S&P Capital IQ

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W. R. Berkley Corporation NYSE:WRB

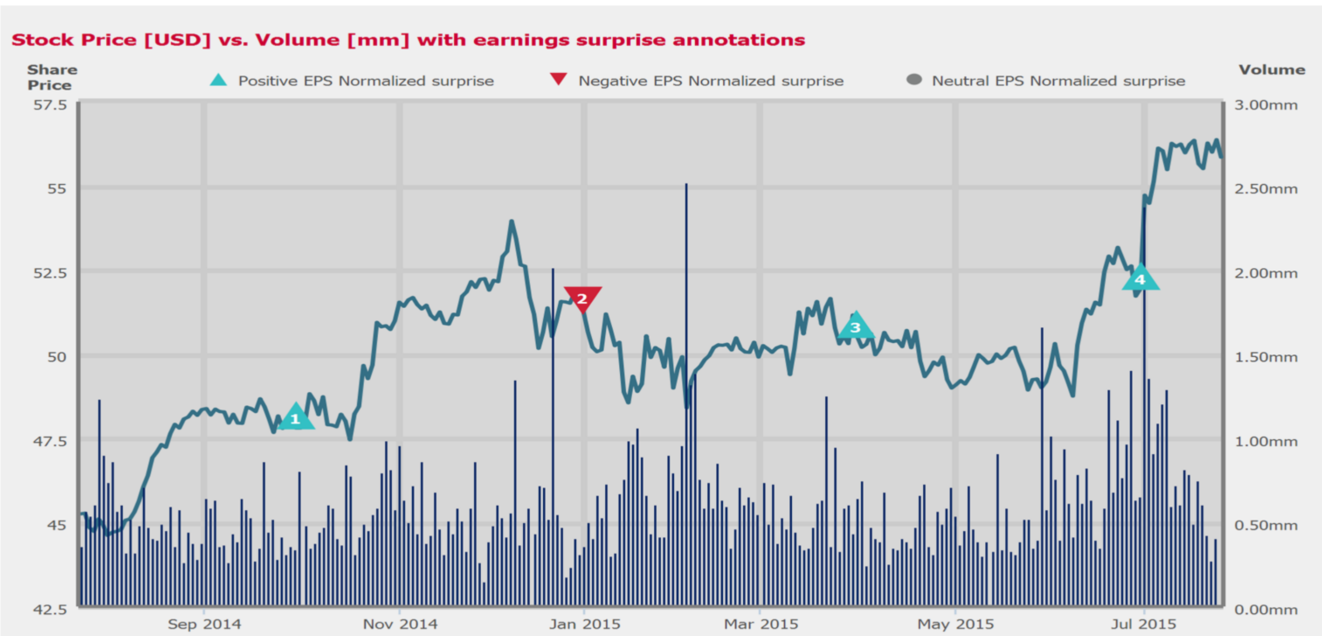
FQ3 2015 Earnings Call Transcripts

Monday, October 26, 2015 9:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.83	0.91	▲9.64	0.89	3.34	3.58
Revenue (mm)	1796.80	1860.96	▲3.57	1836.10	7102.65	7492.53

Currency: USD
Consensus as of Oct-26-2015 8:58 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	0.90	1.06	▲17.78 %
FQ4 2014	0.82	0.73	▼(10.98 %)
FQ1 2015	0.75	0.80	▲6.67 %
FQ2 2015	0.80	0.81	▲1.25 %

Call Participants

EXECUTIVES

Eugene G. Ballard
Executive Vice President of Finance

William Robert Berkley
Chief Executive Officer, President and Director

William Robert Berkley
Founder and Executive Chairman

ANALYSTS

Zhang Lu
Crédit Suisse AG, Research Division

Presentation

Operator

Good day, and welcome to W. R. Berkley Corporation's Third Quarter 2015 Earnings Conference Call. Today's conference is being recorded. 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 a 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 31, 2014, 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 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 Robert Berkley
Founder and Executive Chairman

Good afternoon. We were pleased with our year, our quarter, and we're looking forward to an excellent year. I think that I'd like to start with Rob, our very soon-to-be Chief Executive, and he's going to talk about our operations.

