S&P Global
Market Intelligence

Markel Corporation NYSE:MKL

FQ3 2012 Earnings Call Transcripts

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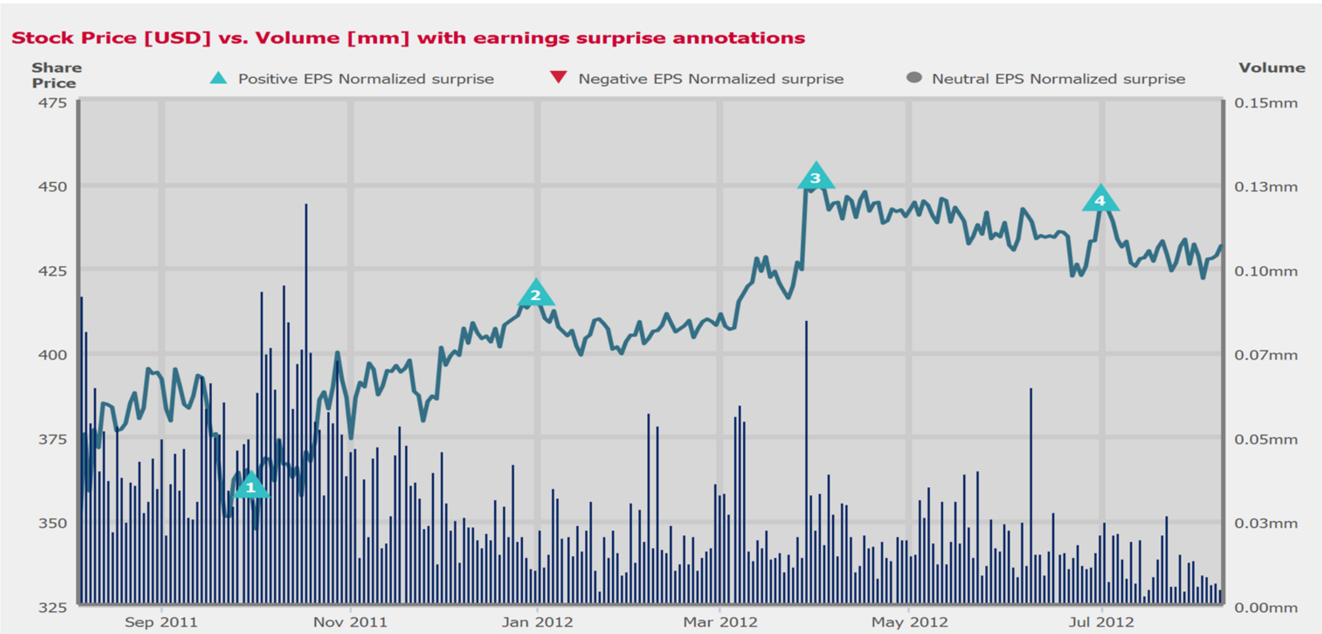
S&P Global Market Intelligence Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	4.27	4.88	▲14.29	4.50	21.15	20.25
Revenue (mm)	699.44	765.78	▲9.48	712.92	2828.90	3076.62

Currency: USD
Consensus as of Nov-09-2012 3:26 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	4.04	4.41	▲9.16 %
FQ4 2011	4.29	4.43	▲3.26 %
FQ1 2012	3.99	4.97	▲24.56 %
FQ2 2012	3.55	7.87	▲121.69 %

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Call Participants

EXECUTIVES

Anne Galbraith Waleski
Executive VP & CFO

Francis Michael Crowley
Vice Chairman

Richard Reeves Whitt
Co-CEO & Director

Thomas S. Gayner
Co-CEO & Director

ANALYSTS

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

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

David McKinley West
Davenport & Company LLC, Research Division

Jay Adam Cohen
BofA Merrill Lynch, Research Division

John D. Fox
Fenimore Asset Management, Inc.

Raymond Iardella
Macquarie Research

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

Ronald David Bobman
Capital Returns Management, LLC

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Greetings and welcome to Markel Corporation's Third Quarter 2012 Earnings [Operator Instructions] A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to turn the conference over to your speaker, Tom Gayner, President. Thank you.

Thomas S. Gayner
Co-CEO & Director

Thank you. Good morning and welcome to the Markel Corporation third quarter conference call. We're pleased to bring you today's report on our solid year-to-date economic returns and we look forward to your thoughtful questions about our strategy, performance, recent developments, and plans for our future. We'll also cheerfully answer your other questions.

To start off, our Chief Financial Officer, Anne Waleski, will review the overall numbers from the first 9 months. Then, my Co-Presidents, Mike Crowley and Richie Whitt, will discuss our international and domestic insurance activity. I will then cover investments in the Markel Ventures operations, and then we will open the floor for your questions.

