S&P Global
Market Intelligence

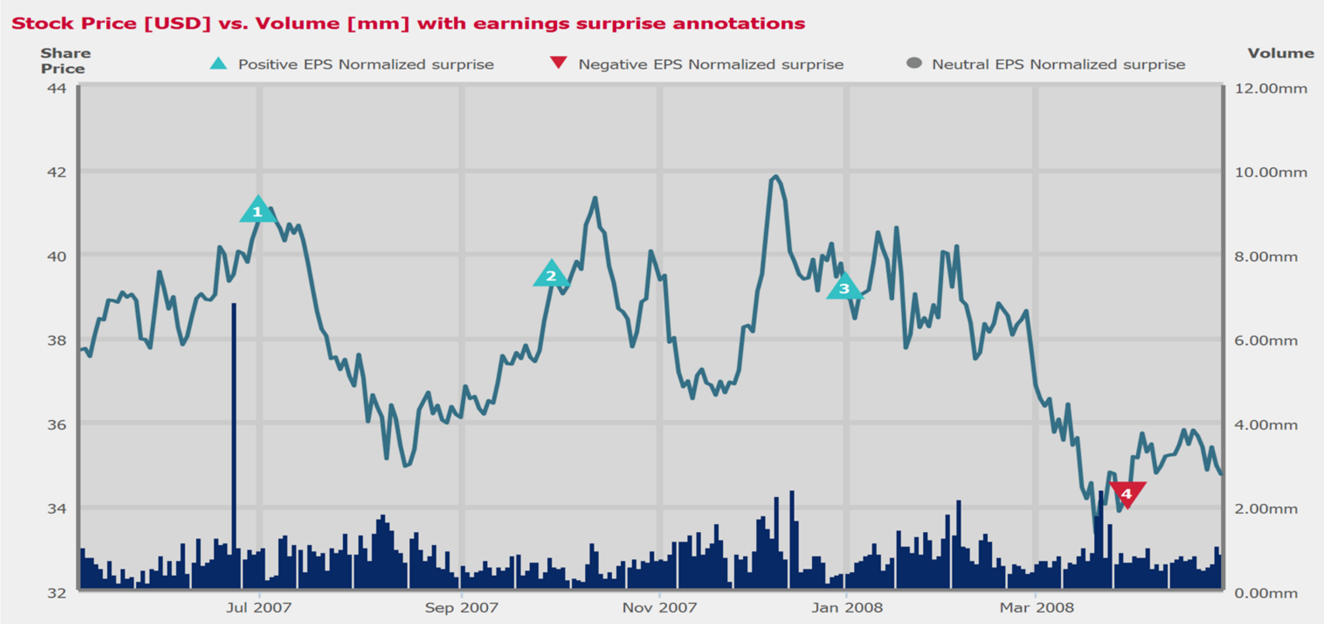
AXIS Capital Holdings Limited NYSE:AXS
FQ2 2008 Earnings Call Transcripts

Tuesday, August 05, 2008 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.36	1.45	6.62	1.14	5.27	5.09
Revenue	-	-	(2.71 %)	-	-	-
Revenue (mm)	703.25	684.22	-	544.30	2676.16	2548.27

Currency: USD
Consensus as of Aug-05-2008 12:35 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	1.46	1.54	5.48 %
FQ3 2007	1.38	1.66	20.29 %
FQ4 2007	1.53	1.83	19.61 %
FQ1 2008	1.39	1.28	(7.91 %)

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Call Participants

EXECUTIVES

David B. Greenfield

John R. Charman

Linda Ventresca

ANALYSTS

Alain Karaoglan
Bank of America Securities

Jay Cohen
Merrill Lynch

Joshua Shanker
Citigroup

Matthew G. Heimermann
JPMorgan

Susan P. Spivak
Wachovia Securities

Vinay Misquith
Credit Suisse First Boston

Presentation

Operator

Good day ladies and gentlemen, and welcome to the Second Quarter 2008 AXIS Capital Holdings Limited Earnings Conference Call. My name is Lacy and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of this conference. [Operator Instructions]. As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today's call, Ms. Linda Ventresca with Investor Relations. Please proceed.

Linda Ventresca

Thank you, Lacy. Good morning, ladies and gentlemen. I am happy to welcome you to our conference call to discuss to the financial results for AXIS Capital for the quarter ended June 30, 2008.

Our second quarter earnings press release and financial supplement were issued yesterday evening after the market closed. If you'd like copies, please visit the Investor Information section of our website, www.axiscapital.com. We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website, through August 29th. An audio replay will also be available through August 15th. The toll-free dial in number for the replay is 888-286-8010 and the international number is 617-801-6888. The pass code for both replay dial-in numbers is 48567247.

With me on today's call are John Charman, our CEO and President and David Greenfield, our CFO. Before I turn the call over to John, I will remind everyone that statements made during this call including the question-and-answer session which are not historical facts, maybe forward-looking statements within the meaning of the U.S. federal securities laws. Forward-looking statements contained in this presentation include but are not necessarily limited to information regarding our estimate of losses related to catastrophes and other loss events, future growth prospects and financial results, evaluation of losses of loss reserves, investment strategies, investment portfolio and market performance, impact of the marketplace with respect to changes and pricing models and our expectations regarding pricing and other market conditions. Each statements involve risks, uncertainties and assumptions which could cause actual results to differ materially from our expectations.

