S&P Global
Market Intelligence

Everest Re Group, Ltd. NYSE:RE

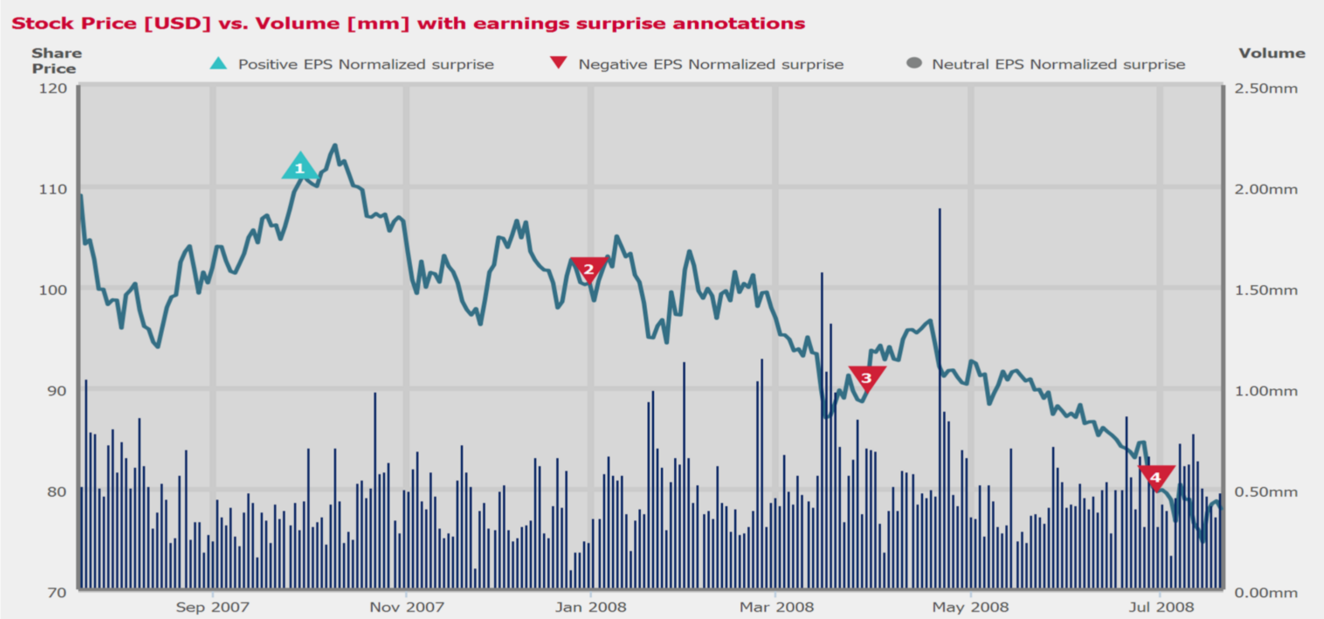
FQ3 2008 Earnings Call Transcripts

Tuesday, October 21, 2008 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.24	0.21	▲(50.00 %)	3.19	9.24	11.54
Revenue	-	-	▲(1.79 %)	-	-	-
Revenue (mm)	978.10	960.60	-	893.08	3560.52	3409.26

Currency: USD
Consensus as of Oct-21-2008 12:46 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	3.09	3.68	▲19.09 %
FQ4 2007	0.99	1.00	▼(15.97 %)
FQ1 2008	3.46	3.03	▼(12.43 %)
FQ2 2008	3.23	2.90	▼(10.22 %)

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Call Participants

EXECUTIVES

Craig E. Eisenacher

Elizabeth B. Farrell
Vice President, Investor Relations

Joseph Victor Taranto
Chairman of the Board

Thomas J. Gallagher

ANALYSTS

Jay H. Gelb
Barclays Capital Inc.

Joshua Shanker
Citigroup

Matthew G. Heimermann
JPMorgan

Susan Spivak
Wachovia Capital Markets

Thomas V. Cholnoky
Goldman Sachs

Unidentified Analyst

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day, everyone, and welcome to the Third Quarter 2008 Earnings Release of Everest Re Group. Today's call is being recorded. At this time, for opening remarks, and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth B. Farrell
Vice President, Investor Relations

Thank you, Mark. Good morning and welcome to Everest Re's third quarter 2008 earnings conference call. Joining me today are Joe Taranto, our Chief Executive Officer; Tom Gallagher, our President; and Craig Eisenacher, our Chief Financial Officer.

Before we begin, I will start with our comments by noting that SEC filings include extensive disclosures with respect to forward-looking statements. In that regard, I note that statements made during today's call, which are forward-looking in nature such as statements about projection, estimates, expectations and the like are subject to various risks.

As you know, actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investor should consider in connection with such statements.

Now, let me turn the call over to Joe Taranto.

Joseph Victor Taranto
Chairman of the Board

Thanks, Beth. Good morning. Normally on the quarterly calls, we go right into what's happening in the insurance world and I will shortly ask Tom to do just that and have Craig follow with the financials.

However, there seems to be little that's normal about this quarter, as the central issue seems to be more of the chaos in the worldwide financial system. It's easy to get down, when you consider the meltdown of the system, the destruction of value, the loss of many companies that were household names, and the many economic close that are still to come.

Perhaps, there were many excesses that needed to be running out of the system. I trust they have been and we can now move forward. At Everest, despite the blood in the Street, we have remained strong with our client base intact, our employees committed and our ratings among the highest in the business.