Before getting started with today's lineup, the rules say we need to repeat the safe harbor statement, so here it goes. During our call today, we may make forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements as described under the captions Risk Factors and Safe Harbor and Cautionary Statements in our most recent Annual Report on Form 10-K and quarterly report on Form 10-Q. We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures on our website at www.markelcorp.com in the Investor Information section under Non-GAAP Reconciliation or in our quarterly report on Form 10-Q.

With that, let me turn it over to Anne.

Anne Galbraith Waleski
Executive VP & CFO

Thanks, Tom, and good morning, everyone. As I will discuss in more detail in just a minute, our financial results for the quarter benefited from strong investment performance, underwriting profits on our ongoing business and increased revenue and profitability from our Markel Ventures company. Our favorable year-to-date, underwriting performance was driven by fewer than anticipated catastrophe events in the first 9 months of 2012. However, we do have additional [ph] losses from the storm that hit the East Coast last week. Our underwriting claims and catastrophe management teams are currently reviewing our exposures, but we do not expect to have solid estimates of our losses for several more weeks. Our losses from Sandy will however be estimated before year end and will be reflected in our fourth quarter results.

Now, we will get into the financial results. I will follow the same format in discussing the results as in past quarters. I will focus my comments primarily on year-to-date results. I will start by discussing our underwriting operations followed by a brief discussion of our investment results and bring the 2 together with a discussion of our total results.

Our total year-to-date operating revenues grew 13% to $2.2 billion in 2012 from $1.9 billion in 2011. The increase is due to an 8% increase in revenue from our insurance operations and a 51% increase in revenue from our non-insurance operations which we refer to as Markel Ventures.

Moving into the underwriting results. Gross written premiums for the 9 months of 2012 were $1.9 billion which is an increase of 8% compared to 2011. The increase in 2012 was due to higher gross premium volumes in each of our 3 operating segments. Net written premiums were up 7% to the prior year at $1.7

billion. Retentions were flat in 2012 at 89%. Earned premiums increased 8%. Again the increase in 2012 was due to higher earned premium volume in each of our 3 operating segments. Increases in gross net and earned premiums have all benefited from our recent insurance acquisitions in the Specialty Admitted segment. Our combined ratio was 96% for the 9 months of 2012 as compared to 105% in 2011. The combined ratio for 2012 includes $41 million or 3 points of expense related to our prospective adoption of the new DAC accounting standards and $9 million or less than 1 point of underwriting loss from Hurricane Isaac in 2012.

The 2011 combined ratios included $133 million or 9 points of underwriting losses related to the catastrophe events which occurred last year in the U.S., Australia, New Zealand and Japan. Setting aside the impact of the prospective adoption of the new DAC accounting standard in 2012 and the effect of catastrophes in both 2012 and 2011, the improvement in our year-to-date combined ratios was primarily due to lower current accident year loss ratios in the Excess and Surplus Lines and London Insurance Market segment.

Favorable development on prior year’s loss reserves represented 17 points on the combined ratio in both 2012 and 2011. Included in the favorable development is $31 million of unfavorable loss reserve development on asbestos and environmental exposures within our discontinued line segments. We completed our annual review of these exposures during the third quarter. During this year’s review, we reduced our estimate of the ultimate claim counts, while increasing our estimate of the number of claims that would be closed with an indemnity payment. Based upon this information, prior year loss reserves for asbestos and environmental will increase.

Next I will discuss the results of our non-insurance operations which we call Markel Ventures. In 2012, year-to-date revenues from our non-insurance operations were $345 million compared to $229 million in 2011. Year-to-date net income to shareholders from our non-insurance operations was $8.6 million in 2012 compared to $8.9 million in 2011. Revenues from our non-insurance operations increased in 2012 compared to 2011, primarily due to our acquisitions of WI Holdings Incorporated in late 2011, and Havco in 2012.

Next, turning to our investment results. Investment income was up 6% in 2012 to just under $208 million. Net investment income for the 9 months of 2012 included a favorable change in the fair value of our credit default swap of $13.7 million compared to an adverse change of $2.7 million in 2011. During 2012, financial markets improved and credit spreads narrowed, which favorably impacted our credit default swap.

Net realized investment gains were $25 million and versus 2012 and 2011. Net realized gains for the 9 months of 2012 included $4 million of write-downs for other than temporary declines in the estimated fair value of investments compared to $15 million in 2011. Unrealized gains increased $330 million before taxes in 2012, driven primarily by increases in equity securities. Tom will go into further detail on investments in his comments.

Looking at our total results for 2012, the effective tax rate was 19% in 2012 compared to an effective tax rate of 17% in 2011. The increase is primarily due to anticipating a smaller tax benefit related to tax-exempt income as a result of projecting higher pre-tax income for 2012 as opposed to 2011. We reported net income to shareholders of $197 million compared to $92 million in 2011. Book value per share increased 12% to $395 per share at September 30, 2012, up from $352 per share at year end.