For a discussion of these matters, please refer to the Risk Factors section in our most recent Form 10-K on file with the Securities and Exchange Commission. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

In addition this presentation contains information regarding operating income, which is up financial measure within the meaning of the U.S. federal securities laws. For a reconciliation in this item to the most directly comparable GAAP financial measures, please refer to our press release and Form 8-K issued last night which can be found on our website.

With that, I now turn the call over to John.

John R. Charman

Good morning, everyone. I am pleased to report we had another strong quarter culminating in an annualized return on average common equity at 19.2%. For the 12 months ended June 30th, of 2008 our diluted book value per share has grown by an excellent 21%.

Despite the extremely competitive market conditions, our underwriting results were good and our reserves from prior accident years continue to develop favorably. We also posted record quarterly net investment income. Our business is still generating very strong underwriting profitability, even against the backdrop of increased market loss activity during this first half of the year in the property lines. However, there are fewer good opportunities becoming available to us in our traditional wholesale markets. Fortunately, the diversification strategy we have from our inception, we accelerated at the right times to help us insulate us from the value disruption we are seeing in those markets. Also we are much less reliant on the big three broking houses. Since 2003, we have deliberately broadened our international distribution capabilities.

As we continue to build out our operational capabilities for the specialty small and middle market business, the underwriting opportunities that we are targeting are not big capital consumers. This combined with the volatility in the financial markets, presented us with the opportunity to return a $175 million to shareholders in the quarter through share repurchases at attractive valuations. These measured share repurchases are a vital for the constructing long-term value for our shareholders.

And with that, I'd like to hand the call over to David.

David B. Greenfield

Thank you, John and good morning everyone. As John mentioned, we're extremely pleased with our results for the quarter. Net income was $231 million or $1.47 per diluted share compared with $252 million or $1.51 per diluted share for the second quarter of 2007. After-tax operating income which excludes the impact of realized gains and losses on investments was $229 million or $1.45 per diluted share compared with $256 million or $1.54 per diluted share for the second quarter of 2007. For the first half of 2008, net income was $469 million compared with $479 million in 2007.

Earnings per diluted share of $2.95 increased 2% from $2.88 per diluted share for the first six months of 2007. After-tax operating income was $434 million or $2.73 per diluted share compared to $483 million or $2.91 per diluted share for the first half of last year. These results translate to an annualized return on average common equity for the quarter of 19.2%. Our diluted book value per share has increased 21% over the last 12 months and 5% for the year-to-date, even after considering the effects of share repurchases which I will discuss later.

Turning to our top line, our consolidated gross premiums written were $874 million for the quarter, down 9% from the second quarter of 2007. The extremely competitive market conditions continued to present challenges this quarter, although we were still able to identify good profit potential within our globally diversified portfolio of businesses.

For the year-to-date, consolidated gross premiums written were $2.1 billion, down 5% from the first six months of 2007. Gross premiums written in our insurance segment were $555 million, down 9% from the prior year quarter. Disciplined and focused underwriting in the face of competitive market conditions, drove exposure reduction in a number of our property in casualty lines. This was partially offset by growth in our political risk business and renewal rights acquired on the purchase of Media Pro late in the second quarter of 2007.

Gross premiums written in our insurance segment for the first half were $990 million down 6% from the same period in 2007. Gross premiums written in our reinsurance segment were $319 million this quarter, down 8% from the second quarter of last year. This decline was driven by competitive market conditions and exposure reductions in our professional lines and catastrophe books of business, reflecting reduced participations in response to deteriorating pricing. This was partially offset by additional excess of loss crop business for which we were able to achieve pricing above market.

In addition, it was worth noting that our property and motor lines recorded modestly higher positive premium adjustments this quarter relative to the same period last year. For the first half of 2008, gross premium written in our reinsurance segment were $1.1 billion, down 5%from the first six months of 2007. Excluding the impact of foreign exchange rate movements, gross written premiums in the reinsurance segment were down 10% in the quarter and 9% for the first six months of the year.

Consolidated net premiums written decreased 9% in the quarter and 6% for the year-to-date, reflecting the previously mentioned reductions in gross premiums written. In line with period-to-period changes in net premiums written and business mix, consolidated net premiums earned were down 2% for the quarter and 3% for the first six months of 2008. Purchase of additional proportional reinsurance coverage for our casualty and professional insurance lines was partially offset by reduced reinsurance costs for our property insurance lines.

Moving on to our underwriting results; I will start with our current accident year loss ratios. Our consolidated current accident year loss ratio for the quarter of 67.4% compares to 65.7% in the second quarter of 2007 and there were a few moving parts. The increase in the consolidated accident loss ratio of 1.7 points emanates from our insurance segment, where the accident year loss ratio increased 5.7 points to 69.2%. This increase was largely due to a higher frequency and severity of worldwide property losses this quarter.

The first quarter of this year was also marked by high frequency of property risk losses, therefore our insurance segment's accident year loss ratio of 69.2 % this quarter compares with 71.4% in the first quarter of the year. We are a major participant in the wholesale commercial P&C markets. And as such, we expect to have exposure to large market losses like these. We do view these events as normal events. However, the less normal part of the loss activity is the frequency that has occurred within the first half of this year. As you can see, even in a difficult environment, our diversified portfolio absorbs this type of volatility, producing good overall underwriting profitability.

