S&P Global
Market Intelligence

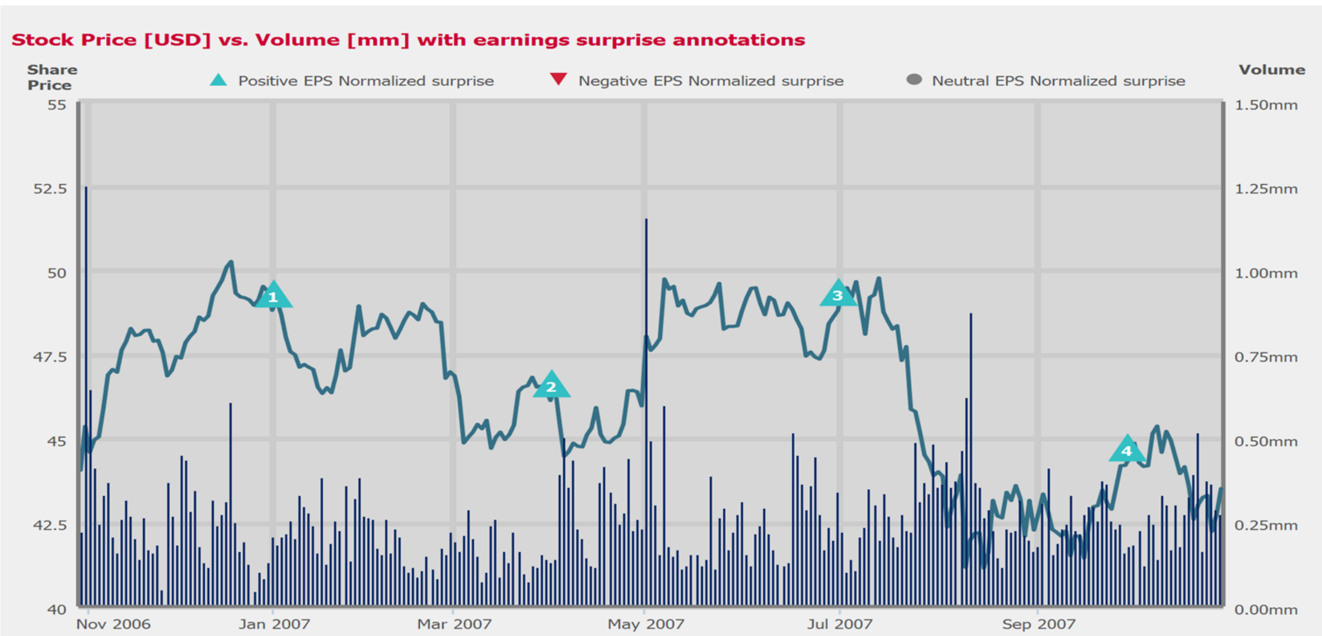
The Hanover Insurance Group, Inc.
NYSE:THG
FQ4 2007 Earnings Call Transcripts

Tuesday, January 29, 2008 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2007-			-FQ1 2008-	-FY 2007-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	1.14	1.20	▲5.26	1.06	4.44	4.56	
Revenue	-	-	▲2.30	-	-	-	
Revenue (mm)	549.00	561.60	-	630.50	2406.97	2415.30	

Currency: USD
Consensus as of Jan-29-2008 2:32 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2006	1.06	1.22	▲1 15.09 %
FQ1 2007	1.04	1.23	▲2 18.27 %
FQ2 2007	1.04	1.14	▲3 8.57 %
FQ3 2007	1.00	1.01	▲4 1.00 %

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Call Participants

EXECUTIVES

Eugene M. Bullis

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Sujata Mutalik

ANALYSTS

Cliff Gallant
KBW

Dan Farrell
FPK

Frederick Eppinger

Unidentified Analyst

Presentation

Operator

Good day, ladies and gentlemen and welcome to the fourth quarter 2007 The Hanover Insurance Group earnings conference call. My name is Maria and I will be your audio coordinator for today. At this time, all participants are in listen-only mode and we will be facilitating a question-and-answer session towards the end of today's conference. [Operator Instructions] At this time, I would now turn the presentation over to Ms. Sujata Mutalik, Vice President of Investor Relations. Please proceed.

Sujata Mutalik

Thank you, Maria. Good morning and thank you for joining our fourth quarter conference call. Participating in today's call are Fred Eppinger; our President and Chief Executive Officer, Gene Bullis, our Executive Vice President and CFO and Marita Zuraitis, President of Property & Casualty Companies.