Finally, I’ll make a couple of comments on cash flow and the balance sheet. Net cash provided by operating activities was approximately $240 million for the 9 months ended September 30th, 2012, compared to approximately $261 million for the same period of 2011. The decrease in net cash provided by operating activities was due to lower underwriting cash flows for the London Insurance Market segment, primarily due to increased claims settlement activity during 2012. Investments in cash at the holding company were approximately $1.1 billion at the end of September, as compared to a little less than $1.2 billion at the December 31, 2011. The decrease in invested assets is primarily the result of acquisitions made during 2012.

With this, I will turn it over to Mike to further discuss operations.

Francis Michael Crowley
Vice Chairman

Thanks, Anne. Good morning. Third quarter results for both E&S and Specialty divisions were again positive from a gross written premium perspective. As Anne said, E&S gross written premium increased 6.9% for the quarter versus 2011 and 6.3% for the 9 months versus 2011. Specialty division gross written premium increased 9.1% for the quarter and 14.9% for 9 months compared to the same period of 2011. The growth in the Specialty Admitted segment was substantially due to the booking of $17 million in the quarter and $43 million year-to-date from the THOMCO acquisition which was announced in January, and a 16% increase in volume for the workers' compensation line of business.

To date, our retention of the THOMCO business through 9 months is exceeding our expectations. Growth from THOMCO and FirstComp was offset by reduced volume in our accident and health, property and casualty and individual risk business in the Specialty division due to the division to exit certain lines of business. The combined ratio for the E&S segment was 89% for the quarter and 91% for 9 months, compared to 89% and 88% perspective for the same period in 2011. The combined ratio for the Specialty Admitted segment was 109% for the quarter and 108% for the 9 months, compared to 116% and 109% for the same periods in 2011. With regards the expense ratio, the E&S segment expense ratio was flat for the quarter, and slightly better for 9 months, excluding the impact of the new DAC accounting methodology and increased profit-sharing accruals. For the Specialty divisions, the expense ratio, excluding DAC and higher profit sharing expenses in 2012 was slightly improved for the quarter, but flat year-to-date, compared to 2011.

Clearly, one of the highlights for the quarter announcement of the new Hagerty-Markel relationship. We are extremely pleased that Hagerty's management chose to select Markel as its underwriting partner for the future. As all of you know, Hagerty is a widely known as the broker in the collective car and boat insurance business. They are a well-managed highly focused specialty firm that continues grow their business. Markel looks forward to long and profitable relationship with McKeel Hagerty and his team.

Another important highlight of the Specialty division was the appointment on Mondeo this week of Greg Thompson as President of Markel Specialty. Greg has been in the insurance business for over 30 years. He led THOMCO for 32 years, growing from a -- growing it from a small operation to a large programs administrator. Markel acquired THOMCO in January 1 of 2012 and in his new role Greg will report directly to me. I am confident that his leadership and experience will be a great boost to our Specialty division.

Additional highlights for the Specialty division include Markel American launching a new product targeted at avid bicyclists which offers physical damage for high end bicycles and liability and medical payments for the rider.

Markel agents knew that FirstComp submitted more than 3,000 new accounts year-to-date resulting in new premiums in excess of 6 figures. Also year-to-date 611 FirstComp agents have signed producer agreements with Markel which should contribute to our cross-selling efforts.

Regarding the E&S segment, the recent creation of the chief underwriting position is producing positive results. Jeff Lamb is proving to be a valuable link between product management and the regions in our PL [ph] product line leadership group. Our E&S division is working closely with our product line management on growing profitable lines of business. During the quarter, we also shifted 13 experienced underwriters to direct underwriting roles in the regions. Our goal is to get more experienced underwriting authority closer to the field and improve our response times for our agents and increase our chances for success. A number of our E&S Associates attended the annual NAPSLO conference, where we held 243 meetings with various agents and brokers. Based on those meetings, we remain very encouraged about our opportunities to continue to grow our E&S business.

I'd like to congratulate Scott Culler who heads our West region on his appointment to the NAPSLO board. I am also pleased to announce that Phil Freda joined Markel as managing director for public entity business. Phil brings more than 20 years' public entity experience to Markel, and previously managed the significant book of this business. Our goal is to significantly expand our position in this niche, which has been very profitable for Markel. Also, Mike Vought has been promoted to managing director of casualty. Michael continues to shoulder his responsibilities for umbrella business. He has 25 years' experience and is well equipped to direct this important line of business for Markel.

Throughout North America and in the entire company, we continue to work aggressively to reduce cost. Richie and I have asked the leaders of all of our shared services to focus on process improvement and deliver their services more efficiently. These efforts are critical to reducing our expense ratios and our leaders have embraced this initiative.

Finally, with regards to the rate environment, rates remain stable, enabling Markel to achieve single-digit rate increases on CAT property business and workers' compensation. The casualty business remains competitive, but we expect to continue to achieve modest rate increases there as well. At this point, we anticipate a similar rate environment for 2013.

I'll turn the call over to Richie to talk about our international operations. Richie?