Our reinsurance segment's current accident year loss ratio for the quarter was 66% compared with 67.3% in the second quarter of 2007. Named U.S. catastrophes this quarter are estimated by PCS to exceed $6 billion. Our reinsurance segment's estimated losses from adverse weather in the United States are $19 million and emanated from our longstanding Midwest regional property portfolio.

Reinsurance segment results for the quarter also included some impact from the Chinese earthquake and other international property risk losses. The collective impact of this quarter's cap and large losses on our reinsurance segment loss ratios was comparable to the impact of severe weather and flooding in Australia and in the U.K. in the same period last year.

As you knowledge, we are in a competitive price environment. We continue to rigorously monitor our loss ratio picks with this, as well as loss cost trends and exposure changes in mind. Our initial expected loss ratios in 2008 are generally higher than those in 2007, reflecting the anticipated impact of pricing deterioration. Offsetting this, our loss ratios continue to be favorably impacted by the incorporation of more of our own historical loss experience rather than industry benchmarks, relative to the prior-year quarter. As we have mentioned previously, this introduces some challenges in comparable period analyses. The bottom line is that we remain prudent and consistent in our approach to reserving and our embedded process systematically captures the impact of the deteriorating pricing environment, as well as exposure and changes in loss trends.

Our net loss and loss expense reserves increased to approximately 14% over the last 12 months to $4.6 billion at quarter end. During the quarter, our estimated reserves from prior accident years continued to develop favorably with prior-year reserves reduced by $87 million this quarter. Of this amount, $46 million was from our insurance segment and $41 million was from our reinsurance segment. Favorable reserve development this quarter is related to short-tail lines, with the exception of releases associated with the political risk line which has short and medium-tail characteristics. The overall favorable development primarily came from accident years 2005 through 2007.

Turning to our G&A expenses, our total G&A ratio for the second quarter was 12.2%, an increase of 2.3 points over the same period in 2007. This was primarily due to the combined impact of increased compensation costs and to a lesser extent, a reduction in net premiums earned in the quarter. The increase in our compensation costs included additional headcount associated with our Media Pro acquisition late in the same quarter last year and restricted stock awards granted in connection with the amendment and extension of our CEO's employment contract.

Last quarter, I said our normalized G&A run rate was expected to be around $80 million. Factoring in this award grant, we expect the run rate for the balance of this year to be closer to $87 million. This run rate of course does not take into account the potential for increased incentive compensation in the event of our performance.

To summarize, our consolidated combined ratio was 81.2%, an increase of 5.8 points from the same period last year. This increase in our consolidated combined ratio was primarily driven by our insurance segment, which increased 13.2 points to 80.3%. It's important to note that the increase was due not only to increased property loss activity and a lower level of favorable reserve development, but also to our continued strategic investment in operations.

Despite continuing pressure on net premiums earned, we believe it is essential to continue our strategic investment in operations to address the smaller specialty commercial end of the marketplace. In our view, against the backdrop of increased loss activity and strong investments in operations, it's an excellent result to be able to pose such strong underwriting margins.

Before I move on to the investment portfolio; I want to comment on one additional item in our underwriting results. You will recall that we have one jeopardy risk exposure in the form of a life settlement agreement in our insurance segment. This exposure is accounted for on a fair-value basis and consequently we are required to review the valuation each quarter. It's important to know that this is long-term risk and quarter-to-quarter movements may not be indicative of the ultimate results for this exposure. However, based on the review of the valuation this quarter, we made a negative fair-value adjustment of $7 million, which is reported in the other insurance related income loss line in our income statement.

Moving on to our investment portfolio, our total cash in investments was $10.8 billion at June 30, 2008 essentially flat for the quarter. We had net cash generated from operations of $415 million during the quarter. This was offset by share repurchases of $175 million. Additionally, fair market value changes in our fixed maturity portfolio resulted in an unrealized loss position of $151 million at the end of the quarter. This increase in unrealized losses reflects changes in interest rates during the quarter. Our fixed income portfolio, remains of high quality with a weighted average rating of AA-plus and 91% of securities are rated A-minus or better.

Our exposure to topical assets remains a negligible portion of our overall portfolio. Subprime or Alt-A residential mortgage exposure remained at 2% of our portfolio or $206 million with a significant majority rated AAA or U.S. government agency bet. We encourage you to review the increased disclosure added this year in our financial supplement for further detail on subprime and Alt-A exposure. The majority of our sub-prime and Alt-A securities are short duration and are currently prepaying principal. Evidence of this is highlighted by the shortened duration of these securities from 1.6 years at year end to about one year at June 30, 2008. While there was further deterioration in pricing and our unrealized losses in this area increased, they remain negligible in the context of the overall portfolio and we feel comfortable with the positions that we currently hold.

Given the recent turmoil surrounding the government sponsored entities, specifically Fannie Mae and Freddie Mac, we thought we would discuss our exposure to these two entities in more detail. Approximately, 24% of our cash and invested assets or $2.5 billion are invested in Fannie Mae and Freddie Mac securities. About 85% of these holdings are pass through or agency CMOs. We also hold approximately $88 million in preferred shares and $290 million in direct debt. We do not presently expect to have any significant impairments from this exposure and we believe dislocations related to these two issuers are creating attractive investment opportunities which we have begun to take advantage of.