Before I turn the call over to Fred for a discussion of our results, let me note that our earnings press release and our current report on Form 8-K were issued last night. Our press release, statistical supplement and a complete slide presentation for today's call are available in the Investor section of our website at www.hanover.com. After the presentation we will answer questions in the Q&A session. After prepared remarks today and responses to your questions today other than statements of historical fact may include forward-looking statements. There are certain factors that could cause actual results to differ materially from those anticipated by the press release, the slide presentation, and the conference call. We caution you with respect to reliance on forward-looking statements and in this respect we refer you to the forward-looking statement section of our press release and slide two of the presentation deck.

Today's discussion will also reference some non-GAAP financial measures such as total segment income, segment results excluding the impact of catastrophes, ex-catalogs ratios and accident-year loss ratio among others. A reconciliation of these non-GAAP financial measures to the close of GAAP measure on our historical basis can be found in the press release of the statistical supplement, which are posted on our website as I mentioned earlier.

Before I turn the call over to Fred, I wanted to remind you that we have scheduled an Investor Day for February 27 to be held in New York. So mark your calendars and we hope to see you there. With that, I will turn the call over to Fred.

Frederick Henry Eppinger
Former President & CEO

Good morning. And thanks everybody for joining the fourth quarter earnings call. I'm very pleased with our performance in 2007. It was a record year for our Property and Casualty Company. Full-year earnings were 395 million for 2007, up over 20% versus the prior year. Net income per share was $4.83 per share for the year, up 48% from $3.27 in the prior-year and results for the fourth quarter were also strong with net income of $1.44 per share for the quarter, up 64% compared to prior-year quarter. Book value per share was up 13.5%, ending the year at $44.37, up from $39.10 at year-end 2006.

At the same time, our P&C leverage or return-on-equity for 2007 was 14.3%, up from 13.5% in 2006. These improvements were supported principally by the strong performance of our Property and Casualty segment, which consistently delivered strong results in each quarter in 2007. Our Property and Casualty pretax segment income was $103 million for the fourth quarter of 2007, up 6% compared to the fourth quarter of 2006. At the same time, we successfully improved our market position, growing net written premium by 5% for the year clearly above industry average.

Several factors favorably affected our earnings for the year. Catastrophes were low helped by the weather and the lack of any major hurricane activity in the United States. Additionally, our business portfolio has matured very favorably and we released reserves related to prior accident years across most of our lines.

Our balance sheet continues to remain very strong and we continue to reserve for our current accident year prudently giving careful thought to pricing environment, introduction of new product enhancements, and entry into new markets, all of which could potentially affect our current accident year's performance. Furthermore, our earnings benefited from a litigation settlement in the fourth-quarter, as well as some strong growth in our net investment income both in the quarter and for the full-year. Finally, we met our expense commitment we made lowering our underwriting expense ratio by a point as promised.

As we announced, Gene Bullis, our Executive Vice President and CFO, who joined the company in November is here on the call with us. It is my pleasure to introduce him today and he will review our financial performance for you in more detail. While I will leave the discussion of the financial topics to Gene I do want to highlight our investment portfolio. As we pointed out in our press release, our company has very little exposure to the sub-prime mortgage risks and to the secondary risk presented by financial guarantors. Gene will discuss this in more detail and will provide you an overview of our investment portfolio and its overall quality.

Clearly I'm very pleased with our performance this year. The quality of our earnings is very sound. Each year of our journey, we've steadily improved the underwriting… the underlying earnings power of this company. Our ex-cat earnings have grown at a cumulative average growth rate of 27% over the past four years. Simultaneously, we've been diligent in our exposure management, growing our business, while reducing concentration risk and lowering our P&L. We also have strengthened our reinsurance program, improving our overall risk profile, while generating valuable business capacity for our agent partners.

With a more stable and predictable earnings base and a solid 5% growth rate in 2007, we are well positioned to continue to achieve profitable growth in our business as we head into 2008. In Personal Lines, we grew 2.5% for the quarter and 3.7% for the year, and I believe we will grow… continue to grow at a low-single-digit growth rate for the full year and 2008.

Our product set is more complete and it has reached a level of distinctiveness. Our new Connections Auto product has improved and it's ready to be sold across our entire footprint, including Massachusetts in April. Our Connections Home product is well positioned and it is now available in 16 states. Additionally, we had expanded our TOI capability [inaudible] etcetera and our commitment to service is taking hold.

The improvements we've made are paying off. For example, we gained solid growth momentum in homeowners despite a slowdown in home sales. This month, our Connections Auto business surpassed the $0.5 billion premium mark and we started to gain more traction with partner agents as we had expected. Additionally, we retained a positive outlook for Massachusetts where our topline suffered in 2007 from a mandated 12% rate decrease, which continues through the first quarter. In the new era of managed competition, we see a huge opportunity to offer our distinctive value proposition to Massachusetts Personal Lines agents, something we couldn't do before and to further leverage our Personal and Commercial Lines capability more fully with our new and existing agent partners in the state.