William Robert Berkley
Chief Executive Officer, President and Director

Okay. Thank you, very much, and good afternoon, everyone. So market conditions during the third quarter were by and large a continuation of what we had seen in the second quarter. Yes, competition is modestly on the rise, but it truly is at an incremental rate. And in spite of some of the recent headlines that we heard about cat or cat-like events occurring and affecting the industry, the impact has really been quite modest, and one is hard-pressed to find any type of catalyst out on the horizon that is going to shift the direction or, I should say, the overall market climate.

As far as the domestic insurance market goes, as we've said over the last couple of quarters, workers compensation, general liability, and many of the professional lines remained very attractive, and we think they're sensible places to be deploying additional capital. On the other hand, aviation, much of the marine market, cat exposed property, as well as offshore energy, are product lines that we are increasingly concerned about and do not see a lot of rational behavior in those parts of the market.

Another large product line that we have been talking to you about, or I would say, at this stage, it probably goes back to 2013 or so or -- maybe even earlier -- is commercial auto, particularly long-haul truck. We have had our reservations about this product line for a very, very long time -- it feels like at least at this stage -- and the lack of rational behavior that existed in the marketplace. While we have not come out of the woods as an industry when it comes to this product line, I think the fact is, that it is beginning to get the attention that is required, and we are beginning to scratch the surface as far as the needed action that one needs to take in order to get this line to return to meaningful profitability.

Moving on to the international market. It is a bit more competitive, no different than it's been in the past few quarters. One of the things that we've seen over the past few years has been many organizations have been looking to increase their footprints and some of the international markets that we have been operating in have become more and more crowded. This is not unique. We've even seen this happen in the past. And what tends to happen is that it ebbs and flows. Folks develop an appetite to expand their footprints, and over time they realize that it is not so easy to get the critical mass that they need in order to make their economic model work. They began to revisit their business plan and in many cases, ultimately retreat. And our sense is, quite frankly, that we may be over the next couple of years approaching a point of inflection with some of the international markets.

In addition to that, we'll be getting on to a couple of comments regarding the reinsurance business shortly, but we all know how competitive it's been. And the international insurance markets tend to be a bit more dependent on the reinsurance markets, and that is due to the fact that much of the international market uses much larger limits on a day-to-day basis than we typically see in the middle and the small commercial market in this country. So consequently, keep reinsurance is perhaps empowered less responsible behavior. And to that point, both domestically and internationally, we have seen an increase in correlation between areas of the industry that are under the greatest pressure and those that are most dependent on reinsurance.

On the topic of reinsurance, certainly, again, a topic we've discussed with you all in the past, the marketplace remains exceptionally competitive. Having said that, it would seem as though the pace of competition seems to be not moving or increasing as quickly as it has over the past several quarters. I don't think that we've necessarily touched bottom, but it would seem as though we continue to get closer, as again, the pace of erosion is slowing. When we look at the reinsurance market, quite frankly, we are convinced that it is unlikely that the market tomorrow will look like it did yesterday. At the same time, we are hopeful it will not look like what it appears to be today. And having said that, we do believe that capacity is becoming an increasing -- is becoming more and more a commodity with every passing day. And ultimately, it boils down to the expertise that you can bring from a value perspective to your clients and focusing on clients that actually do value expertise and don't just view you as a commodity.

Turning to our quarter, and I promised Gene I would keep this on a very high level and I wouldn't steal his thunder, but I do want to tuck in a couple of quick comments here. Top line came in at $1.57 billion. This is up about 3%. The growth was led by our domestic insurance business, which was up about 6%. Of that 6 points of growth, roughly one point of it was associated with rate. The top line growth was somewhat offset by our international as well as our reinsurance segments, which were both off. And that was primarily driven by FX, and I will leave the rest of that for Gene to touch on. As far as the loss ratio goes, coming in at 60.5%, by and large in line with our expectations. The reinsurance and the international segments both had good quarters -- or certainly improving quarters when compared with the corresponding period last year. And the domestic business moved slightly in the wrong direction, and that was primarily driven by non-cat-related property losses.