Richard Reeves Whitt
Co-CEO & Director

Thanks, Mike. Good morning, everyone. I'll start off and talk a little bit about results at Markel International for the first 9 months and then I'll cover off a few things at the corporate level.

During the first 9 months of 2012, Markel International's gross written premiums grew 4% to $705 million. There was a little bit of FX effect on that. If you had kept the constant rate of exchange, it would have about 6% growth. Significant areas of growth continue to be in the energy and catastrophe-exposed property areas. This has been partially offset by declines in some of our professional liability lines. Pricing trends that we talked about in the first 2 quarters have largely continued in the third quarter.

We continue to see price increases on CAT-exposed property in the marine energy business. However, as the year progressed, price increases in these areas have moderated. Our overall average price increase on renewal business for the first 9 months of the year was right around 5%. CAT property increases have generally been between the 10% and 20%, and energy has seen single-digit increases. All the other lines have seen relatively stable pricing. Despite price increases in these areas, in many areas the market is still pretty competitive. As an example, while we've been able to maintain our modestly push pricing in our professional liability division, premium volume is down against prior year as a result.

International's combined ratio for the 9 months of 2012 was 88%. That includes 2 points of expenses related to the adoption of the new DAC accounting standard. Obviously, as opposed to the significant CAT losses we experienced in 2011, our first 9 months of 2012 results include minimal catastrophe losses with Hurricane Isaac being the largest single event at approximately $3 million.

The 9 months result also benefitted from $119 million of prior-year favorable development across a variety of programs. I know we've said it a lot of times and we'll say it again, we always strive to establish reserves that are more likely redundant and deficient. However, the releases we have experienced in the first 9 months at Markel International are more than we normally would have expected and are the result of favorable development across the number of the product lines, including the 2001 and prior reserves.

Moving to the Markel levels, while the first 9 months of 2012, as Anne said, were benign from a catastrophe standpoint, Markel's fourth quarter will be impacted by Hurricane Sandy which hit the northeast U.S. last week. Our thoughts go out all those affected, which includes many of our Markel associates. We're currently working to assist our policyholders with their claims and recovery efforts, but it's still very early in the loss adjustment recovery phase, and we're going to have to work over the next several weeks to determine the storm's financial impact to Markel.

Finally, I'd like to mention 2 promotions at the Markel corporation level. Brad Kiscaden has been promoted to Executive Vice President of Markel. Brad has been with Markel for over 25 years, many of these years as our chief actuary. Brad and his team have been instrumental in implementing and safekeeping our reserving philosophy, which has been one of the cornerstones of our success for over the years. Brad will be adding IT to his area of responsibility and is going to be moving to Richmond to join our senior executive team.

Ron Harry is going to be stepping into the role of chief actuary for North American. Ron has been Brad's partner for many years and played a critical role in the recent implementation of our data warehouse. I'd just like to congratulate both Brad and Ron. I inadvertantly failed to mention them on last quarter's call.

At this point, I'd like to turn it over to Tom and afterwards we'll be glad to take your questions.

Thomas S. Gayner
Co-CEO & Director

Thank you, Richie. And what I'm sure comes as relief to my colleagues, my comments today will be shorter than usual, since I think the numbers largely speak for themselves. As Anne mentioned earlier, book value per share grows to a new record high of $395 as of September 30. Our comprehensive income so far in 2012, $426 million, created an increase in book value per share of roughly $43 or 12% during the first 9 months. I am very happy with those results and I hope you are as well.

As for some details, during the first 9 months, the total return on the investment portfolio was 7.4%. Equities enjoyed a return of 15.5% and fixed income produced a positive overall return of 4.5%. At Markel Ventures, we enjoyed a great third quarter and that brought year-to-date results closer to my expectations. Revenues totaled approximately $345 million and EBITDA totaled roughly $41 million. This compares to revenues of $228 million a year ago and EBITDA of roughly $34 million. As always, a reconciliation of EBITDA to net income is available on the Markel Corporation website.

Additionally, during the quarter, we completed the acquisition of Tromp Bakery systems in the Netherlands, which makes equipment for pizza, pastry, pie and bread makers. We also purchases controlling interest in Reading Bakery Systems, which make bakery equipment for the production of crackers, pretzels, cookies, and other baked snacks. They will operate as part of our AMF Bakery Systems business and we think we will do very well with these businesses as long as the Atkins Diet doesn't become popular again.

Additionally, the growth of Markel Ventures should provide our shareholders with positive returns and cash flow even when we're seen news headlines that affect the short-term results of our insurance business. We are relentless in our drive to build the value of the Markel Corporation, and Markel Ventures should continue to be a growing force to help make that happen.