Going forward, I expect the world will be very different and that these changes will work to our benefit. As a reinsurer, we are capacity provider. Well, many of our clients are suddenly in need of more capacity, we'll try to help.

As a reinsurer, we mitigate our clients' risk. Again, many of our clients as most of the world will be more risk-averse and looking for more partners to sharing their risk, again, we'll try to help.

As a reinsurer and an insurer, we have extremely strong financials and financial ratings. Well again, the world is looking more closely at the credit quality of its partners than ever before and paying more for credit quality than ever before, which works well for Everest.

Some of our competition has lost strength and as a result will lose business. There will be opportunities for us to pick up business, people and perhaps other companies.

Much of the money that so easily came into our space from hedge funds and other sources has dried up. The staying power of many of the smaller companies in our sector will be questioned more than ever, again this will work to the advantage of Everest.

The insurance market has been softening; in past cycles it had taken many years of deteriorating rates and conditions before the market turns up. At the beginning of the quarter, I thought we had years to go before better days appear.

Now I see that timeframe dramatically reduced and expect the portions of the reinsurance and insurance market to improve by the one-month renewal season.

In summary, it's been a rough three months but I see change coming and much will work to our company's benefit. Tom?

Thomas J. Gallagher

Hi, thanks Joe. Well, I'll continue what Joe, said about in his comments. It's been quite challenging in the last nine months.

But as Joe said, we are entering a changed world. And we are well positioned to take full advantage of these changes. Let me make some brief comments on each segment of our portfolio which is a reflection of where the overall market has been in the first nine months of '08.

Recognizing that third quarter has continued to perform generally as it has to the first six months of the year.

Our international business including London and European ops represent almost 38% of our worldwide portfolio. We continue to see the treaty reinsurers being disciplined in their approach.

Fortunate programs have remained stable with some price reductions on excess programs with good results both for our cat as well as per risk. And increases in areas where loses have impacted programs such as China, Chile, Australia and Peru. We have been able to increase our premium volume through new business as well as increased participations on existing programs in Latin America, Asia, Middle East as well as Brazil due to the recent opening of the reinsurance market in that country.

We continue to benefit from our strong long-term relationships, preceding companies and our solid financial strength ratings which has allowed us to obtain preferential signings. Our U.S. business, including business written out of our Bermuda branch. This year RE represents 32% of our worldwide business with property being 22% and casualty 12%.

The market conditions in these segments continue to be the most stressed. With pricing pressure both on property and casualty warrants, as well as ample capacity even at reduced prices.

Though there has been limited treaty activity in the past quarter, our assessments of these segments are based on feedback from our clients or audit observations and our calculative step. And that is, that the overall price continues to decline. But the rate of decline seems to have slowdown.

The only increases have been where loses have emerged such as property per risk business and our financial D&O and the E&O sector. It is the market that needs the most attention. And we don't expect major movements until January as Joe said. And those adjustments will vary by market segments, but change is on our horizon.

Our focus continues to be the same maintaining our most profitable relationships and growing with claims that are key to our success. Our specialty reinsurance book represents 7% of our worldwide book and includes accident and health, marine, aviation and surety.

We continue to experience increased competitive pressure in most of these areas and we appear though in our portfolio overtime to key core programs, and are comfortable with where we are today. And we don't anticipate much change for the remainder of 2008.

Insurance; our insurance operation represents roughly 21% of our worldwide premium. It's the U.S. portfolio and we continue to mainly focus on niche casualty business. Though we have expanded our writings this year in the property area, through the first nine months of this year, we have written some new programs and lost some older programs. And as expected, have been impacted by increased pressure for reduced rates and higher retail commissions.

But today, we are very comfortable with our mix of business, and continue to see a good flow of new opportunities, both in a program area as well as retail business. And we see this area, as a key area of growth for us in the future.

That's where we are today. Now, looking forward to the future. The market is poised for positive change. The combination of price reductions, the recent loss activity book to pattern risk resulting in increasing combined ratios plus the current financial crisis has impacted the whole market greatly.

This environment look for us all participants in the market. To revaluate their willing-to-risk position going forward, and increase their pricing posture and reinsurance purchases to address their portfolio more in balance with a reduced surplus.

Our insurer plans were changed, we are in the works right now at all companies. Which will be implemented beginning 2009 or sooner. Initially, we don't expect change to be dramatic or for all segments. But it will come and take hold throughout 2009. And I believe we are in a excellent position to respond to these changes very quickly.

Now, I'll turn it over to, Craig.

Craig E. Eisenacher

Thanks, Tom. Our third quarter net after tax operating income was $12.6 million which includes $210 million net loss from Hurricanes Gustav and Ike. Net operating income per share was $0.21 compared to $3.68 per fully diluted share in the third quarter of 2007. Catastrophe loses were much less significant at $17 million after tax in last year's third quarter.

Absent all cat loses from both periods net operating income was $231 million in this year's third quarter compared to $249 million in last year's third quarter.

So our underlying operating income fundamentals remained quite strong. The financial markets were front page news this quarter and they affected us. We incurred $246 million of net after tax realized capital loses in the quarter. After these loses, our net results were a $233 million loss equating to $3.80 per share.

The realized losses broke down as follows on an after tax basis; $131 million from other contemporary impairments on fixed income securities largely financial institutions. $53 million from mark-to-market losses on our equity portfolio which is carried at fair value and $62 million in realized capitalized losses on sales of booked equities and fixed income securities.

