then the last question just on pricing. You consistently say, you think pricing was getting better or will get better at some point.

William Berkley

What I know - what I said is, prices have stopped going down.

Keith Walsh
Citi

Okay.

William Berkley

I didn't say, they're getting better. And I specifically said, prices are down, eight-tenths of a percent in the quarter.

Keith Walsh
Citi

Okay. So my question is from a client point of view, why should I care about lower investment yield when the industry is still putting up reported underwriting profits. Why should I factor into my decision of why pricing needs to - why I need to pay more for insurance? Thanks.

William Berkley

Who are your clients? Are they the people who buy insurance or are they the people who invest in insurance?

Keith Walsh
Citi

I'm talking about as a buyer of insurance.

William Berkley

The answer is buyers of insurance have only one thing in mind. They would like to have the least possible costly insurance from the highest quality, most certain providers who pay claims the fairest.

Keith Walsh
Citi

I guess the point I'm getting, when I talk to risk managers or even smaller customers that buy insurance out there, they don't care necessarily about what you get on your investment yield. They just care about, they look at the underwriting profits in the industry. So why should they -

William Berkley

Well, we don't disagree. The question is, the people who are running insurance companies, the nature of a well-run business is the markets - the competitive markets sets the price. But competitors are supposed to price based on their cost of goods sold. And what I am suggesting is based on cost of goods sold, everybody would like to buy insurance for nothing. $1 would be a good price, but that's not a rational economic scenario.

And if the people who've bought insurance from Allianz or Frontier 10 years ago, how happy they are with that settlement or mutual risk. The answer is, people do have the sense to know they need to buy insurance from companies that will pay. And most responsible companies recognize at some point they have to make a returns so they can attract capital. Attracting capital requires return. Not many people who manage companies should find it attractive to raise new capital at less than book value, which is what a many of those stocks are selling and they're selling there because of the inadequate returns those companies are generating.

So, at some point, what's going to happen is, people say, we answer to our shareholders, though shareholders don't want to be diluted. And, therefore, we better get better returns, so we won't have to raise capital and dilute our shareholders. Eventually, that's where it all plays out. The price people, people always want to buy the most they can for the lowest price. We totally agree on that. And people buying insurance don't care what my investment returns are.

Keith Walsh
Citi

Thanks a lot. I appreciate it.

Operator

Our next question comes from Mike Grasher with Piper Jaffray.

Mike Grasher
Piper Jaffray

Thanks very much. Good morning, everyone. Bill or Rob, maybe you could comment a little bit on the growth that you achieved that in the quarter around the alternative markets line of business. I guess, my perception on that business would be, that would be, sort of new business development or small business is starting up, and in this economic environment, that just doesn't seem to be the case. I'm curious about that business and how you're achieving that growth.

William Berkley

Yes, I'm going to let Rob go into the details. But it's - that business has some ups and downs in the quarter and the second quarter is one of its smallest quarters. So while I've chose the percentage increase of some consequence, the quarter as you might see was the first quarter was sort of $250 million and this quarter is a $150 million so to start with. So it's a smaller quarter. So a modest gain gives you a bigger percentage gain. But, with that, let me let Rob comment.

Rob Berkley

I think, as you suggested, obviously Q2, we're working off a smaller base in some of the quarters. But the - the most significant growth was probably coming from our accidents and health business specifically around the medical stop-loss lines. But we did see growth in some of the other lines as well. We certainly are seeing some improving conditions in the California comp and a couple of other spots as well. But, once again, I think that one needs to keep in mind it's a smaller quarter, so it takes a little bit less to move the needle.

William Berkley

And, while accident and health doesn't flow into that startup Group per se, it is really in many ways it's starting up as an enterprise because of the business it does.

Mike Grasher
Piper Jaffray

Okay. And then, the California comp portion, was that driven more by rate filings or by exposure units?

Rob Berkley

It's more - it's exposure units. But you need to keep in mind that in the great State of California, one files their rates and I think you have the ability to deviate from those filings by a notable margin as if appropriate. I wouldn't focus too much on people's filings in California as it relates to comp as much as - we - long story short, we think that there, as we mentioned in prior calls, reason to believe that the California comp market has bottomed up and is beginning to reform slowly.

Mike Grasher
Piper Jaffray

Understood. Thanks for taking the questions.