With all this positive momentum, we've not lost sight of the challenge we faced with the Michigan economy. Michigan remains an important state for us and we continue to devote time and resources to managing it prudently so as to maximize the franchise value and state… our franchise value and the state.

All in all I'm confident we will continue to grow Personal Lines in 2008. However, we do expect that that the first quarter will be challenging due to the timing of several initiatives. This is driven by the continued impact of Massachusetts [inaudible] that stays in effect through the first quarter. Our expected trends in Michigan we think will be difficult the first full quarter, as well as the difficult comparisons given some things that happened in the first quarter of '07 as far as growth. However, these factors will mitigate through the year and the low single-digit growth rate for the full-year of 2008 is achievable target.

In Commercial Lines, we grew 6% for the year, in line with guidance we had provided. Once again, we believe we will maintain this pace of mid-single digit growth in 2008. Several factors contributed to the positive growth momentum we have established in Commercial Lines as we head into 2008. Our Commercial Lines platform is in a great position. We made significant upgrades to our small commercial model and platform at the end of the second quarter with many enhancements including more sophisticated pricing and ease of doing business.

The performance in our small Commercial business started to gain traction in this third quarter and has continued ever since. We have been able to take positive pricing action and generate new business momentum. We believe this will continue to give us added impetus for growth heading into 2008 as the adoption of this enhanced model continues to increase with our existing and new partners.

Our Specialty business continue to be robust and show solid growth of 25% for the year. Specialties now represent one-third of our Commercial Lines business, which provides a great diversity and more stable margins. Furthermore, our acquisition of Professionals Direct, a specialized provider of lawyers' professional liability closed in September and our announced intent to acquire Verlan, a Specialty property writer is expected to close in March. These investments further expand our Specialty capabilities and enable our agent partners to meet more of their client needs and to grow their business. We see significant opportunity cross-sell these products with our Hanover agents. We also think there is a significant benefit to be realized by aligning the administrative functions and a more prudent reinsurance purchases given that both companies will now be part of a much larger group.

Of course, we will be affected by market conditions as we were in 2007, particularly in the middle market Commercial segment where pricing and competitiveness continues to be difficult but with the work we have done in 2007, including the acquisitions we have made and the opportunities we will continue to evaluate, we have given ourselves many options for profitable growth and position ourselves well for success.

As I review our progress, I remain convinced that our disciplined approach to identify winning agents in our broad product approach is working, and we are building momentum in market share with winning agents. At all times we endeavor to carefully manage our growth at the agent level to ensure continued attractive margins and this will not change.

To summarize, I'm very pleased with 2007 results but I am much more pleased with how well we are positioned for 2008 and 2009. Clearly this is a competitive market and a difficult economy. Our company is in a very strong position. Our product set is as strong and stable it has been since we begin our journey. While we continue to innovate and add capabilities in all our lines, this is the first year we are not significantly revamping our core line. This stability gives us greater transparency to our margins and gives us even greater confidence in our ability to solve agents' problems. In addition, our team is stronger than it has ever been. In the last 36 months, we have added over 2,300 professionals to our strong team. Our field leadership is outstanding and our local underwriting is in place aligned with partner agents in each market. Finally, our operating model continues to improve. We improved our efficiency this year and we have set ourselves up to improve even more in '08 and '09.

In 2007 we demonstrated that our best of both strategy combining people, product and service on par with the best nationals with a local presence and responsiveness of the best regionals, resonates in the market and has been successful in making us a distinctive carrier for our partner agents. As we have said before we believe this will enable us to take advantage of market opportunities as weaker companies struggle through difficult market conditions. We will take intense focus and hard work to remain successful, but by doing so, overtime we will continue to create significant value for our agents and our shareholders through the cycle.

As you know, we have an Investor Day scheduled on February 27 in New York. I look forward to providing more insight in our progress and our plans for '08 along with more formal financial guidance. But looking ahead I feel very good about continuing the pace of growth in '08 at the rate above the industry for an overall growth rate of low-to-mid single digits and the low-single digit earnings growth with an expectation of normal cats for next year.

With that I will turn over the call to Gene for the financial review of the business.

Eugene M. Bullis

Thank you Fred. Good morning everyone and thank you for joining our call. This is my first conference call with The Hanover and I'm very pleased to be here. I'm sure that overtime I will get to know you all better and I look forward to that in seeing many of you at Investor Day next month. Today, I will be reviewing the company's financial results using the slide presentation that you're familiar with.