In addition, we suffered approximately $190 million of after tax unrealized losses on our fixed income portfolio as credit spreads widened significantly during the quarter. We repurchased 3,002,000 shares of our common stock early in the quarter at a cost of $25 million and we declared and paid our regular dividends to shareholders.

After all of these items, our GAAP equity declined by $530 million in the quarter to $5.04 billion from $5.57 billion at June 30th. As well, our book value per share decreased by 9% to $82.02 from $90.32 at the end of the second quarter.

I will talk about liquidity and capital resources in a moment but suffice it to say that both are strong and we have plenty of capital to support our financial ratings. Through the nine months, net operating income was $383 million compared to $714 million for this first nine months of 2007.

Realized capital losses and fair value adjustments year-to-date were a loss of $385 million after tax. In contrast, we had a realized capital gain of $113 million during the nine months of 2007. Net income then including after tax realized capital gains and losses was essentially a breakeven to the nine months of this year compared to a gain of $827 million for the same period last year.

Looking a little deeper at our operating results. In total, our gross written premiums were $999 million for the quarter, 7% lower than in the third quarter of last year. Year-to-date, our gross written premium was $2.8 billion, which is 8% lower than for the nine months of 2007. The decline is not unexpected, it very much reflects our underwriting discipline as markets have continued to soften.

By segment, U.S. reinsurance at $280 million was 14% lower for the quarter than in last year's third quarter. Most of the decline was in our treaty property book. Despite good renewal results, increased common account reinsurance protections particularly on one quota-to-quota share count and two non-renewals of quota shares resulted in a 13% decline in premiums compared to last year's third quarter.

At the same time, treaty properties gross written premium was substantially higher than in any quarters since the third quarter of 2007. Treaty casualty was lower than in last year's third quarter, but by just 5% as we have now reduced this book to a group of core accounts in response to the softer market conditions.

U.S. insurance recorded gross written premium of $194 million and that's down 15% compared to the third quarter of 2007. Conditions for workers compensation, contractors and public entity business have gotten increasingly competitive, which has reduced the volume of business which meets our underwriting and pricing criteria. Although less than half of the short fall compared to last year's third quarter is from the CV star program, where we have lost several public entity accounts because it would not match market pricing and terms.

International at $249 million was 16% higher than in the third quarter of last year. Approximately one quarter of the growth emanated from foreign exchange. International experienced strong renewal increases in the quarter and saw higher rates in some markets.

As Tom noted, our long-term relationships and our solid financial strength ratings are definite advantages in the international markets. Recently, we obtained preferential signings and in some cases preferential terms and conditions. We've also seen several opportunities recently to replace reinsurers which offer less solid financial strength ratings.

The Bermuda segment had gross written premium of $221 million for the quarter which was lower than the third quarter of 2007 by 6%. The London and European brokers leveled with the third quarter of 2007, although Bermuda portion declined principally due to the conversion of one large casualty quota share contract to excess.

Gross written premium for the specialty segment was $55 million for the quarter and that's down 22% from last year's third quarter. Marine and A&H premiums were each lower, surety was a bit higher. We had no aviation premium for the quarter as marketplace premium volumes and rates continued to decline.

Now, looking at underwriting results, the group combined ratio was 115% for the quarter and it now stands at 99.6% on a year-to-date basis. Hurricanes, Gustav and Ike were significant events we have estimated gross losses of $40 million and $255 million for the two events respectively. That's $295 million before reinstatement premiums and $257 million after reinstatement premiums.

Here is another $10 million of what I will call the noise in the quarter some ups and downs on older events, so $267 million in cat losses in total. That's 34.2 combined ratio points on the quarter.

We also had a small amount nine-tenths to 1% of favorable development. No significant movements just some minor ups and downs. The accident year accretion loss ratio was 55.5% versus the identical to last year's third quarter results.

Our commission and expense ratio ran at 27.7% for the quarter a little better than the 28.1% we had in last year's third quarter. So our underwriting results continue to be quite attractive on a fundamental basis with a combined ratio under 85 and about on par with last year.

Investment income for the third quarter was $164 million compared to $173 million for the third quarter of 2007. The $9 million decline was primarily attributable to a reduction in limited partnership income and lower rates on short and long-term bonds.

Of note although it may seem odd we had a gain of $15 million on the equity put option contracts in the quarter. Under these agreements we have a future payment obligation on multiple contracts settling between 8 and 23 years in the future. If a reference index is below the threshold level.

But both the index is still in the quarter the valuation model uses a AAA corporate discount rate which increased by close to 200 basis points.

Given the long dated nature of the contracts the strongest determinants of gain or loss is movements in interest rates. Which provides a bit of a hedge against the impact of interest rates on our bond portfolios.

So a little of bit of good news among the bad news if you will. Other terms principally foreign exchange was $8.2 million in the quarter, the U.S. dollar strengthened against the British Pound and the Euro, and since we hold investments and receivables in both of these currencies, their value has declined in U.S. dollar terms.

Looking at cash flow, cash flow from operations was $375 million for the quarter compared to $356 million from the third quarter of last year. Excluding income tax, we see some payments cash flow from operations was $278 million in this year's third quarter compared to $463 million in last year's third quarter. The primary driver of that reduction was premium collections, which were $153 million lower in this year's third quarter than in last year's, not unexpected due to our low volume.