In the equity portfolio, our focus on high-quality securities as well as our commitment to continuing to invest in equities paid off. During the first 9 months, we earned 15.5% compared to the S&P 500 total return of 16.4%. I never like to underperform, ever. But in shorter-term measurement periods, it happens all the time. I'm comforted by the fact that we earned these returns in 2012, despite not owning one of the most popular stocks of all time, which contributed 700 basis points to this year's S&P return. We have a long history of earning excellent investment returns without owning the stocks that most people are talking about. And over time, this approach has served to reduce risk and create outperformance during tough periods.

Over the last 23 years, a longer and more meaningful timeframe, we've outperformed the S&P 500 by a 150 basis points a year. Our equities have also outperformed the Barclays Aggregate Bond Index by 280 basis points a year, which demonstrates the value we add to our shareholders by sticking with the relatively unpopular idea of investing in stocks. Equities now represents roughly 52% of our total shareholders' equity, up from 55% at year end. We continue to be steadily and regularly add to our equity investment portfolio and we expect to continue to do so. As you heard from my colleagues, revenues are going up around here, and we've ideas for where to invest the money.

In our fixed income operations, we earned a total return of 4.5%. I'll repeat what I've repeated before and be just as surprised to say at this time and the last time. Interest rates moved lower yet again during the third quarter, so we over-earned the coupon from our bond portfolio. Yet again, I continue to be amazed that this is happening and we remain every more defensively positioned for this portfolio. Duration for the overall bond portfolio is now at a new record low for us in slightly less than 3 years. The perverse good news is that the opportunity cost of holding an ever-shorter duration bond portfolio continues to go down. Given the low rates at the front and long-end of the curve we could not stretch for yield even if we wanted to. There isn't any worthwhile yield out there to be had.

As such, we have a portfolio where the difference between what one would call action equivalence and longer-term fixed income instruments continues to diminish. That means that for all practical purposes we have a lot of cash and all of the options that go with it, such as deploying it at higher rates of return when we get the chance to do so. It also means we're protecting our balance sheet against the rising interest rates even more than last quarter and last year. You might recognize the familiar sound of these comments. I remain convinced that this is the prudent way to manage the portfolio.

In total, the comprehensive results of our insurance, investments, and Markel Ventures operations produced excellent results for your company so far this year. I'm excited as we continue our long-tem path of building one of the world's great companies and we look forward to your questions.
With that, Kathleen, if you'd open the mic for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is coming from Adam Klauber of William Blair.

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

A couple of different questions. You mentioned that you are discontinuing a couple of lines in the E&S segment and A&H, some properties, some specialty. Roughly, how big are those books of business and...

Thomas S. Gayner
Co-CEO & Director

It was in the Specialty segment.

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

Specialty. Sorry, Specialty...

Francis Michael Crowley
Vice Chairman

We're not exiting all -- the couple of lines that we're exiting, Adam. are very small. They're lines that we had for a while and we just aren't growing them. But also in the A&H segment, we're exiting several lines that just haven't been profitable for us, and we are shrinking our A&H division because of that. But I don't have the total in front of me.

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

Okay. Okay. And you think that process will be done by the end of this year or is that going to run into 2013?

Francis Michael Crowley
Vice Chairman

Mostly, so. Some of lines we have not announced yet, and that that will happen over the course of next year. But those are the smaller lines. I mean, they are really small. But all of this is to improve our results and our loss ratio on the Specialty business.

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

Okay. And your accident year, the loss ratios and catastrophes again were good and lower than last year, but sequentially they were up in the third quarter compared to the first half in both E&S and Specialty Admitted. I guess, why were they up a little?

Francis Michael Crowley
Vice Chairman

Adam, I think that is primarily related to adjusting our profit-sharing accrual in the third quarter. It's something we do each year. We'll be looking at it again this year in the fourth quarter, given the storm that just occurred. But I think that's what's driving what you're seeing.

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

Okay. Makes sense. And then as far as FirstComp, what sort of rate increases are you getting in that book of business and will that business be more profitable going forward, do you think?

Richard Reeves Whitt
Co-CEO & Director

Yes. The FirstComp is trending to exactly -- the way we want it to trend. And they are in the same boat. They're getting 4% or 5% rate increases. But we're also as I said in the last quarter call changing our geographic mix there. I mean, they're on track to do exactly what we want them to do. They're moving in the right direction. The trends are good. And they're not only adjusting rate where they can, but they're changing their geographic mix and we're exiting some areas where it's not profitable to be in the comp business [ph].

Operator

[Operator instructions] Your next question is coming from Arash Soleimani from Stifel, Nicolaus.

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

Just a couple of questions here. I know you talked about rates are little bit, but looking at CID and markets coverage, I mean, it looks they ticked down. So my question is is that just lumpiness or is that indicative of a trend? I just wanted to get your thoughts around that.

Francis Michael Crowley
Vice Chairman

I would say its lumpiness. I mean, if you look at the CID analysis and other analysis, some of them show it ticking down a little bit, but it was minor. It's lumpy.

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. That's fair. And then I think you mentioned something about the tax rate for the first 9 months, but looking at the third quarter, what was that attributable to, the pretty low tax there?