In our fixed maturity portfolio, we have substantially completed the targeted repositioning that we've discussed last quarter. We are comfortable that we've take advantage of the spread widening in the fixed income markets by deploying cash balances into spread products, specifically high-quality corporates and mortgage-backed securities.

Additionally, during the quarter we began to fund the global equity allocation in line with our long-term strategic diversification of our investment portfolio. We expect that the current weakness in the equity markets to continue scaling into this asset class towards our long-term strategic objectives.

During the second quarter of 2008, we produced record net investment income of a $137 million. This represents an increase of 21% over our net investment income in the prior year's quarter of a $114 million. This result was due to the combination of increased income from our cash and fixed maturity portfolio, resulting in $114 million of net investment income this quarter and the meaningful positive contribution of $20 million from our other investments portfolio.

The contribution to our net investment income from our cash and fixed maturities portfolios includes a higher contribution from fixed maturities relative to cash. The declines in income from cash reflect not only the impact of declining short-term rates over the last six months, but also our response to these declining rates which was to deploy cash balances into higher quality spread products. Higher investment balances related to fixed maturities offset the reduction in earned portfolio yield to 4.8% from 5% in the prior-year quarter.

New money in the fixed income portfolio is earning yields between 4.75% and 5%. Despite the challenging investment environment, our net investment income from alternatives or other investments was $20 million during the quarter. This represented an increase of $17 million over the same quarter last year. This quarter exceeded our average expectation for performance from these investments. The income in this quarter primarily emanated from a recovery in the senior secured loan market. While we are very satisfied with this resilience, the financial markets do remain difficult and unpredictable. Over the long term, we continue to expect this segment of the portfolio to provide added value over fixed maturities and cash, but it may not do so evenly or predictably from quarter-to-quarter.

Moving on; net realized gains for the quarter were $2 million as compared with $5 million and losses in the prior-year quarter. These gains are net of $1 million and other than temporary impairment charges taken during the quarter, emanating from our corporate exposure. With respect to foreign exchange, during the second quarter, changes in the euro and yen exchange rates resulted in foreign exchange losses of $7 million versus foreign exchange gains in the prior-year quarter of $7 million.

Our interest expense for the quarter was $8 million, in line with the first quarter but substantially below the $14 million incurred in the prior-year quarter. The reduction against the prior-year quarter reflects the termination of the $400 million Repo agreement in place through most of the third quarter of 2007. With respect to capital management, during the quarter, we were able to take advantage of the equity market volatility to repurchase 5 million common shares in the open market, at an average price of approximately $35 per share for a total cost of approximately $175 million.

In terms of the impact of these share repurchases on some of our key performance measures, share repurchases enhanced our annualized return on average common equity for the quarter by 34 basis points. The repurchases, net of accretion, reduced our diluted book value per share by $0.14. We have a further $320 million available under our current share repurchase authorization. We will continue to actively manage our capital position and evaluate opportunities as they arise.

Given recent declines in our stock price and our current capital position, we may continue to repurchase shares opportunistically through the balance of the year, with appropriate consideration for the fact that we are in hurricane season at the moment.

Now, I'd like to turn the call back to John.

John R. Charman

Thank you, David. Now I'd like to comment on market conditions in more detail. In our insurance segment depressingly not much has changed since last quarter. All of our business lines are under extreme pricing pressure with only one notable exception. We continue to see improvement in the financial institution's classes within our professional lines business. However, the balance of our professional lines business remains under pressure with rate decreases in the single digits.

Large account property rate decreases freely applied by the market continue to be in the range of 20% to 50% with supplements increasing. Despite the recent high-profile loss activity, there has been no noticeable impact on general levels of pricing or discipline throughout the market.

In the mining and heavy industrial sectors where recent large losses have been concentrated, the market is put through price increases at renewal but at levels we do not consider adequate. In a number of cases the market broadens the terms and conditions rendering those renewals inappropriate to us. Overall, property account retention in our U.S. surplus lines insurance business has been impacted by extreme competition. Particularly, for the Californian earthquake peril and this has brought us to walk-away levels of an increasing number of cases. Exposure adjusted offshore energy rate decreases are in the region of 20% for international business and 15% for Gulf of Mexico business.

U.S. casualty insurance business continues to see great decline unabated. Umbrella business has lagged primary casualty for some time in terms of the level of competition. The competition here is accelerated to the point where it is caught up with primary casualty. Our U.S. casualty portfolio, which we believe is not representative of the overall market, because we write this account very selectively, is seeing rate decline by about 10%.

Turning to the reinsurance market, as we have noted for some time, this markets remains relatively stable with small pockets of increasingly irrational behavior. Our reinsurance portfolio continues to be more significantly impacted by seasons retaining more business. Importantly, we continue to demonstrate strong leadership in the marketplace through our non-renewals and declinations of new business, because of either pricing concerns or underlying portfolio concerns. In our reinsurance segment, two major property catastrophe markets renewed during the second quarter, Japan and Florida. Rates were under pressure in both these regions. We continue to deliberately reduce exposure to the Florida-only markets, plus maintaining a very conservative exposure profile in Japan. We have redistributed exposure within the Southeast of the U.S. through opportunities where the risk-reward characteristics are much more in our favor.