Looking in investments, the meltdown of the global financial markets drove down the values of both equities and fixed income securities. In the aggregate, our investment portfolios experienced a negative 2.5% total return for the quarter. That's made up of investment income of $164 million and realized and unrealized capital losses aggregating $549 million including impairments.

Our investment portfolio has been and is one of the diversified liquid, high quality and short duration. The average quality rating of our portfolio remains very strong and AA too. The duration was 4.4 years as of the end of the quarter unchanged from June 30th.

We have virtually no exposure to sub-prime or all time mortgages, CDOs or COOs. We have not brought nor sold credit default swaps. We have virtually no counterparty risk beyond the issuers of our fixed income securities.

By policy, our maximum exposure to any single issuer is $75 million, which represents one-half of 1% of our invested assets. Our actual exposures are lower than that. Nevertheless, when you experience the devastation we experienced during the third quarter and continuing into the fourth no portfolio, however, carefully constructed is going to be immune.

To put it in perspective, a AAA corporate with a 10-year maturity loss 15% of its market value between June 30th and September 30th. And the S&P Index declined by... as well by a little over 9%. And while we have been reducing our equity exposure since the beginning of the year, our equity portfolio still lost $127 million in the quarter.

In order to give investors more and hopefully useful insight into our investment portfolios, we've expanded the information in our earnings supplement which is posted on our website. We've broken down the categories a little more finely, and we've provided unrealized gain and loss information by category.

Now, I'd like to talk a little bit about capital and liquidity. The following comments maybe over done but given our recent stock price performance and investor sentiment generally, I think it's useful to reiterate what you may already know, reiterate the obvious if you will.

We are extremely liquid and we have no current or foreseeable cash needs beyond what is readily available or even close to what is readily available on our balance sheet. As of September 30th, our cash and short-terms aggregated $1.4 billion and that's slightly higher as of now. All of our securities are mark-to-market and most have ready markets, so there is significant availability even beyond the $1.4 billion.

We began the year with a significant capital redundancy related to our financial ratings. Our capitalization remains strong and comfortably supports our current rating levels. Our debt to capital ratios are well below currents as expressed by each of the rating agencies.

We have committed an unused revolving credit availability of $500 million which could be used to bolster capital if we felt the need to do that, which we do not.

In addition, our statutory operating companies are well capitalized and can provide about $650 million of additional dividends to the Group if that were needed which it is not.

We don't see or foresee a near-term capital need. Our capital supports our ratings with a good size cushion, our debt is longer term with the earliest coming due in 2010 and that for only $200 million.

Our run-rate of operating income is in the neighborhood of $225 million per quarter and operating cash flow is running at a similar pace, so the operation is self sustaining.

The story this quarter is the catastrophic events both natural and man-made. Significant hurricane losses and financial market losses would have been characterized as a black swan event comparable to winning the lottery twice in a week.

While, I don't think I buy into that level of remoteness, I do agree that this has been a very unique quarter nothing like we've ever seen before. And while, our investment portfolios took a hit it was not a devastating one.

Our basic conservative nature and diversified portfolio mitigated against a much larger loss. We do not feel we need to fundamentally change our investment strategies which have kept us away from major pit falls.

We've maintained our underwriting discipline and our fundamental operating results were strong, our accident quarter combined ratio ex-catastrophe losses was under 85, adding to that our expected cat losses of 9 points gives you an expected combined ratio in the low 90s, quite good at this point in the cycle.

We have to our back a significant amount of stock over the past year and a half and we are ever mindful of capital management and the potential benefits to our shareholders. Our stock is very attractively priced in our view, 80% of book value looks like a real bargain to us. Nevertheless, given this current uncertainty in the financial markets, we think it makes sense to be less aggressive until the environment becomes less volatile.

That doesn't mean we'll not buy in additional shares, but given that we now have less capacity to do so, we will likely be less aggressive than we might otherwise have been.

We continue to have a very strong balance sheet. Our reserves are solid and our capital position is strong with low operating and financial leverage. We have plenty of liquidity to meet our cash obligations. We have no issues with respect to debt service or financial covenants in our credit agreements.

Our capital position continues to be redundant relative to our meetings. We are optimistic that the recent financial market turmoil will hasten a turn in the insurance and reinsurance marketplace. And when that happens, we believe we are and we will be in a good position to capitalize on the opportunities.

That concludes my remarks and we will open it up for questions now.
Question And Answer

Question and Answer

Operator

Thank you very much. [Operator Instructions]. Let's take our first question today from Josh Shanker with Citi.

Joshua Shanker
Citigroup

Good morning. In your opening remarks, you mentioned that these CV Starr business might have appeared under price to that you are receiving and for you are returning it down. I'm wondering if you have any opinions about this. Is this business that would be otherwise placed at AIG or what the... or where that business is going and whether it will turn it back to if things harden?

And the second question and then I will get back in line. I was wondering if you can talk a little bit about outlook on 4Q investment losses?

Craig E. Eisenacher

Okay. If I can try on the CV Starr, I mean my understanding is that the biggest part of the decline was the public entity business in the quarter. And it's simply that the pricing pressures in the market are such that the business just isn't meeting our return levels and therefore we're not riding it.

Joshua Shanker
Citigroup

And where is it going to?

Joseph Victor Taranto
Chairman of the Board

It is going to be a variety of competitors, but certainly AIG would be the one but not the only one. It tends to be the bigger company is riding that business.