Moving on to the expense ratio, which is certainly something that we have discussed several times in the past. First off, the 33.2% was by and large in line with our expectations. We continued to be pleased with the progress that we've made on the domestic front. The reinsurance segment, the internals are flat. The rise that you see in the quarter is due to commissions and related. And Gene, I guess, you'll be going into some of that in some more detail. And then, finally, on the international front, the tick up, I think, is in keeping with what we suggested you would see when we had a discussion about 90 days ago, with some onetime expenses associated with some of our operations in the U.K.

So when you put it altogether, the company achieved a 93.7, which by and large, is right in line with our expectations. We think that the performance of the business is reasonably good at this stage. Having said that, we think some of the obstacles that we have been wrestling with to date, we're getting those are behind us. And we are optimistic as to how we are positioned going forward for the fourth quarter but particularly '16. Thank you.

William Robert Berkley
Founder and Executive Chairman

Thanks, Rob. Gene, you want to take us through the numbers?

Eugene G. Ballard
Executive Vice President of Finance

Okay, thank you. Well, for the quarter, we reported operating income of $118 million or $0.91 per share. That's up from $0.80 and $0.81 that we reported in the first and second quarters of this year, but below the $1.06 that we reported in the third quarter of 2014, which included significantly higher-than-average earnings from investment funds. For the quarter, our premiums -- our net premiums, increased $46 million, or 3%, from a year ago to almost $1.6 billion. As Rob said, domestic premiums grew by 6% to

$1.25 billion, that was led by 11% growth in workers compensation business and 8% for other liability business. International premiums declined 5% to $164 million due to the strengthening of the U.S. dollar against the pound, the Canadian and Australian dollar and the Brazilian real, in our case. In local currency terms, international premiums actually grew 7% and that was led by growth in Canada, Germany and South America. Reinsurance premiums declined 7% to $171 million due to the continuing soft market conditions in both the U.S. and overseas. Without the impact of FX changes, they would have declined as well, but by 5% instead of 7%. Our overall pretax underwriting profits were up 2% in the quarter to $96 million. The third quarter accident year loss ratio before cats was 61%, that's unchanged from a year ago. In fact, if you look back for each of the past 7 quarters, our accident year loss ratio has been between 60% and 61% throughout that period as pricing and loss cost trends have generally offset one another. Our cat losses were relatively light again this quarter at $6 million or 0.4 loss ratio points. That's down from $15 million in the third quarter of 2014. And on a year-to-date basis, our cat losses were $46 million, or one loss ratio point. We reported favorable reserve development of $15 million in the quarter with modest favorable development in all 3 business segments. That $15 million is in line with our year-to-date variable development which is $49 million. That gives us a calendar year loss ratio after cat from reserve releases of $60.5 million, slightly below the $60.7 million a year ago. Our overall expense ratio for the third quarter was 33.2, that's down 0.6 from the third quarter of 2014. The domestic expense ratio declined to $30.8 million, 0.3 below the third quarter of last year and almost a full point below the full year 2014. On the other hand, the international expense ratio increased 2.5 points to 43.4 points. The increase was due to both the decline in premium volume as well as continuing costs relating to Solvency II, and the integration of our U.K. company with our Lloyd Syndicate, and we do expect those costs to decline beginning in the fourth quarter of this year. Reinsurance expense ratio increased by 5 points to 39.0. The increase is attributable to the structured treaties that incepted earlier in the year. I mentioned those in the second quarter call. These treaties have higher than average commissions including profit commissions that are more than offset by lower loss ratios. And if you look at the expense ratio, the noncommissioned portion of the reinsurance expense ratio, it was unchanged from a year ago at roughly 10 percentage points. That gives us an underwriting profit of $96 million for the quarter and a GAAP combined ratio of 93.7.

Turning to investment income. Our investment income was $133 million this year -- this quarter compared with 197 -- excuse me, $179 million in the third quarter of 2014. Earnings from our core portfolio, including arbitrage trading, declined 8% to $110 million, due primarily to lower reinvestment rates available for maturing bonds. The average bond yield for the first 9 months of 2015 was 3.3%, down 0.2 from 3.5% in 2014. Income from investment funds were $23 million in the quarter, which is an annualized return of 8%. That compares with $59 million in investment fund income a year ago to well above averages that quarter from our aviation and real estate funds. Realized investment gains were $54 million in the quarter and were primarily due to the sale of a portion of our investment in HealthEquity. At September 30, 2015, the average credit rating for the fixed income security portfolio was AA- and the average duration was 3.2 years, which is a full year shorter than the duration of our loss reserves. Aggregate unrealized after-tax investment gains were $227 million at September 30, 2015. Our overall effective tax rate for the quarter increased by one point from a year ago to 33.3% and that's due to higher taxes in certain U.S. states, as well as a couple of non-U.S. jurisdictions.