Operator

Our next question comes from the line of Meyer Shields with Stifel Nicolaus.

Meyer Shields
Stifel Nicolaus

Quick question if I can on alternate risk. Can you quantify the modest premium contribution to the premium growth?

William Berkley

I'm sorry, could you repeat the question?

Meyer Shields
Stifel Nicolaus

Yes, I'm sorry, I hear an echo. Can you quantify the contribution of written premiums or additional audit premiums to alternative risk growth in the quarter?

William Berkley

You mean the alternative of market segment to what extent that growth was driven by audit premiums?

Meyer Shields
Stifel Nicolaus

Yes.

William Berkley

It was not significant. The net of the auto premiums and the written premiums wouldn't be significant.

Rob Berkley

One comment I would make is that, audit premiums and written premiums generally speaking are not overly meaningful, rather I highlighted that in my comments, because I think it's just one more indicator so to speak as to impact the economy is having on the industry and by extension our business.

Meyer Shields
Stifel Nicolaus

Okay, that's helpful. On the reserve side, if we look at the first quarter stat numbers, there was actually a reserve strengthening for exiting your 2009. And based on Gene's comments, it looks like we went the other way in the second quarter. And I was hoping you could put some color on that?

Gene Ballard

Nothing in particular. Just the ordinary re-estimating the reserves from one period to the next. Nothing significant in that change.

Meyer Shields
Stifel Nicolaus

Okay. And one last question, if I can, I was hoping Bill could give us some thoughts from his recent trip to Washington.

William Berkley

I think this - I testified before the House, no one from the other side - in fact we chose to testify, although they were invited. I think that they - we think that there is a fair possibility of this happening, but one never knows in Washington how things play out. I've been at this now for four years. I have perfectly - I have lots of tenacity and I'm going to persevere as we move through this.

And I would suggest that we probably are now with a better than 50-50 chance we'll get some - some thing attached to other legislation because of the need to raise money, and the blatant unfairness of the existing tax structure. And the fact is that the United States insurance companies pay taxes in different way.

And if you write business in the United States, you won't pay taxes the same way we do for that business and that's really what the new bill says, and we certainly believe there is a reasonable possibility that that will happen. If doesn't happen, it just means Congress will decide to continue to give a competitive advantage to non-domestic companies.

Meyer Shields
Stifel Nicolaus

Okay, thank you very much.

Operator

Our next question comes from the line of Doug McGregor, RBC Capital Markets.

Doug McGregor
RBC Capital Markets

Hi, good morning. Most of my questions have been answered. I guess, my two questions revolve around - first question revolve around startup businesses. Especially with the growth of the international business and then there is certainly wide variety of countries and underwriters as well as in the domestic area, does that - do you think it would meaningfully change the profile of your insurance portfolio overtime and maybe a more of a swing toward property or a certain kind of casualty or do you think that your - sort of your business is still kind of consistent with your historical profile?

William Berkley

I don't think our business mix is making any long-term dramatic changes. In the short run, obviously, when more business comes from new units, there is some subtle changes. But the mix of our startups is primarily looks like our existing business. There is some additional property exposures, although, it's not catastrophe related property exposure. There is certainly some additional property exposure, no different than the startup being our offshore energy business where we had the Transocean risk, which in fact, was the charged statement, but didn't change our operating results.

So, I think that we were in this position once before and we don't really think that this is going to have a material impact. We think what's going to really happen is as the cycle starts to turn, our other domestic businesses will start to grow dramatically. And, candidly, this business will not grow at that point in time, and nearly as greater rate, and we'll just be a much larger company, and this will be a piece of that larger company.

Doug McGregor
RBC Capital Markets

Okay. And then the second question which is, more in the what's happening right now. The rates seemed to be, I guess, I would say, fairly benign based on your tracking. How are terms and conditions hoarding up? I've heard little rumors here and there that there is - people are softening terms and conditions because they really can't - they are seeing every pressure to keep above the line of price.

William Berkley

You mean price, prices are so low already, there is nothing else they can do but look.

Doug McGregor
RBC Capital Markets

Yes.