Joshua Shanker
Citigroup

And any comments you can make about equity losses or other investment losses in the fourth quarter?

Craig E. Eisenacher

Clearly, since the end of the third quarter the equity markets have declined further and we've taken some unrealized losses there as well both credit and the Muni bond markets have widened some more. And we've taken some losses there. I think at this point it's premature to speculate of how much that might be. But it's not a significant amount from our perspective.

Joshua Shanker
Citigroup

Now, I'll get back in line. Thank you.

Operator

Our next question will come from Susan Spivak with Wachovia.

Susan Spivak
Wachovia Capital Markets

Good morning. Joe, thanks for your comments just on where we are in this cycle. And I guess, I just wanted to follow-up on something we heard this morning from a broker about the pricing in AIG in Lexington. Basically what AIG is doing everything they can to defend the pricing on this business.

And my question to you is whether do you think this will work and will reinsurers be there to provide capacity outlook competitive prices or will we be in a better environment as you alluded to in your openings comments, where the clients will need more capacity and reinsurers will fit to the discipline?

Joseph Victor Taranto
Chairman of the Board

Well Susan, I certainly I would like to think that that the reinsurers will take a good look at what they're supporting and only support those that are riding at adequate rates.

We have seen certainly that AIG has some difficulty with attaining new business and even with some of its renewals given the changes that have happened for them and I'm certain here and there that they and others have gone to lower prices to maintain business.

Again, we kind of are looking for a different world not just from them but from the whole marketplace going forward. A lot of this competition that we're talking about took place in the third quarter. And again, most people when they put their financials together at the end of the third quarter are looking at different numbers than they were at the end of the second quarter.

So we certainly are hopeful that we will see some improvements across the board as we move toward one - one, as we move into 2009 from most of the companies out there because that really is what is needed, might you see some short term distress from those that have been harder hit by the changes? Yes we hope that works its way out, we hope that reinsurers only support those that are riding business at adequate rates.

Susan Spivak
Wachovia Capital Markets

Okay. And just I think a follow-up Joe, it's really the first time in years I heard you actually talk about an opportunity to pick up other companies and so I was wondering if you could just give us some more details of what might make a good fit with Everest?

Joseph Victor Taranto
Chairman of the Board

Well, you are right Susan, historically we have looked to home growth and still that will be the primary focus. But there are some good companies out there that are certainly at very attractive prices and there are some small good companies that may want some added strength to give them better staying power in the current environment. And so I do think there maybe some increased opportunities. Now, our stock is not what it was, but that's the case for many of the public companies out there. So, that might even itself out. But looking for a better future in the industry and looking at some of the prices on some of the quality businesses out there, we are going to look around and have more conversations than we would have had a year ago.

Susan Spivak
Wachovia Capital Markets

Okay. That's fair. And just one more, any premium targets you have for '09 or is just too early?

Joseph Victor Taranto
Chairman of the Board

Too early. We put together budgets in the last couple of weeks, but I think we need to re-visit those budgets in light of new circumstances.

Susan Spivak
Wachovia Capital Markets

Okay. That's great. Thanks for the answer.

Operator

Next is Jay Gelb with Barclays Capital.

Jay H. Gelb
Barclays Capital Inc.

Thanks. Good morning. On the potential for a cycle turn, could this be a situation perhaps more like after the 2005 hurricane season, where there was expectations of perhaps more of a broad based churn and it just didn't come about given the amount of capital that was in the system or urged us, just something fundamentally different about it from this perspective?

Joseph Victor Taranto
Chairman of the Board

Well certainly, that could happen, we can't tell you precisely what's going to happen, but there is certainly less capital suddenly in this system. And that's something that wasn't as much the case I think at the end of 2005.

So that would mean that you might see changes that go beyond just the sectors that were hit by the hurricanes in 2005. And certainly we are hopeful that, that would be the case. But we can't guarantee anything in terms of how the world would change. I think Tom and I believe there certainly will be pockets that will change for January 1st, there will be more changes as we go into 2009.

We don't expect wholesale across the board, every product, every country that happened before. I mean that happened in 2001 that happened in 1986. We don't see that happening, but we certainly are hopeful that as an intelligent industry that response to the conditions and we do see some improvements.

Jay H. Gelb
Barclays Capital Inc.

Okay. And then just to switch gears on investment income, the $11 million of partnership income in the third quarter. Any prospects of what that could be in the fourth quarter given dislocations in the market?

Craig E. Eisenacher

That income tends to be fairly volatile. We had exited some of our public securities oriented limited partnerships. At the same time we've embarked on an enhancement I guess to our equity management strategy and we've allocated some funds to some strategic equity managers. So we both decreased and increased our exposure to public securities in that sector of our income statement if you will.

So at this point, we've got about 25% exposure to public securities in the overall limited partnership bucket. The project oriented part of the portfolio which is close to 50% and it's 45% to 50% tends to be more stable. And then we have another 30% that's in the Mezodine private equity finance and that tends to be more stable as well.

So it's a little difficult to tell because you've got operating income or I guess I should say earned income flowing through there on the investments. And as well any mark-to-market gains to losses flow through that as income. I think it's likely to continue to be quite volatile given that the financial markets continue to be quite volatile.

Jay H. Gelb
Barclays Capital Inc.

Is there any lag on that from what was reported in the third quarter?