From our perspective, the Paris market continues to suffer serious price competition. Many layers we analyzed appear to be priced at or below historical firm cost. Our expectations going into July 1st renewals were that reductions will be consistent with the 5% to 10% decreases experienced earlier in the year. However, supply exceeded demand to the point where we saw a rate decline more aggressively. We worked hard to reassemble our quality portfolio for which the returns appear to be attractive.

Moving on, the greatest pressure we're experiencing in that reinsurance segment is coming from our U.S. casualty reinsurance operations, largely driven by the continuing trend of seasons to retain more of their own business. Pricing pressure continues on all accounts with a benchmark expectation of a 10% decrease. Accounts with good experience are obtaining minor reductions. Clients continue to ask for higher ceding commissions to offset their higher expenses. We have generally pushed back on these requests and often our clients have only obtained a much smaller increase in commission than they originally requested.

In our specialty casualty reinsurance lines dominated by professional liability, we have added opportunistic financial institutions deals and maintained accounts with commercial D&A exposure that we believe will perform well. Other lines such as lawyers business are still performing well. But even here, we have retrenched somewhat. While negative pricing trends in the underlying insurance marketplace have been working against us, we expect our portfolio will continue to generate good underwriting profitability as major terms and conditions have not materially eroded.

We continue to rigorously monitor the impact of subprime issues and other credit issues on both of our underwriting and investment portfolios and remain comfortable with our identified exposures. Most activity with respect to D&O claims emanating from the subprime event relates to the 2007 accident year end. And importantly, we have no material adverse news with respect to our previously identified exposures.

With respect to deterioration more broadly in the global current environment; in the early part of this year, we have prudently increased our expected ultimate loss ratios for the 2007 and 2008 accident years, for our Continental European credit and bond reinsurance portfolio. Our cedents in Europe quickly recognized this deteriorating situation and reacted strongly to manage their exposures. We believe that their prudence in risk management coupled with our conservative loss picks addresses the potential for any increased frequency of loss for this type of business.

I am happy with our overall underwriting portfolio, and the embedded value it produced for us during this difficult trading conditions. We are determined to continue to recruit book value over time and to out perform our peers. As you all are aware, we believe we are in the softest part of the cycle in most lines, particularly in the insurance marketplace. History has shown that there is significant dispersion of results amongst companies emerging from the trough of the cycle. History has also shown that there is a material difference between high quality, well managed underwriting businesses and those that are loosely managed revenue-generating businesses.

AXIS prides itself on being the former and intends to continue to demonstrate this through the superior real returns that we provide our shareholders, regardless of market conditions. We also believe that reinvestment in our business, even at this point in the cycle, is essential to strengthen franchise value and increase future profitability.

Our view of such investment encompasses both buy and builds strategies. However, with respect to buy strategies you would expect us to be and we are very circumspect when evaluating portfolios that have not been underwritten to our high standards. We are confident that our focused strategies are much more appropriate for the modern business world. We will not duplicate historic industry posturing as a guide for future value creation.

Now I would like to open the line for questions.
Question And Answer

Question and Answer

Operator

[Operator Instructions]. And our first question will come from the line of Susan Spivak with Wachovia. Please proceed.

Susan P. Spivak
Wachovia Securities

Good morning, John and David. Thanks, for the --

John R. Charman

Good morning, Susan.

David B. Greenfield

Good morning, Susan.

Susan P. Spivak
Wachovia Securities

Commentary. Just a couple of questions. David, on those reserve releases, on the political risk line, can you just remind me is this first time that you're releasing within that line?

David B. Greenfield

We also had some releases in the first quarter of this year, Susan.

Susan P. Spivak
Wachovia Securities

Okay. But the majority of your longer tail lines is still something that would be up for review say, to second half of this year?

David B. Greenfield

Yes, that's correct. Although I didn't say at this time in my remarks, as I've said over the last several quarters, we have not released any of our long tail reserves as of yet, with the exception of I think, there was one case reserve we released last year. But we are reviewing that as I have said on earlier calls and you will hear more about that in the second half of the year.

Susan P. Spivak
Wachovia Securities

Okay. And then just a couple more follow-ups. John, with the increase in the frequency of these smaller events on the insurance side, I am just wondering if you are looking into buying more reinsurance coverage to cover those. And then secondly, as we head into this storm season, we've seen couple of these tropical storms hitting the Texas coast. I just wanted to review, how large of a hurricane loss would it have to be to an insured loss to say hit your reinsurance portfolio? And then, do you have meaningful exposure on the Texas coast on the insurance side?

John R. Charman

Good morning, Susan. And I am slightly puzzled by the fact that the losses in the second quarter from the property sides have not been replicated elsewhere. But I don't know how other people reserve. I can assure you that the losses were rather than mill losses, we had our normal market shares on those losses and they... the rest of the subscription market were along side us. So, I'm not quite sure how to comment on that, but what I will say is the fact that we will not need to buy anymore reinsurance capital, we were very successful in completing May renewals on the property side this year in which we continued to reduce our retentions. We continued to buyout reinstatements, we continued to take out aggregate deductibles and we continued to buy more coverage. And we were fortunate that our reinsurance acknowledged the quality of our underwriting in order to provide attractive pricing for us. So, I think as an overall statement, the depths and strengths of our reinsurance program relative to our insurance business, because don't forget we buy it on our insurance business, and we run our reinsurance business net. But the strengths and depths of our reinsurance program is the strongest it has been since the inception of the company. But I'm very comfortable about that.