William Berkley

Yes, I think the answer is, for probably the past six months there has been some changes in terms and conditions, especially on very large risks that's the case. We - as I have said now for probably the past 12 months, we've lost virtually all our large risks and terms and conditions don't change much on small risk, although they have changed somewhat. I think that that seems to not have continued to get worse at the moment. But you can have a rash of a couple companies wanting to get more business for the quarter, so you can have a month where crazy things happen.

One of the signs of the turn in the cycle is seemingly volatile decision-making in various companies where they zig and zaggle a lot and that's some of the things you are seeing, people getting into one business, getting out of another business, doing all kinds of things to try to generate business. And I think you're starting to see that and they're all the signs of that turn of the cycle coming, but it's not here yet. There's no question, it's not here yet.

Doug McGregor
RBC Capital Markets

Okay, thanks. That's all my questions.

Operator

Our next question comes from the line of Michael Nannizzi with Oppenheimer.

Michael Nannizzi
Oppenheimer

Thank you. Just a question on the ventures, if I could. Can you talk about how the accident year picks have been an ample growth as to the rest of your book? And then, also, since I think you had Gene that most of the development across the entire business has been in '06 and since years, has there been any sort of development in the startup? And if I can one follow-up. Thanks.

William Berkley

I really think our loss picks have been conservative pretty much in every year and more conservative anything in the startups than in the existing businesses. We consistently increased our loss picks each year to reflect what we think our trends for inflation and pricing trends.

So our loss picks, for instance, are - have more probably 10 plus points higher than our developed loss ratio for instance in 2007. So it's - so we've got substantially increases in our loss fix and that may or may not prove to be needed, but that is how we go and the startups have more conservative loss fix as opposed to less conservative loss fix.

Michael Nannizzi
Oppenheimer

Okay.

William Berkley

You had another piece of your question, you asked Gene.

Michael Nannizzi
Oppenheimer

No, no, that was it on the startups. And if I could one - I mean, maybe mostly for Rob. On the alternative business, it look like the gross written premiums were higher, seating was also hiring. Can you just kind of talk about what drove those trend and maybe it's just a one-quarter phenomenon? I'm sorry.

William Berkley

Just one second.

Rob Berkley

One second.

Michael Nannizzi
Oppenheimer

Okay.

Rob Berkley

I think that that has more to do with the assigned risk premiums that flow through as far as the gross versus net.

Gene Ballard

Well, and in addition to that, we historically have written and assigned risk business in two segments, the regional segment and the alternative market segment, where on - we're gradually migrating all the business into the regional segment, so we'd no longer - and into the alternative margin. So you're seeing some noise from that. But, the important thing about that, our business is, is that's a 100% reinsured, so it goes through our gross numbers, gets a 100% reinsured back out and it has no impact on our bottom line.

William Berkley

Or on our net numbers.

Gene Ballard

On our net numbers.

Michael Nannizzi
Oppenheimer

Great, got it. And then, just a capital question mostly, so portfolio and debt relative to equity are bit higher than the peer group, and I would have guessed that the debt is costing you more than you can generate right now just on dollars invested basis in the portfolio. So what would need to happen on the underwriting side or just on the outlook for the business side to consider buying back some of your own debt and reducing both of those portfolio and debt?

William Berkley

Well, by September, we payoff I think a $150 million just as it comes due.

Michael Nannizzi
Oppenheimer

Right.

William Berkley

And I think that, there is a whole lot of issues that you have with characteristics of the debt that's issued an outstanding. And some of the debt that that's out there has some characteristics that you can't issue anymore. It's 30, 40 plus years, trust preferreds and some other things that has terms and conditions and they are out there in ways that would be hard to replace. And we think that the return on our equity is such that the - if anything would better off using new capital generated to buyback stocks, than to reduce that at the moment.

I am - I think that at some point we may consider that buying back debt would be a better alternative but not now. I think that when we look at capital management, we look at several things, one, we look at buying back stocks, two, we look at buying back debt, and three, we look at dividends. Do we want to change our dividend policy? You want to pay a special dividend?

And every Board meeting we sit and we talk about that issue of our capital management and best used as alternative for that capital. And at this point, we think given the quality of our ability to generate underwriting income and investment income, the returns are still better than keeping the debt outstanding is a better alternative for the moment.