Turning to slide 5 for a discussion of our net income. Net income for the fourth quarter of 2007 was $76 million or $1.44 per share, up 65% compared to $46 million or $0.88 a share in the fourth quarter of 2006. Contributing to this increase was first, a tax benefit of $13 million or $0.24 per share in the fourth quarter of 2007 related to our discontinued life operations. This tax benefit resulted from a settlement of an IRS audit related to the 2002 through 2004 tax years.

Net income for the fourth quarter of 2006 on the other hand included an after-tax net realized loss on investments of 14.3 million or $0.28 per share. For the full-year 2007, our net income was 253 million or $4.83 per share compared to net income of $170 million or $3.27 per share in 2006, an increase of 49%. The principal factors contributing to this increase were the items already discussed for the quarter. Additionally, in 2006 we incurred an after-tax loss of $22 million or $0.42 a share related to expenses associated with the sale of our variable life and annuity business. Net income for 2007 reflects a 20% increase in pretax Property and Casualty segment income.

Now let's turn to slide 6 for a discussion of segment earnings. Segment income after taxes was $61 million for the quarter, which is consistent with the fourth quarter of 2006. Higher P&C earnings were partially offset by higher Life Company losses and a higher effective tax rate. The Life Company losses are due to finalizing the pension adjustment that we identified last quarter. This issue has been fully resolved and reflected in our financials for 2007. The GAAP effective of tax rate is 32% in the fourth quarter of 2007 compared to 31% in the prior period due to an increase in underwriting income. The current quarter's tax rate reflects the benefit from the IRS Audit we talked about earlier which also produced a small benefit pertaining to our ongoing life business. Therefore, our expectation is that we will revert back to a normal 33% to 34% effective tax rate going forward.

Property and Casualty pretax segment earnings were $103 million, $5 million higher than the fourth quarter of 2006, driven primarily by Personal Lines earnings, which were $10 million higher in the fourth quarter compared to the prior year period. This increase was partially offset by the Other P&C segment, which was $3.5 million lower than the prior year while Commercial Lines segment earnings remained consistent for this comparison period. I will discuss the principal financial drivers of each of these segments separately.

Before I turn to a discussion of the segments, let me comment on expenses. Our expense ratio for the quarter was 33.1%. However, there were several items that impacted this quarterly ratio so normalization will be helpful to understand the run rate of expenses. The principal factors impacting expenses in the fourth quarter were a $12 million benefit from a litigation settlement that lowered the ratio by about 2 points. Partially offsetting this benefit were higher pension expenses related to the census data cleanup project that added three-tenths of a point to the ratio. Accelerated investments in our Specialty business contributed another 0.5 point to the expense ratio and finally accelerated investment spending on the Massachusetts Auto project, payroll system conversion, and continued investments in our small commercial platform added another five-tenths of a point to our expense ratio for the quarter.

Adjusting for these items, our normalized fourth quarter expense ratio would have been 33.8%, which is higher than our year-to-date run rate through nine months due to some typical fourth quarter seasonal spending patterns. We view our 2007 normalized expense ratio to be 33.3% for the year, which is in line with our expectations.

I will now turn to a discussion of each of our segments starting with Personal Lines on slide 7. The Personal Lines segment generated pre-tax earnings of $59 million in the current quarter versus $49 million in the prior-year quarter. Catastrophe losses were $5 million for the current quarter of 2007, which is consistent with the prior-year quarter. Earnings in the Personal Lines segment improved for several reasons. One major benefit was of course the litigation settlement previously mentioned that we received in the fourth quarter. Additionally, earnings in this segment also improved due to higher investment income from cash flows.

Partially offsetting these favorable items was a $3 million increase at ex-catastrophe losses. The favorable development of prior year reserves resulted in a $16 million reserve release for the current quarter. This compared to $10 million of prior year favorable development reported in the fourth quarter of 2006. However, our current accident year losses were about $9 million higher than the quarter principally due to weather-related losses, causing the $3 million net increase in our Personal Lines ex-cat losses for the quarter. Additionally, earnings were negatively impacted in the fourth quarter of 2007 due to the out-of-period pension expense, which as I said earlier, has now been fully resolved.

Now let's look at Commercial Lines earnings for the quarter, which are on slide 8. The Commercial Lines segment generated pretax segment income of $43 million in the current quarter, which is consistent with $43 million in the prior-year quarter. Catastrophes were $6 million in the current quarter compared to $12 million in the fourth quarter of 2006. Excluding the impact to catastrophes, pretax segment income would have been $49 million in the current quarter compared to $59 million in the prior period. This $6 million increase… decrease in the quarter is principally due to higher ex-cat losses, higher underwriting expenses including the out-of-period pension expense, partially offset by other miscellaneous items.