Anne Galbraith Waleski
Executive VP & CFO

During this third quarter, we changed our estimate of how much of our foreign income would be taxed in the U.S, so basically we've caught up the benefit of a lower rate in the quarter, which ultimately changed the expected effective tax rates for the year downwards.

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And then just sort of back maybe to the -- not necessarily the rate alignment [ph], but in terms of the Specialty business, getting back to E&S, is that continuing? Is that slowing down or accelerating? I just wanted to get some thoughts around that.

Francis Michael Crowley
Vice Chairman

In terms of what, the volume or the rate?

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

Just the volume.

Francis Michael Crowley
Vice Chairman

Are you talking about the E&S segment or are you talking about those Specialty segments?

Arash Soleimani
Stifel, Nicolaus & Company, Incorporated, Research Division

I'm sorry. Let me clarify. I was talking more about the standard carriers cutting business back or letting the specialty carriers handle that business moreso than they have in the past.

Francis Michael Crowley
Vice Chairman

Well the only way I can answer that is that we continue to be pleased with the submission counts that we're getting, and obviously our E&S business is growing. Based on all of the business that we had, and I attended a lot of them myself at NAPSLO, we are very encouraged with our relationships with the wholesale brokers and we're seeing some modest improvement there, business going back. It's not a -- certainly not a waterfall at this point.

Operator

Thank you. The next question is coming from Ron Bobman of Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had some Sandy E&S questions of a general nature. I was wondering if you could talk a little bit about the prevalence in -- and I guess it's hard to use the word traditional E&S, but if there is sort of a core E&S product, how prevalent flood sub-limits appear in that line of business or that sub-segment? And then also sort of BI, how often are there sort of constraints or limitations of coverage with respect to BI in core E&S commercial products?

Francis Michael Crowley
Vice Chairman

Well, Richie is going to jump in on this too, but a lot of it has to do with the perils obviously that are insured under our property policy. And if there is no flood coverage for the property, there is not going to be any flood coverage for business interruption. It depends on the risk. We write some flood, not a lot of flood. And our exposure is more wind.

Richard Reeves Whitt
Co-CEO & Director

And I think -- Ron, I think it's going to be across the board. I mean different people are going to do different things in terms of the flood sub-limits or the waiting period for the business interruptions. I mean it's going to be all over the map, but typically, as Mike said, if there is no flood coverage for the properties, there will be no flood coverage for the BI. And it all depends -- if people do have flood coverage, there is usually pretty substantial deductibles on those policies. So it's going to be different depending on what the property is and who the coverage is with.

Ronald David Bobman
Capital Returns Management, LLC

Is there anything uniform or common practice in the New York/New Jersey/Pennsylvania E&S market whereby those policies as compared to other geographies had more or less flood sub-limiting or is there...

Francis Michael Crowley
Vice Chairman

There's really nothing standard in the business anywhere. I think that -- clearly sometimes you think that -- if you think of the southern East Coast or you think of earthquakes in California, you tend to think that that's a more exposed area.

Ronald David Bobman

Capital Returns Management, LLC

That's a more what area?

Francis Michael Crowley
Vice Chairman

More exposed area, but in terms of -- but there is not -- there is just no standard. I mean clearly there is exposure in New York and New Jersey as we unfortunately found out. But everybody knew it was there. It was just a matter of the frequency.

Ronald David Bobman
Capital Returns Management, LLC

Right. And is it the kind of thing where one E&S company may have had a more restrictive form or underwriting selection process?

Francis Michael Crowley
Vice Chairman

I mean, certainly that could happen. I mean again there is no standard.

Ronald David Bobman
Capital Returns Management, LLC

Any other thoughts worth sharing on the topic of BI or flood in E&S, or in the context of Sandy?

Francis Michael Crowley
Vice Chairman

I think we're all just going to have wait and see how -- the situation's obviously still developing. I mean the recovery efforts were delayed with recent storm. So I think it's going to just take everybody a little while to see what the actual situation ends up being. I mean everybody has seen the numbers, the industry numbers that people have been attempting to predict, and I think most people feel those are going to continue to creep upward. We just going to -- I think we all just need to let the people work on recovery, and let the claims come in and we'll figure out what it looks like.

Ronald David Bobman
Capital Returns Management, LLC

Is it safe to assume that -- let's call it the pressure or the appearance in personal lines with respect to storm sub-limits not being -- windstorm sub-limits basically being decorated, is it safe to assume that we're not going to take that into commercial area in any form?

Richard Reeves Whitt
Co-CEO & Director

I would say it's going to be -- I mean everybody remembers in Katrina. There was obviously lots of legal action and the departments of insurance were active in terms of interpreting, helping to interpret what they thought coverage meant. So, I would suggest and I would assume that it would be a similar situation that you would see. You would see people trying to work through what the coverage is. So I expect a very similar sort of that situation there.

Operator

Our next question is coming from Ray Lardella of Macquarie.