Craig E. Eisenacher

There tends to be a lag it can be a month to a quarter I will tell you one of our equity oriented limited partnerships did report their September results in time for us to book that in the quarter it was a loss and as a result we booked it.

Jay H. Gelb
Barclays Capital Inc.

Okay. And then I think you also mentioned the $15 million equity put option where did that get reflected in the income statement?

Craig E. Eisenacher

That's in derivative income; it has got a separate line item.

Jay H. Gelb
Barclays Capital Inc.

Okay, is that included in operating income?

Craig E. Eisenacher

Yes.

Jay H. Gelb
Barclays Capital Inc.

So $15 million benefit?

Craig E. Eisenacher

Yes.

Jay H. Gelb
Barclays Capital Inc.

Okay, thank you.

Craig E. Eisenacher

You are welcome.

Operator

Our next question comes from Tom Cholnoky with Goldman Sachs.

Thomas V. Cholnoky
Goldman Sachs

Good morning. And just two question, Joe. Just going back to acquisitions should we think, how should we think about you looking at there from a strategic perspective are you going to be looking at bolt on transactions potentially or transformational ones? I guess that's my first question and I will follow-up with another one. And would it be reinsurance versus insurance?

Joseph Victor Taranto
Chairman of the Board

Tom, I think in the last few years we probably were more interested in insurance than reinsurance but at this stage I think we would open up the... what we look out a little bit more. And I wouldn't rule out either, I mean bolt on always sounds more manageable, transformational sounds bolder for sure but I wouldn't dismiss either.

Thomas V. Cholnoky
Goldman Sachs

Okay. And then just, I don't know if there are any updates on Centrix at all or as you can just... we are still comfortably with where we are?

Joseph Victor Taranto
Chairman of the Board

Sure, Craig, will give you the answer.

Craig E. Eisenacher

Yes, very comfortable with where we are at present. Based upon well we commuted about a-third of our exposure with one of the policy holders and that was as of the end of last quarter, I think we covered that in our call last quarter.

Looking at the actual paid losses this quarter, I think we would have expected about $10.5 million and we've seen $8.5 million. It's only one quarter so, I think it's probably premature to get too excited about it. But it's probably the first quarter we've seen in the long time, where we have seen actual results better than what we would have expected.

The portfolio continues to decline and value are estimated, overall exposure is down in another $20 million - $30 million from last quarter. The portfolio is more mature, 90% plus of it, tends to be 60 days or less past due. So things seem to be pretty much under control there.

Thomas V. Cholnoky
Goldman Sachs

Okay. Then just sorry, one other final question, just in terms of the market environment in '09, is it my sense correct that probably perhaps more of the opportunities will be on the reinsurance than necessarily the insurance side? Is that the way to think about it given the way you describe the market environment?

Joseph Victor Taranto
Chairman of the Board

If I could think, it will be both Tom, I mean we are certainly hoping that insurance rates reverse and begin to go up, in some pockets that have been heard like the property side, or the D&O side lead the way.

We are also hopeful that there will be increased reinsurance opportunities, especially for companies that have the ratings and the financials that we have as the world wants to reduce some of this risk, and at the same time, get the best quality in terms of the reinsurance that it purchases.

So it's a fluid situation. We can't predict it entirely, we'll see what happens and take it from there. But I'm hopeful both sides, we see increased opportunities.

Thomas V. Cholnoky
Goldman Sachs

I know, this I said was the last question, I'll get one more, sorry. Just going back to acquisitions, if in fact you were to do something on a transformational basis, would we... should we expect you to do that maybe perhaps within equity offering in conjunction within a large acquisition or how would you fund something like that?

Joseph Victor Taranto
Chairman of the Board

Well, again Tom, in every situation would have its own uniqueness. Let me just state the obvious in terms of our stock is down and that's kind of something that makes you less keen to use it. But if you are talking to a potential partner that is also public with their stock down in our sector. Well as I said that kind of is offsetting, starts to make those kind of transactions more possible.

The cash side of things, we're all looking to kind of maintain cash at this point and you had at the same time, you are looking at entities often that are selling below book. So that kind of is an inducement to go that way. So it would depend on the situation and the size and what we thought we have in the way of excess capital and what we thought the other entity has in the way of capitals and we deal with the uniquely molded.

Thomas V. Cholnoky
Goldman Sachs

Okay. Great. Thank you.

Operator

Matthew Heimermann with JPMorgan has a question.

Matthew G. Heimermann
JPMorgan

Good morning, everybody. Couple of questions, first on with respect to the improving pricing conditions next year, I guess one question I had was the sustainability, if we suddenly see credit improving and a lot of the damage has been done the fixed income side if spreads suddenly starts to come in, how would that affect the sustainability in your mind or the duration of any hardening we see next year?

Joseph Victor Taranto
Chairman of the Board

That's really good question and I can't pretend that I know more than you know in terms of the answer to that. Let's face it most of us sit here hoping that the credit situation does improve and that bond values do come back. And if that's the case then suddenly you have more surplus coming back and I could see where that might mitigate some of the transformation that we are hoping will take place. But I would just say to you that, you know the dynamics on that as well as I do and so you can kind of do your own guess work, it's as probably as good as my guess work.

Matthew G. Heimermann
JPMorgan

Fair enough. And then I guess, how much of your, I guess one thing as I mean at '09, it's... in my view would be there is probably pressure there. So how much of you can book renews let's say in the first three months of the year where you potentially have maybe have higher probability to walk in a better environment?