Michael Nannizzi
Oppenheimer

And just one follow-up, if I could, on that topic. On the ARB business, so I think you had said that spread income was about $7 million lighter over the link quarter last year. So what - what would have to happen there for you say, maybe, that that's something that you either don't want to keep doing or maybe just set a timeframe for achieving what might be adequate returns in that business. I guess it's been kind of a decent year on the M&A front relative to last year. So I just want to understand like how you're thinking about that as part of your overall portfolio. Thank you for all the questions.

William Berkley

Yes, the amount of money we allocate to our ARB business was up and down. I mean, at one point, 18 months ago, I think we had a $150 million allocated to in the rest of the cash we had.

Michael Nannizzi
Oppenheimer

Right.

William Berkley

So it's not - it's not we give them and money it - money and it just sits there, they have it. So it's an integral part of our portfolio. And we've gotten fabulous returns over 20 years, substantially better than alternatives and we've had money in other - outside of our accounts and our guys have basically on a risk-adjusted basis have equaled or exceeded those returns in virtually every year. So we're pretty happy with the returns they've generated.

We're not happy with some of the volatility we have in a quarter there and it's aggravating. But I have to practice what I preach and that is I can't change our strategy, because one quarter was disappointing and they continue to do an outstanding job and we expect we'll continue to get great returns. And then, frankly, I'm more concerned with how do I maintain liquidity and get - we're getting such crappy returns on cash which is a bigger concern for our company and for every insurance company, returns on cash is so crummy.

Michael Nannizzi
Oppenheimer

Right. Thank you so much for the answers.

Operator

Our next question comes from Vinay Misquith with Credit Suisse.

Vinay Misquith
Credit Suisse

Hi, good morning. Could you provide some clarity on the growth in the international business? And the combined ratios in the business have a 100% plus, so if you could help us understand how you gain comfort on the newer business? And is some of that growth because of the new large platforms?

William Berkley

Go ahead, Rob, why don't you start.

Rob Berkley

Yes, a significant amount of it is from the Lloyd's platform. We are comfortable with the growth. Because when you put aside the combined ratios, I think that you mentioned a moment ago, when the businesses are in their infancy, we are particularly focused on what we believe the loss ratio is and we believe that the expense ratio will get sorted out as scale comes along in an appropriate manner and we have earned premium that will be able to leverage, so that we can leverage the expenses by.

So is there another question you had?

Vinay Misquith
Credit Suisse

Specific to that, that was it. And the second question was with respect to reserving on this is - I think you mentioned something about that before. I just wanted to confirm that the loss pick on new business relative to the renewals is higher. I mean are you picking at higher loss ratio for the new business?

Rob Berkley

The answer is, that generally speaking, when use design loss ratios for our younger businesses or startups if you like, we feel as though it is prudent to err perhaps on the side of caution, because clearly, the available data and information with a new business is not as plentiful as it would be with the business that has been part of the Group for an extended period of time or more mature.

Vinay Misquith
Credit Suisse

Sure. So since this business surely hasn't earned through as yet, should we expect lower accident - higher accident DR loss ratios for the company in the near term, just as the new business earns through?

Rob Berkley

I don't think that's necessarily should be the case. I think that our writings have been gradually growing over some period of time and I think you're going to see the earned premium begin to become more visible that have has in prior quarters.

William Berkley

And I think that while the payout tale for losses maybe the same as their averaged duration, there isn't the same risk of new losses and the development as new losses themselves. So we should - we should know pretty quickly as to the loss picks, although the payout patterns are still going to be in the probably three plus year duration.

So we're going to know pretty quickly we have not gotten into in the international business other than Australia which has a fairly long duration, we have not gotten into any businesses that we will find - we should find anyway surprises as to the loss picks, payout patterns they're long they'll also in some of these areas.

Vinay Misquith
Credit Suisse

And, how has Berkley managed to grow in these international locations versus the US peers? Is it that US peers don't have this sort of presence in the foreign countries that you have?

William Berkley

Well, I think, again it comes to hiring teams of people who are well connected, who have relationships in these countries, who know people. And, it's also it's not like we started yesterday, okay? We started these things three years ago and it's taken a long time before we've gotten any significant traction at all that they're just starting to do well. If you look at the total volume from all these businesses, they're all very small.

I mean, as I said before, some of these teams of people ran businesses that were 300, 400, 500 million. In fact, one of them was $1 billion team that today they're writing 10%, 20%, 30% of what they were writing three years later. So it's not like they're suddenly writing these huge amounts of business that they're barely scratching the surface and that's the price we paid for when we started.