Susan P. Spivak
Wachovia Securities

Okay, great.

David B. Greenfield

With regard to your point about our hurricane loss, as I just said to you that I think that we have an extremely robust and strong reinsurance program. Our market shares as a guide of what we would expect from a major hurricane will be between 1% and 2%.

Susan P. Spivak
Wachovia Securities

Okay. Thanks very much and I'll get back in line for the rest of my questions.

David B. Greenfield

Yes but as I said that if you look at that the difference between '05 and where we are today, where our modeling say much more superior, our understanding of the underlying data and the way that we analyze it so much more superior. And that's why we still tend to look at it as a market share, but I would optimistically look at it from a Southeast win point of view being closer to 1% than 2%.

Operator

And our next question will come from the line of Vinay Misquith with Credit Suisse. Please proceed.

Vinay Misquith
Credit Suisse First Boston

Hi, good morning.

David B. Greenfield

Good morning, Vinay.

John R. Charman

Good morning, Vinay.

Vinay Misquith
Credit Suisse First Boston

Could you comment on the difference between the professional lines business that you are writing in your reinsurance segment versus what's been written by Media Pro. My understanding was that the Media Pro was more small account business?

John R. Charman

Yes, it is. It's completely different.

Vinay Misquith
Credit Suisse First Boston

So, you are saying that the pricing on that is holding up better than the larger accounts, on your reinsurance lines?

John R. Charman

Yes, the price rate... it's at a completely different price level. And it's that small middle market business where it's very difficult, unless you got the technology and the specialty capability to access that business, the distribution is much broader and very different from the traditional professional lines business.

Vinay Misquith
Credit Suisse First Boston

And you've spent a reasonable amount of money trying to build out that platform and going global over that. If you could give us a sense for how that's progressing and when do you expect that to really impact the bottom line?

John R. Charman

We've been... we embarked on this over two years ago in terms of the diversification strategy. And especially in this area, we have spent heavily, in a very targeted way over the last 12 to 18 months. And that is now coming on stream really for the third quarter onwards. And I would expect to ramp up out that business over the next 15 months.

Vinay Misquith
Credit Suisse First Boston

So, that's great. And this is the question for David. David, looking at your reserves on the long-tail liability side. You said we should be seeing more of that in the second half of this year. Would you remind us how much of your reserves are liability reserves, and how much pertains to your '03 to'05?

David B. Greenfield

I think on the first point, I mean, I think roughly I am just looking for the numbers here. I mean, I think, I gave you some of these numbers in the first quarter, but in terms of some of our longer tail lines, we are probably looking at close to 60% of the reserves are related to longer tail lines.

Vinay Misquith
Credit Suisse First Boston

Alright.

David B. Greenfield

And that encompasses professional lines liability-type coverages. I don't have the breakdown in terms of what accident years those recover in front of me. But again I'd just reiterate that, we've said our loss picks on those reserves on those lines when we originally began to ride them. We have not adjusted those given that they were relatively new and the length of our business and we are looking at this year to determine whether we should make adjustments to those loss picks.

John R. Charman

And Vinay, that you remember because you were on those early phone calls that when we started writing those lines principally in 2003 in both insurance and reinsurance lines, which has very conservative loss picks which were at the upper end of the industry, loss picks. And that's been evidenced by all sorts of third-party papers since then.

Vinay Misquith
Credit Suisse First Boston

Okay, that's fair. Thank you very much.

John R. Charman

Thank you.

Operator

And our next question will come from the line of Jay Cohen with Merrill Lynch. Please proceed.

Jay Cohen
Merrill Lynch

Thank you. Good morning, everybody.

John R. Charman

Hi Jay, good morning.

David B. Greenfield

Good morning.

Jay Cohen
Merrill Lynch

I got three questions that should be relatively short. In the first quarter as I recall, you had slowed down the pace of the buyback. This quarter, you stepped it up and what was more important in that decision, was it the price coming down or the realization at the opportunities to deploy capital weren't quite as good as you had thought?

David B. Greenfield

I think if you go back to what I said in the first quarter, Jay, a lot of what drove our decision making in the first quarter had to do with the volatility in the financial markets and the fact that many of the market were effectively closed. So, we're being cautious about what we're doing with our capital under the circumstances. In the second quarter, I think we looked at the market opportunities that were there and felt very comfortable with doing a buyback in the range of $175 million.

Jay Cohen
Merrill Lynch

So, just more of the stabilization of what was happening in the financial markets?

David B. Greenfield

Well, I hope they were stable, but I don't think they're stable yet. But they were more open in the second quarter than they were in the first quarter. But even saying it that way, as you know them, the markets really aren't that open even today, but certainly a little more stable than they were three months ago.

Jay Cohen
Merrill Lynch

Got it. Secondly, what was the expense that ran through the income statement related to the restricted stock?

David B. Greenfield

In this quarter it was, I don't have the number right in front but it was a couple of million dollars but you were talking about on the CEO amendment, right... the contract amendment?

Jay Cohen
Merrill Lynch

Yes.

David B. Greenfield

Yes. So, it was a couple of million in the second quarter. But as I said in my remarks, it will be higher in the third and fourth quarter, because that grant was made towards the end of the second quarter.

Jay Cohen
Merrill Lynch

Okay. And then last question. As you look at potential acquisition opportunities I'm sure you are seeing a lot these days, what's more intriguing to you? Is it buying a company or an MGA as you have done in the past?