Thomas J. Gallagher

I will have to say we probably do about 45% to 50% of our business during that period.

Matthew G. Heimermann
JPMorgan

Okay. And then... I was just hoping you could confirm or correct, my rough math was that AIG was roughly 7% of your business and I wanted to know if that was correct and in particular, how that's going to change given, I don't know whether to think of them was somebody you potentially needs more of your capacity or because of some of the dynamics potentially, you'll be looking elsewhere?

Joseph Victor Taranto
Chairman of the Board

It's a mixed bag AIG has been and continues to be an important client to us. We deal with a number of the subs and entities within AIG. Clearly, they are going through some changes and those changes will continue. Certainly, you could argue that they may look to buy more reinsurance because of the surplus issues they have had.

In addition, to that, a lot of these companies maybe sold and then they may have some new reinsurance purchasing missions after that. So far, we've probably seen little change in terms of the reinsurance purchasing that they do. It's been on that side of the fence for them, it's kind of been business as usual.

But of course if there are sales and other things that may change going forward, it's hard to figure out whether all of what they are going through is good or bad or someone like in Everest, I'd like to think that as they go to their changes, we stand there ready to help them and it will actually be a net positive for us.

Matthew G. Heimermann
JPMorgan

Okay. And then I guess one for Craig, you made the comment that all your books mark-to-market and you have liquid proxies for most of it. I wanted to drove down on the Muni book, there is a big difference between where secondary pricing and where primary pricing is on similar new obligations coming to market. And I was just curious, which... how much flexibility you had in marketing and which price I guess signal you are relying on?

Craig E. Eisenacher

Okay. I believe its secondary market. Its interactive data, Corp does our pricing for us through Deutsche and that's based on actual trades and similar trades and similarity in issues. And of course as you know that the muni market has been under a significant amount of pressure and we think... I guess it's more technical and fundamental as well as leverage structures are coming undone.

Muni bond funds are in a negative cash flow position, the auction market of course collapsed etcetera so. It is the secondary market measure I believe and I can verify that to make sure that, that's my belief.

Matthew G. Heimermann
JPMorgan

Okay. Perfect, thank you very much.

Operator

Your next question will come from Ian Betterman with Adage Capital [ph].

Unidentified Analyst

Hi, guys. I want to ask you how you are thinking about your cost of capital today versus what it was say year ago? And what I mean by that is... if I am an insurer, a client of yours who maybe made some bad investment decisions maybe got hit by the cash pretty hard and the agencies are breathing down my neck a little.

And I have a choice between raising capital well below book or given that I've raised my retentions the last few years coming to you guys and saying you know what maybe I am just going to buy a whole lot more reinsurance this year, because the cost of that capital is maybe today is 12% to 15%, maybe next year even if it is a little over 15%, still a heck of a lot cheaper than my alternative.

So I guess what I am wondering is maybe pricing even more than your suggesting than maybe should be charging at 20% cost of capital because these clients do not have better alternatives and sure supply and demand with suggest. It is almost a new version of the reinsurance over charged not to your be ticking that business but that you are sort of that the cheap capital around the world for anyone to access?

Joseph Victor Taranto
Chairman of the Board

Well, we certainly are hopeful that pricing will trends up and you probably need to give that speech to all of our competitors.

Unidentified Analyst

I hope they are listening.

Joseph Victor Taranto
Chairman of the Board

We make an interesting point obviously companies that have dropped below the capital level that they need to run their businesses it's not an attractive option to go out to the market right now and raise additional capital. And so, one would guess that a better alternative might be increased use of reinsurance, which kind of just get back to our capital usage as well. So I think we're talking the same thing and I think we are seeing a dynamic play to improvements in our space and we certainly hope it does.

Unidentified Analyst

Well you have a higher hurdle rate for new business at one - one of '09 or one - one of '08?

Joseph Victor Taranto
Chairman of the Board

We will. For certain segments of our business, we really will look to have improved conditions.

Unidentified Analyst

Okay. Great. That's what I wanted to hear. Thanks, Joe.

Operator

Our next question comes from Vinay Misquith with Credit Suisse.

Vinay Misquith
Credit Suisse

Hi, good morning.

Craig E. Eisenacher

Good morning.

Vinay Misquith
Credit Suisse

In looking at the impact of unrealized losses on the capital of companies, could you help me understand whether rating agencies are actually looking at the unrealized losses because of your spread widening and things you have to hold more capital or are they looking beyond that? And this management that I... thinking in terms of the unrealized losses due to spread widening, is just a temporary phenomenon or how do you see that just more of a capital depletion which would make you to want raise rates more?

Craig E. Eisenacher

Okay. Vinay, I think there is two parts to the question. On the first one kind of I guess is may sound a little flip, but intrusive how the rating agencies reviewing unrealized losses it's probably best to talk to them about that. Generally, the capital models require certain levels of capitals to back certain sort of risks. And unless and until they change those factors, the fact that you are in an unrealized or even a realized loss position isn't going to change those factors. As a result of what's happened in the last quarter or quarter and a half, they may reassess some of the those factors, and it may have an impact on the capital that they require at various rating levels going forward, but thus far, we haven't seen that.

We have had discussions, and the discussions that we have had with the rating agencies relative to where we are, they seem to be quite comfortable.