Vinay Misquith
Credit Suisse

Thanks everyone.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Meredith
UBS

Hi, good morning. I have two questions here. First, just a quick one for Gene, tax rate in the quarter looks like it was a little bit low. Was there anything unusual there or is it just my calculation?

Gene Ballard

Yes, no, it's nothing unusual. I mean, it's just the mix of our tax exempts then come relative to our total profit. But it's probably -

Brian Meredith
UBS

This will be the - because the arbitrage is probably down, that's probably why.

Gene Ballard

Well, yes, it's a function of how much our pretax income is, because the tax exempts have a - lower the pretax, the more the tax exempts impact, we get some exempt, so it varies some. But the amount of tax exempts that we invested in has not changed.

Brian Meredith
UBS

Got you.

William Berkley

It's actually - it was about 24%.

Gene Ballard

Yes.

Brian Meredith
UBS

Okay. And just one other just quick number question for Gene. Do you have the reserve relations by business segment?

Gene Ballard

We'll have those in the Q.

Brian Meredith
UBS

Okay, thanks. And then the last question, Rob and Bill, on the new business or try to be [inaudible] in this, but is it more that your submission activity is up or you're actually seeing hit ratios rise as well as on that business?

Rob Berkley

The answer is that, the most of the growth is coming because people are showing us business due to the relationships that these teams have. So it's not necessarily that there's been the constant flow of business and all of a sudden hit ratios are ticking up in a meaningful ways rather it's driven by business being brought to our attention, because of the relationships and people's presence in the marketplace and the - if there are the distribution system and insurers want to do business with us.

Brian Meredith
UBS

Got you. Thank you.

Operator

Our next question comes from the line of Larry Greenberg with Langen McAlenney.

Larry Greenberg
Langen McAlenney

Good morning and thank you. Bill, with you guys realizing accelerating and I don't know what looks like to me record reserve redundancies over the last four or five quarters, have you - are you seeing anything that changes your thinking with regard to when the industry's redundancies might run out?

William Berkley

It's very hard to assess other people's redundancies, not so hard to look at where the current loss picks have been. I think that we have consistently and continued to be more cautious in our current accident year picks as prior year redundancies become greater since we set our current years based on the prior years that automatically means our current years are going to prove to be more conservative.

So if 2006 was set and it was proved to be 7 points or 8 points redundant, that means, however we set 2010, the establishment of that base was going to have started from a base level that was 7 points redundant. So that automatically means our current accident years are more cautious.

As far as the industry goes, I think that if you look at the industry, at the non-catastrophe accident year loss ratio, I think that probably a number of companies are picking pretty conservative numbers and I think most of all larger companies are. The question is, are they conservative enough. And some companies are pricing their business knowingly at a more aggressive price basis, expecting that on renewal, they'll be able to raise prices which hasn't in fact in the case.

So I think that this is a game of actuaries and accountants giving together and look backwards and forwards and trying to conclude where the returns are. I think when you look at the world and you see the judgments that Boards need to may and they have to focus on and that is when you see stock selling at discounts to book value, the marketplace is telling you that your returns are less than what they need to be.

And, therefore, since if the printed returns will be reflective of the current returns, that wouldn't be the case. So, I guess, the long and the short of it is, I think people are being overly optimistic that their redundancies are certainly on their last legs, whether that means they have one quarter, one month, or one year, I can't tell you though.

Larry Greenberg
Langen McAlenney

But you - you would say that your results currently are a reflective of conservative loss picks going in as opposed to, you're just seeing no loss is developed in certainly lines of the regional business where you might have go up there and see losses before.

William Berkley

I wish there were no losses. Every night, some people ask they should live another day, I say, could I please have no more losses for one day and that never happens. We get losses every day and they're within the realm of predictability, there is no question, the trends have been better than we would have expected, but not enough to offset the silliness with the pricing levels. And, again, if you recast everyone's invest income to current yield, you don't have anybody or certainly have very few people making decent returns.

Larry Greenberg
Langen McAlenney

Thank you.

Operator

Our next question comes from the line of Jay Cohen with Bank of America Merrill Lynch.