David B. Greenfield

Well, I think we had the same questions last quarter, Jay, but I'll will try and respond it in a consistent manner. But, that you know that we look internationally for MGA-type arrangements where they can provide us with embedded value, niche market embedded value so that we can look for an opportunity to create greater value on an ongoing basis. And we did that with Media Pro and we certainly would expect to continue to acquire a limited number of strategic businesses in the near future.

With regard to what I consider to be the traditional M&A side, every man and his dog has been hooked around the market by the investment bankers over the last 18 months, two years, and it's still surprising that even though price to foot values have come off by about 30% or 40% there is still no sign of any real M&A activity. We've maintained and I said in my prepared remarks that we are very, very conservative when we approach a third party for the view to looking at an acquisition. And we will not destroy the franchise that we have built so strongly over the last seven years by not applying the same rigorous standards to a third party in terms of underwriting background reserve people. We are not interested in having overwhelming ourselves with legacy issues, whether it's infrastructure, people, reserve systems. So, the reality is the M&A opportunities for us in the market as it stands are pretty limited. But nonetheless we are open to them. We look very carefully but we have yet to find real value in that market.

Jay Cohen
Merrill Lynch

Great, thank you.

David B. Greenfield

Thank you, Jay.

John R. Charman

Thanks, Jay.

Operator

And our next question will come from the line of Matthew Heimermann with JPMorgan. Please proceed

Matthew G. Heimermann
JPMorgan

Hi, good morning everyone.

David B. Greenfield

Hi, Matt.

John R. Charman

Good morning, Matt.

Matthew G. Heimermann
JPMorgan

Hi. Couple of questions and these are hopefully pretty quick as well. The bad debt provision, reinsurance bad debt provision this quarter didn't really change in aggregate but reinsurance dropped dramatically and I didn't know if there was unusual driving this, if you actually got a collection or just what changed there?

David B. Greenfield

We did have a positive outcome on our arbitration on the reinsurance side related to some claims for the 2004 hurricanes. And then separately, we took a more adverse view on a claim related to Hurricane Katrina. So coincidentally, they were close in numbers and sort of offset each other but there was some movement between the two lines.

Matthew G. Heimermann
JPMorgan

Okay. And then you mentioned that in the motor reinsurance book there was some higher premium adjustments this quarter and I was curious, does that explain the entire difference in volume year-on-year or are you also seeing maybe some opportunities there?

David B. Greenfield

That was most of the change year-on-year between the two years, was the adjustments.

Matthew G. Heimermann
JPMorgan

Okay, that's fair. And then just within the reinsurance segment, you talked about the cedents, the appetite by cedents to retain business continues to be quite high. Just curious how concentrated is your reinsurance book on the professional lines? Is this just a couple of treaties moving off the books or is this the impact of multiple treaties coming off the book?

John R. Charman

Well, I think that we had a couple of large treaties, longstanding treaties coming off the books. But it's been a consistent trend across the portfolio as well. But if you got a couple of large ones on the books, of course it's going to have disproportionate effect, but the large ones are done. It's more of an attritional position now. And then just going back to the French... the European motor, we actually have been more defensive at the last year end. So, as you made a comment, I think a little bit about market conditions. We are more on the defensive side than opportunistic.

Matthew G. Heimermann
JPMorgan

Okay, that makes sense. And then the last one is just on the Fannie/Freddie preferred stock, did you make any adjustments to the fair value in this quarter?

David B. Greenfield

Well, we carry them at fair value as required. And so, there is an unrealized loss associated with them, but we did not make any impairment charges related to those securities this quarter.

Matthew G. Heimermann
JPMorgan

Okay, perfect. Thank you.

David B. Greenfield

Thanks.

John R. Charman

Thank you.

Operator

[Operator Instructions]. And our next question will come from the line of Alain Karaoglan with Bank of America Securities. Please proceed.

Alain Karaoglan
Bank of America Securities

Good morning.

David B. Greenfield

Good morning, Alain.

John R. Charman

Good morning, Alain.

Alain Karaoglan
Bank of America Securities

The question relates to both the expense ratio and share buybacks. Since we are in a much more competitive environment John, and it doesn't seem that its going to change any time soon. Does that fact, how do you think about the expense ratio going forward? Is there a certain percentage that starts to bother you given that just arithmetically premium are going to continue to decline, that ratio is going to continue to go up and affect your results? And from a capital position, your common equity is almost $1 billion more than it was at the end of '06, premiums are at the same level, reserves are around the same level. If you don't make an acquisition, don't your share buyback and capital management have to become much more aggressive in an environment where you don't see things improving?

John R. Charman

Let me answer the first one. David, can go to the second one. The first one is of course we are mindful of our expense ratios. We have been at the bottom end of the industry expense ratios since we've founded AXIS. I told you we're never going to overwhelm ourselves with people, infrastructure, legacy systems and costs. But at the same time, as I said in my prepared remarks, we have to continue to invest strongly in the future. If we don't position our business for the diversification that we need to continue to grow our business, we will be subjected to the excessive competition that regularly occurs within the insurance wholesale markets and I believe very strongly that we must forge ahead and continue to make appropriate investment, regardless of market circumstances in those areas. And we've been doing so for the last two years and we will continue to do so probably for the next couple of years. But at the same time, we have to be mindful of those increased expenses against the declining revenue base.