Cash flow from operations was $620 million for the first 9 months of 2015 compared with $646 million in 2014, and in the first 9 months, we purchased 4.5 million shares of our stock for an aggregate cost of $224 million. All in, that gets us to net income of $153 million and after tax ROE of 13.3% and an ending book value per share of $37.18.

William Robert Berkley
Founder and Executive Chairman
Thank you, Gene. Well, these are especially interesting times. We really do focus on risk-adjusted return. It means we do some things that some of our competitors don't do. We don't focus purely on accounting results, because we're focused on creating shareholder value more than reported earnings per se. That means we start businesses instead of buying them because that's a better economic return. It's not a better accounting statement return. We're maintaining the quality of our investment portfolio and keeping a short duration, because the risks of an insurance company are doubling down if inflation comes. You get

hurt with your loss reserves. And if you extend the maturity and duration of your investment portfolio, you're effectively doubling down. So we've chosen to reduce that risk, the one that we can control. We haven't lowered the quality of our investment portfolio. Because the risk of an adverse economic turn will have a general adverse view on our business, therefore, we've chosen not to take the risk. So we're constantly looking at the risk side of how we manage our business because all of our employees are owners, it's the biggest single element on our profit sharing plan. Clearly, the management of the company views that as how they bet on their future. We continue to look out and see lots of volatility and uncertainty in the future, but we have a lot of confidence in the things that we see. For every problem, for every change, it creates new opportunities. And we think having the smartest people, the best underwriters and the best teams of people continues to give us a competitive advantage. Rob spends a substantial amount of his time out talking to new teams, constantly trying to find the best teams to do particular things, whatever they may be. They can be small niches or big chunks of opportunity, but we're constantly out there looking. And what we really are is a large group of small niches. And we do it in a way that we can compete administratively and cost-wise. We don't look like the people we compete with even though the numbers claim to be the same. So we're very excited. We think the future is coming along today. And we think that the numbers are moving in the direction we like. Clearly, it's a cyclical business, but we think we're well-positioned, and we're constantly investing in that future. It probably costs us $20 million a quarter each year for the new things we've been investing in. Things we invested in 3 years ago, give us a positive return, the new things that we're spending money on, cost us money. We think that's how you build a business for the future. We think we're going to have a better business in the future than we have today. And today's business is better than yesterday. So, I'm happy to answer any questions. Patricia, we'll take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Ryan Tunis with Credit Suisse.

Zhang Lu
Crédit Suisse AG, Research Division

This is Crystal Lu in for Ryan Tunis. Our first question is just -- do you have any fourth quarter visibility in to the investment fund returns, given the move in energy?

William Robert Berkley
Chief Executive Officer, President and Director

Well, we know that the energy prices are down and that we're going to probably have a small loss there. But we haven't released that number yet. We normally put that in our 10-Q filing.

William Robert Berkley
Founder and Executive Chairman

And our net position in our energy funds, as it relates to our overall funds, has continued to diminish as a percentage of our funds. So it's a smaller and smaller number. But we -- when we file our Q, we will announce those funds that we know already.

Zhang Lu
Crédit Suisse AG, Research Division

Okay, great. And how should we think about the level of share repurchase this quarter? What kind of -- what considerations were there?

William Robert Berkley
Founder and Executive Chairman

It's the same considerations we always give. We consider how to best use the capital owned by our shareholders, which is either buying back stock, paying special dividends or expanding the business. And we are always looking at the balance for those things and the cost to balance -- of that balance is the price of the shares, the availability of the shares and opportunities that we see.

Operator

[Operator Instructions] I'm showing no further questions at this time.

William Robert Berkley
Founder and Executive Chairman

Okay. I thank Mike McGavick [ph] for that. Have a wonderful day.

Operator
Ladies and gentlemen, that does conclude today's program. You may all disconnect. Everyone have a great day.