Vinay Misquith
Credit Suisse

Okay. So, just to paraphrase that, would it be fair to assume that right now at least the rating agencies are looking beyond these spread widening and saying this is more of a temporary factor. And therefore, not pressing companies to keep more capital because of that.

Craig E. Eisenacher

Well no, I mean I think realistically, the rating agencies look at the required capital based upon the makeup of the income statement, the balance sheet, the reserves, the lines of business premium, growth, all of the aspects that they require capital for. They look at that relative to the capital that you have in your business, and then in essence they have a grid, right, that based upon the relationship between their view of the required capital and the actual capital that you have, you fall in the ratings grid. So, whether it's realized or unrealized I don't think that has a big impact at this point.

Having said that, I would say in the short-term given that we're beginning at least to see a little bit of improvement maybe in the credit markets they may not be too active in terms of reducing company's ratings and give us some time to see what happens if some companies capital positions are not as strong as they were.

Vinay Misquith
Credit Suisse

Fair enough. The second question would be about your capacity to AIG. Now, we've heard anecdotes in the market about they being more competitive, would you be willing to pull back based on as you thought that the pricing was not adequate?

Joseph Victor Taranto
Chairman of the Board

Yes, always that's what we do. I don't want you to sing a lot of AIG for us on that. That's true with any company we'd be training with. And sometime, we just look at the line of business that frankly we see if we did this to last soft market. It cuts to the point where many lines of business. We didn't like anybody was riding the business at. And so we pulled back from the entire market.

So I think no one has done that better in the past than we have. And frankly, when you look at our numbers through the nine months, you can kind of see that even though we have great credit, we have been doing less business as we really have pulled back from certain areas. We continue to do that we thought rates were inadequate.

Vinay Misquith
Credit Suisse

It's fair enough. One last question if I may. Have you actually seen trying to become more rating sensitive because I often heard the arguments during hard markets as lines go to better red that green shows and of course you're one of them but have you actually seen that happen this time and if you could talk about the last hard market that's really happened?

Craig E. Eisenacher

I think we're seeing it internationally probably more so than domestically. We're hearing that companies are looking to upgrade the overall credit rating with their panels; they are looking to replace companies whose credit ratings have fallen off etcetera. And in fact we can get, we have got seen some situations were we've gotten preferential pricing in preferential terms as a result of that. I think there is some shopping going on here in both on the direct side and the reinsurance side where companies whether they are actually replacing insurers and reinsurers in their programs. They are at least in the market looking where they think may have some credit concerns so I think from that standpoint stronger ratings it is definitely a benefit in this market.

Joseph Victor Taranto
Chairman of the Board

But we see it in the U.S. on the casualty side not as much on the property side, but on the casualty side where it takes years for the losses to play out, and you were reinsurers would be around many years later we see a flight toward security.

Vinay Misquith
Credit Suisse

And would you say that a AA rating is sort of a must for the casualty reinsurance business?

Joseph Victor Taranto
Chairman of the Board

Well I'd like to say that... various company is do is another matter and that obviously would be great limitation to the panel if they just use that. Although there are a few that keep the quality that high. There are some big companies that really only five or six reinsurers that they deal with and we just about always we are one of those five or six. But there are other companies that want a broader panel and certainly if it's property business they tend to broaden the panel because they are looking at it like they just need to the reinsurer to be around from one or two years. And so it's a lower requirement than the casualty business.

Vinay Misquith
Credit Suisse

And I thank you.

Operator

Josh Shanker with Citi has a follow-up question.

Joshua Shanker
Citigroup

Thank you, I don't mean to have you comment too much on a competitor but it's... remain to your business, I want to talk a little about what are you seeing in your business for the relation to the AIG situation are you seeing resonates are you seeing brokers contracting, and finally are you getting calls from clients who are just sniffing around finding out what their alternatives are?

Joseph Victor Taranto
Chairman of the Board

Well, the answer is all of the above. I mean, I don't want to this call to turn into call that AIG, suppose to--

Joshua Shanker
Citigroup

I understand.

Joseph Victor Taranto
Chairman of the Board

About Everest. But some of the things you cited are the things that you expect to be happening given the situation that AIG defends. And so, these things are at least in part happening. Now, where they go from here, the time will tell, we know that's going to be number of sales, we'll see what that does as they do get broken up.

But I just want to cut a talk about it from the emphasis side, yes, there will be people, yes that will look to do other things outside of what the situation currently is at AIG. Of course their world has changed. At the same time, I think a lot of the units within AIG are still looking to bind together and still looking to be a major player and still looking to buy a reinsurance and still looking to deal with a company as like ourselves that they've been dealing with for many years.

Even if they get sold, in fact if they get sold they may need us more than they ever have before, because certainly we're not talking to this company that's $200 billion in market cap and could very, very frequently tell us, we'll just keep it next if you don't like it. So, I do think it will make for opportunities for us, but as far as the AIG itself the things that you mentioned. Sure, I mean that's happening because of what they are going through.

Joshua Shanker

Citigroup

I appreciate I really think you can't give too much away. But, thank you.

Operator

And that does conclude our question-and-answer session. I'll now turn the conference to our host for any closing or additional remarks.

Elizabeth B. Farrell
Vice President, Investor Relations

Thank you for joining us this morning and certainly as always if you have any follow-up questions that we did not touch on, please feel free to call me. Again, thank you.

Operator
And that does conclude our conference call. Thank you for joining us today. .