Raymond Iardella
Macquarie Research

So just to follow up a little bit on the Sandy. I am not going to ask estimates or anything of that nature. Just curious in terms of business segments. Do you think you'll have exposure in each one or is the discretion in the embedded [ph] market not going to have any exposure? I am assuming that the answer is no.

Richard Reeves Whitt
Co-CEO & Director

Yes, we'll have exposure in each of our segments.

Raymond Iardella
Macquarie Research

Okay. And then I know, Tom had mentioned the amount of cash you guys have. Just curious on -- I know you've been a little bit acquisitive in the Markel Ventures side. But just curious in terms of, too, on the insurance side, how was the M&A environment looking in [indiscernible]?

Francis Michael Crowley
Vice Chairman

Well, I would say on the insurance side, it's normal. I mean we see things. We have things presented to us. And as we have said on this call before, we may look at 10 or 15 or 20 things before we find one that we might find attractive and then of course then it's a matter of can we do a deal that meets our return results requirements.

Richard Reeves Whitt
Co-CEO & Director

And I would echo Mike's comments. I mean in terms of the acquisition environment, fortunately Markel has become a well known acquirer of insurance and other businesses. So as a consequence, we did a lot of inbound phone calls and the good news about that is to find the one as you really wanted to. It helps to look at a lot that you don't. Just being part of the flow is very helpful and we continue to see robust flow.

Raymond Iardella
Macquarie Research

Okay. That's helpful. I mean in terms of return requirements, is there any sort of benchmark that we should be thinking about when you guys look at acquisitions?

Richard Reeves Whitt
Co-CEO & Director

Well, before we would lay out of dollar of capital that we have any discretion about at all, and this would be the public equity investment portfolio, looking at an insurance company deal, looking at a non-insurance company deal, it's got to start with double digits for us to be we willing to expend capital and that remains the case.

Operator

Your next question is coming from John Fox of Fenimore.

John D. Fox
Fenimore Asset Management, Inc.

Two questions and a comment. Did I miss it in London? If I'm reading this correct, the gross rate in premium was down. Could you comment on that?

Richard Reeves Whitt
Co-CEO & Director

It's down a little bit in the third quarter, John. I mean it's up year-to-date. But we have been doing some acquisitions and opening offices over the last several years and so I mean I think we have kind of gotten to a sort of steady state in London now. And as I said, we have had some nice growth in the CAT-exposed property and the marine and energy, but the other side of that is we've had a little bit of shrinkage on some of our professional liability lines because as I was saying there's still -- fairly competitive there.

John D. Fox
Fenimore Asset Management, Inc.

Okay. Yes, I just sort of saw the kind of general lift in rates. That would be -- I mean, am I being too optimistic, or are the rate increases are not that great, or...

Richard Reeves Whitt
Co-CEO & Director

No, we're still getting -- we're still seeing rate increases. The other thing, and Mike pointed out, is we did discontinue our U.S. binding property earlier in the year, so that obviously is impacting it a little bit. But there is no concern there. It's sort of what we would have expected for the third quarter.

John D. Fox
Fenimore Asset Management, Inc.

Okay. And then I know you guys talked year-to-date, but I have another question on the third quarter. And if I'm doing this correct with the accounting change, but the expense ratio looked higher than it has been, and I'm just using the $225 million.

Anne Galbraith Waleski
Executive VP & CFO

Yes, John. Again I think that's the profit-sharing accrual, the incentive comp accrual increase that we did in the third quarter.

Richard Reeves Whitt
Co-CEO & Director

Yes, John -- and this is something that's probably worth just talking about for everybody. So we have pretty -- we have had very nice prior-year redundancies come through this year. We pay out our profit-sharing to the underwriters as the year develops. So as we have more favorable development, we increase the profit-sharing accrual. So that prior year development is wonderful when it comes through, but it has an impact on the current year expense ratio when we have to put up the bonus accruals. We love having to do that, quite honestly.

John D. Fox
Fenimore Asset Management, Inc.

Yes, that's terrific. Okay. And the comment is for Tom Gayner. The 10-year treasury yield had declined 1 basis point since the end of the quarter, Tom.

Thomas S. Gayner
Co-CEO & Director

Well, the rate of change is slowing there.

Operator

Our next question is coming from Scott Heleniak of RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Just wondered if you have any other details on the Hagerty acquisition you made. I'm assuming that's an MGA you convert to fees to premiums. But can you talk about what kind of size that book might be?

Francis Michael Crowley
Vice Chairman

The only thing that we have said is that if you look at the A.M. Best guide for 2011, Essentia was for the -- that we're acquiring a shell company there -- Essentia was for the Hagerty business and their previous carrier and they had $170 million in that entity in 2011.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And do you -- how much of that you plan to keep? I don't know if you're going to talk about...