Jay Cohen
Bank of America Merrill Lynch

Yes, just a follow-up on that last question, and specifically on the claims, I mean, you had mentioned that the claims trends maybe have been somewhat better than you had expected. Have you guys been able to dig into why that is, because we hear from others, but no one has a good sense of why and it's probably an important question if we're kind of concerned about that going the other way at some point?

William Berkley

Well, I think first of all, I think there are a couple of external factors Jay, that you have to look at. First of all, inflation has been virtually nonexistent except for medical. Medical inflation has been rear, it's been substantial, and it's had an adverse impact on cost trends for lots of lines of business.

But the other side is, because of a difficult economy, people have been more willing and more anxious to settle claims and get paid. So the capacity to settle claims will then reason has really improved somewhat. So I think you've got those two things at an external basis.

Less business activity, less drive, and all those kinds of things that take place in a more difficult economic time certainly reduce the number of exposures you have to bad things happening. So I think you just put all those things together and things were a little better. A little better however isn't enough to take care of to offset the medical cost inflation and declines in prices. So my guess is that people are being a bit optimist.

Jay Cohen
Bank of America Merrill Lynch

I guess, if we do have a stronger recovery and there is more miles driven than - and more workers out there, I guess there's a change we do see an increase in claims frequency at that point.

William Berkley

I would think that. But also simultaneously would that be industry would have a more courage to raise prices. I think right now theirs - right now, there is a driving price today, really are companies are afraid to lose business, the agents and brokers are afraid to lose business, and the customer is reluctant to pay more even for better coverages, so you've got everything including that. I think that that's easy up, because those lots of companies that are recognize they are not making any money in the current situation. And there are a lot.

Jay Cohen
Bank of America Merrill Lynch

Thanks Bill.

William Berkley

Yes, sir.

Operator

Our next question comes from Dan Johnson from Citadel.

Dan Johnson
Citadel

Thanks. My questions have been asked and answered.

Operator

Our question comes from Greg Locraft with Morgan Stanley.

Greg Locraft
Morgan Stanley

Hi, thanks. Just wanted to get an update on how much capital is at the holding company level. And once the debt comes due, how you're thinking about proceeds going forward?

William Berkley

I think we have - in terms of cash capital, maybe $300 million, and we also have some investments that we can turn into cash probably for another $100 million to $150 million. So probably $450 million of available resources, $400 million. And we buyback stocks on a quarter-to-quarter basis, we'll look at that, we'll look at dividends.

But, right now, the plan is, as we said, we're going to effectively and that's what we earn each quarter in buying back stocks, but we have a Board meeting coming up and we'll discuss whether that's the optimal alternative or not.

Greg Locraft
Morgan Stanley

Okay. And then, just shifting gears to the portfolio, you mentioned that, is your new money yield today equal to - equal to what's rolling off?

William Berkley

It's pretty close, yes.

Greg Locraft
Morgan Stanley

So what -

William Berkley

Pretty close.

Greg Locraft
Morgan Stanley

So I think you gave a little bit of color. But, just once again, what are you buying today that's able to equal those yields?

William Berkley

We really don't talk about individual purchases of securities, but there are things around, one of the benefits of having a property and casualty company, we have positive cash flow is, you can buy things that don't give you instant liquidity. And, therefore, if you sit in the marketplace and deal with people, you find things that are of high quality, but not easily liquid. And when you look along those lines, most investors create liquidity and therefore can't or aren't track those things. It's one of the benefits we have.

Greg Locraft
Morgan Stanley

Okay. So you're buying less liquid things. It sounds -

William Berkley

No, I said - didn't I say that, I said that that is one of the attractive - we're buying a whole array of individual securities that effectively it can give us that 4.2% give or take return.

Greg Locraft
Morgan Stanley

Okay. And what's the average duration of what you're buying?

William Berkley

Well, why don't we do, when we file our Q, all that information will be there.

Greg Locraft
Morgan Stanley

Okay, okay, because the duration seems to be going down, but -

William Berkley

Duration is - in our portfolio was virtually flat. It varies one month plus or minus and that's all it's varied for an extended period of time.

Greg Locraft
Morgan Stanley

Okay, great. Thanks guys.

Operator

Our next question comes from Robert Barnum with KBW.