But because of the diversity we have in our portfolio, those geographically and byproduct lines through both our insurance and reinsurance businesses, we are able to trade much more efficiently in the market globally today than we've would have been three years ago. And it's because of our investment and our people, our infrastructure, our product lines that we're able to do so. So, we can squeeze more business out of the system, regardless of the competitive environment because of that spending than we otherwise would have been. And so, I am pretty comfortable where we are. We are certainly not complacent about cost, because we realize that... but at the same time we have to invest in the future. And the quality of our current earnings will continue to improve as that investment flows through our operating capabilities.

David, do you want to?

David B. Greenfield

Sure, thank you. As you can appreciate it and as you also stated I mean, the point around capital management and capital levels is a very dynamic approach or consideration. I think, we are very comfortable with the position we have currently. I think, I mentioned in my opening or my comments that we have a further $320 million of buyback authorization available to us. We expect to be active with that throughout the rest of the year, given whatever the market conditions maybe in the time of the year we are in. But as long as we are continuing to produce very healthy return on equity, we're going to continue to want to have a strong capital base to continue to build out the franchise that we've continually told you about and what John, is commenting about with respect to building our business in the future years.

So, I think it's not a simple answer as we are just going to have the same capital level that we had two years ago. We are looking to the future, we are making investments in our business, we are continuing to return to the shareholders, a very healthy return on equity, and as these you heard we are being very active with our capital management at the appropriate times and we'll continue to do that.

Alain Karaoglan
Bank of America Securities

And David, you did mention, I don't know if I missed it; did you mention the return on alternative investment this quarter? I know you mentioned that it was higher than you would expect sort of front rate to be, but did you mention the percentage return?

David B. Greenfield

I didn't actually mention it and I don't have the portfolio number in front of me but I'll try to get that before we finish or we'll call you back. But effectively, I think on an expected portfolio basis, I think we've said in the past, we've tried to achieve about an 8% or 9% return on that portfolio. Clearly we had a very good portfolio... return on the portfolio this quarter. We don't expect that will continue unabated in the quarters ahead. So, it will be a little bit choppy, but I'll try and get the... I don't have the actual number here unfortunately in front of me.

Alain Karaoglan
Bank of America Securities

Thank you, very much.

David B. Greenfield

Thanks.

Operator

And your next question will come from the line of Josh Shanker with Citi. Please proceed.

Joshua Shanker
Citigroup

Thank you. Good morning, everyone.

David B. Greenfield

Good morning, Josh.

Joshua Shanker
Citigroup

Given the losses in China, I'm wondering if there is an opportunity for you guys to grow in that market and what is the real long-term market opportunity for China? How will that develop over time?

David B. Greenfield

Well, I worked for the Chinese, back in 1981 for five years. And I've traveled extensively to Mainland, China. And we have been extremely conservative in our approach to the Chinese market. The life and asset management market in China, is a market that I see great potential in. And if you look at the way that IIG expanded in China you can see that.

The P&C market is still completely undeveloped. And I think the aspirations for premium volume as well as quality of business are ahead of reality and I believe that will remain so probably for the next five to seven years. The reality is that the Chinese market is a very undeveloped market in... along P&C lines. We tend to assume that the mature markets of Europe and America, the buying habits of those matured markets have replicated in Asia, but they're not. In certain parts of Asia, people deem it unlucky to actually buy insurance coverage both personally and corporately. And it's not until there is much greater western capital going into places like China and with capital come board representation. With board representation comes better risk management and better identification of threat. And with naturally follows the capital markets protection of traditional insurance and reinsurance protection. That has a long way to go and even though I'm still deeply involved with China, for us as a company, we actually had extremely limited exposure there. Because we just do not see every man and his dog as I used the expression earlier, once again put a pin in the map of China and put that flag on it. The reality, if you were to get them to split out their revenue and their lack of profitability from many years of their involvement in that region, you will see the reality of it.

And quite frankly, I don't buy this story of the fact you've got to get in there early and build up your franchise name. Because it's a commoditized market and you could go in there at anytime, as long as you are competitive, efficient and service-oriented, you'll be able to get whatever market share you want and there is very little customer loyalty. If that helps you.

Joshua Shanker
Citigroup

And so, when we look at the losses accumulate this quarter, what types of businesses are buying protection that are mature enough to be wanting to do it right now?

John R. Charman

In China, most of the businesses that are buying protections are actually international companies with operations in China, Josh. Not many of the pure Chinese industrial companies are buying substantial amount of insurance or business interruption coverage. That may change in the aftermath of the terrible earthquake there. But I suspect it's got to take a while for that to feed through. Most of the losses were as a result of international companies operations in China, not actual Chinese domestic companies. It's very interesting question.

Joshua Shanker
Citigroup

Well, I appreciate your responses. Thank you.

David B. Greenfield

Great, pleasure.

John R. Charman

Thank you, Josh.

Operator

At this time, we have no questions in queue. I would now like to turn the call back over to John Charman, for closing remarks.

John R. Charman

Well, thank you very much ladies and gentlemen for taking the time to listen to us. And I hope you have a good August. And I hope the weather is favorable to you and we look forward to seeing you in a quarter's time. Thank you.

Operator
Thank you for your participation in today's conference. This concludes your presentation. You may now disconnect. Good day.