Francis Michael Crowley
Vice Chairman

Hagerty is a growing business.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

All right. Fair enough. And then I wanted to just ask about the pricing environments. Some of the competitors has talked about how they expect rates to increase pretty significantly next year in the northeast just because of what we're seeing with Sandy on property. Do you see that playing out, and if so, do you think that has any kind of staying power?

Francis Michael Crowley
Vice Chairman

I think we have to wait and see as I said in my earlier comments. Obviously I can understand why somebody would say that, but we are expecting -- right now we are expecting the same kind of rate environment in 2013 that we've seen so far in 2012 and we're planning accordingly.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then just the final question I had was just on Markel Ventures. I think the target that you gave a few years ago was to reach -- eventually reach $500 million. You are kind of running almost at that run rate, $500 million in revenue, and I'm just wondering if there is a particular target where you see that going in the next sort of 5 to 10 years or longer term?

Richard Reeves Whitt
Co-CEO & Director

Well, the real target is to layout capital and produce double-digit returns for having done so. And to do that in a crawl, walk, run fashion, and we continue to do that. You are correct, the run rate of revenue is probably north of $500 million at this point. We continue to see opportunities and we're pleased in large part with the way the businesses are running and developing. We're also learning lessons as we go along and we will continue to be prudent. And if I look at the 5 or 10 years I am certainly expecting to be a bigger business but that will come in lumps depending on our skills and the opportunities we see.

Operator

Our next question is coming from Jay Cohen, Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. I guess, if you could break out in the international business, what -- roughly, what percent of that business would be catastrophe reinsurance?

Thomas S. Gayner
Co-CEO & Director

Well, catastrophe reinsurance is probably about $60 million, $70 million book of business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That's very helpful. And then secondly, obviously the ventures earnings, it's a relatively new business. It's growing. It's hard to pin down quarter-to-quarter from our standpoint. There does seem to be just be, just looking the last 2 or 3 years, some seasonality where the third quarter seems to be bigger from an earnings standpoint. Am I reading too much into this?

Thomas S. Gayner
Co-CEO & Director

Well, a little bit. We do have one business that is very concentrated in the third quarter, but it's small. I mean that's our dorm room furniture businesses for colleges and universities. You can think about when students are out of school, that is when we scramble and put everything in place and send over [ph] bills, so the biggest chunk of earnings is indeed concentrated in the third quarter, but that is a relatively small business. The other factor is just sort of the luck of the draw the last couple of years. The capital equipment business by definition is a lumpy business and we've just happened to hit on some larger orders during the third quarter. But I wouldn't assign seasonality to those factors.

Operator

Your next question is coming from David West of Davenport & Company.

David McKinley West
Davenport & Company LLC, Research Division

Mike, one for you first. Your comments on the casualty environment, you described it as competitive. Do we infer from that that rates are flat or are you getting any rate increase at all?

Francis Michael Crowley
Vice Chairman

Well, we're still getting modest single-digit rate increases there. It's just more competitive I think than maybe some of the property lines this year, but we are getting rate increases there, David.

David McKinley West
Davenport & Company LLC, Research Division

Okay. All right. Very good. And Tom, just looking at Ventures, the EBITDA margin year-to-date is running about 12% versus 15% last year. I guess given your pretty conservative nature, the way you book things at Markel and account for them, as you're being inquisitive should you expect some pressure on the EBITDA margin at Ventures?

Thomas S. Gayner
Co-CEO & Director

No, not really. I mean the businesses that we look at, typically they have to be double-digit EBITDA margins to be attractive to us. So, some businesses will have higher EBITDA margins. Often times they have a little higher capital spending requirement, so you sort of net that out. I mean, I'm looking at the true cash returns. But as a general rule I want double-digit EBITDA margins and I would not -- I mean, I'd be disappointed if they go below that.

Operator

Thank you. Our next question is from Rob Farnam of KBW.

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

I just have one question on reinsurance. I know you're not heavy users of reinsurance at all, but just curious if you can tell us what type of property CAT reinsurance coverage you have.

Thomas S. Gayner
Co-CEO & Director

Well, we have several pieces of reinsurance around property CAT, and so it's a little hard to kind of give you a thumbnail sketch of it. One of the things you can do -- they invest in their reports -- they put kind of a quick-and-dirty profile of the reinsurance and that might be worth looking at. But basically we have both risk insurance, so -- for example, we have some quota share on some of their business. We have some excess of loss reinsurance that will come into play, and then we buy CAT reinsurance which for the majority of our business, the cash is at about a $100 million and then we will participate to some extent later as it goes up. But it's not as easy telling you we've got one tower. We have various towers and we have various heights of reinsurance, both risk and CAT that will respond.

Operator

[Operator Instructions] I am sorry. No further questions coming into queue at this time.

Thomas S. Gayner
Co-CEO & Director

All right. Well, with that, thank you very much for joining us. We look forward to seeing you around the neighborhood. Take care.

Operator
Thank you, ladies and gentlemen. It does conclude today's teleconference. You may disconnect your lines at this time. And thank you for your participation.