Robert Barnum
KBW

Hi there, good morning. So for rates to go up by yearend, you're going to need your competitors to come to their senses it sounds like. So why are you so optimist that this will be the case and can a few renegade companies keep that from happening?

William Berkley

You make a judgment, you look at the world, and the fact is that that my judgment is - first of all, a few renegade companies can't make it happen. They can't pre keep it from happening. And I think that there are lots of people who are sitting back and saying, "You know, if we repriced our portfolio to yield what current yields are with the same portfolio, it's going to be very hard to maintain the returns." And I think that there are a lot of people who are thinking about that now. And there's always a few people out there who are aggressive, but they don't have unlimited capacity.

And, in fact, there are several people who are in the marketplace trying to get into new lines of business and couldn't find any reinsurers who would support them, because they did right what they were doing price wise. So there is discipline in the marketplace and thank goodness there are actually a lot of reinsurers who say, "Hey, you know, this is silly." And who aren't supporting the most aggressive players. And that's one of the things which starts to bring that discipline about. But I think for the most parts and most serious people in the business understand where things are and they're going to come to the conclusion that they need to make those changes.

Robert Barnum
KBW

So, you do not see new competition coming in right now or do you think that's pretty slow at this point?

William Berkley

Not - in general, no. There's always competition, there are always people going in and out. But it's certainly, there's not aggressive new competitions of the business. By in large, there are more people leaving the business and getting in. And, if I had money to invest and I was outside the business, it's even not very attractive things we'd add to is a new competitor.

Robert Barnum
KBW

Right. Okay. And do you - what changes do you see in the marine energy market and maybe early, but just curious what you see out there?

Rob Berkley

I think that generally speaking we're a bit surprised that the liability rates haven't been moving up, even though we're not really much of a player in that space, as much as we were thought on the heels of a recent events and certainly as property rates have been moving up. Having said that, that's very much driven an influence by quality of operator and region of the world.

Robert Barnum
KBW

Okay, very good. And, thank you, that's it from me.

Operator

Our next question comes from Meyer Shields with Stifel Nicolaus.

Meyer Shields
Stifel Nicolaus

Thanks. Just one quick follow-up. Bill, can you talk about was there any trends in companies looking to be bailed out by being acquired?

William Berkley

It's actually - we're just beginning to see people know they have problems, they would not tell you they're being bailed out. They would tell you there is an opportunity for you. But it's just beginning to be that point. And I think that you're starting to see accountants and actuaries looking at things and beginning to be a bit more skeptical. So I think that's just at the starting phase.

That would be - I think that - and there's something in the market turning around, it would be the - but one of the best things it can happen is, someone getting a lot more pressure from their outside auditors or accountants that something had to be done. But, in fact, we've seen people who we thought were in trouble and having difficulties get acquired in the past six months - past few months.

Meyer Shields
Stifel Nicolaus

Okay, excellent. Thank you.

Operator

Our next question comes from Howard Schlenker [ph] with Schlenker & Company [ph].

Howard Schlenker
Schlenker & Company

Hello Bill. First, I'd like to pay you complement and then I have a question. I saw that your early payment of your customer's claim at the Deepwater Horizon or Deep Horizon whatever it's called, was really brilliant, and you lost the interest maybe six months to 12 months on the cash you laid out, which your goodwill is probably 50 or 100 times what you had as an opportunity cost. Kudos to you. And, my question is, in your rating or reserving, approximately what do you think your underlying inflationary estimate is?

William Berkley

The answer is, we don't - we don't establish the inflation rate per se.

Howard Schlenker
Schlenker & Company

No, just back of your - it's somewhere in the back of your mind, that's what I was trying.

William Berkley

I think we generally look depending on what it is, it's sort of a 6% medical number and sort of a 3% general inflation number when we look at the mix of the claims. But it depends on how long we hold this, it depends on the pad, it depends on the type of line of business, so it widely varies.

Howard Schlenker
Schlenker & Company

That's okay. I just wanted to know - I'll ask each management that because conditions are changing in a way we haven't seen in probably 50 years or 70 years. And, one way or another, there'll be a surprise and an opportunity.

William Berkley

There are no questions.

Howard Schlenker
Schlenker & Company

Thanks.

Operator

I'm showing no further questions in the queue.

William Berkley

Okay, thank you all very much. Have a great day.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may all disconnect. Everyone have a great day.