Ex-cat losses were higher in the quarter, primarily due to lower favorable development of prior-year reserves. Favorable development of prior-year reserves were $18 million in the fourth quarter 2007 and was generally favorable across all lines. However, the quarter suffers from a tough comparison to an even stronger fourth quarter in 2006 with $28 million in favorable prior-year development. This resulted in a $10 million reduction in current quarter earnings related to lower prior-year development.

Current accident year margins were strong, driven by the significant growth in our Specialty Lines, which helped to partially mitigate the lower favorable development in the quarter. Additionally, expenses were $4 million higher in the quarter, principally due to increased investments in our business platform, primarily in our Specialty Lines, a $1 million premium tax benefit in 2006 that did not recur, and from a $1 million increase in pension expense as discussed earlier.

Now, let's turn to production beginning on the slide 9. For the quarter we reported an increase in overall net written premium of 6% with a 2.5% growth rate in Personal Lines, and 11.2% growth rate in Commercial Lines. Commercial Lines growth in the quarter includes the effect of the acquisition of Professionals Direct, which we acquired effective September 14, 2007 and also includes the favorable effect of reinsurance adjustments. Normalizing for these items, Commercial Lines growth for the quarter would have been about 8%.

Now, let's turn to slide 10. For the full year, we reported an increase in overall net written premium of 5%, 4% growth in Personal Lines, and 6% growth in Commercial Lines. The full-year growth is in line with the guidance that was provided at the beginning of the year. Personal Lines growth is at the low end of our range while Commercial growth… while Commercial Lines growth is in the middle. Marita will discuss production in more detail in her remarks.

Now, let's turn to the investment section. As you can see on slide 12, our general account investment assets had a carrying value of $6.2 billion at year-end 2007, fixed income securities constituted 92% of our portfolio, equities were less than 1%, 95% of our fixed income portfolio carries an investment grade rating, and the average quality rating of our portfolio was A-plus.

Turning to page 13. You can see the sector break down of our fixed income portfolio. Here again, we have a conservative risk profile with 48% of our fixed income portfolio in corporate securities. MBS and CMBS were 28% of our portfolio and our municipal bond portfolio constitutes 15% of total investments.

On page 14, you can see a break out of our residential mortgage-backed securities, which represents a total of $1.1 billion with less than 15% of this portfolio in non-agency securities. Our non-agency securities carry AAA ratings. None of our mortgage-backed securities have sub-prime exposure.

Page 15 breaks out our municipal bond portfolio. We have $808 million of municipal holdings, of which $368 million carry an insurance enhancement by financial guarantors. However, the average underlying ratings quality of these securities, even without regard to the insurance enhancement is AA-minus.

Turning to page 16. We have provided some additional information on our unrealized losses for the year… our unrealized loss position Gross unrealized losses on below investment grade fixed maturities and equity securities a useful indicator of potential future impairments was only $9 million at December 31, 2007.

Finally on page 17, you can see the significant improvements in our balance sheet. Our balance sheet reflects the strength we believe we need to execute our growth strategy with operating leverage of 1.421 compared to 1.621, a year ago and year-end financial leverage improving to a debt-to-capital… to total capital of 18.2% compared to 20.3% from a year ago. These financial leverage ratios do not take into effect the hybrid equity credit in our trust preferred debt that is allowed by most rating agencies.

While our holding company cash position was $317 million at the end of 2007, which provides more than adequate liquidity it represents a coverage ratio of 6.8 times of fixed obligations. Our fixed obligations include an after-tax debt expense of $26 million and a common share dividend of about $21 million.

Before I hand the call over to Marita, I have a few updates. First, is the status on Life Companies dividend. Subsequent to year-end we have declared and received regulatory approval for a dividend of $17 million, which approximately equals to company's or FAFLIC 2007 statutory net gain from operations. We have now reached the point where we are confident, a substantial portion of our FAFLIC related tax attributes have been or should be realized in our 2008 consolidated return such that we can begin to evaluate alternatives to accelerating the realization of the embedded value of the Life business. Next on the topic is share buyback. As you know we have an authorized… authorization to buyback a $100 million. Through January, we have bought back 235,000 shares for a total cost of just over $10 million.

And finally, as you have probably seen, Moody's upgraded us to investment grade yesterday. We are obviously pleased with this upgrade and we are convinced that overtime our investment grade performance and financial strength will be recognized by the other rating agencies.

With that, I will turn the call over to Marita Zuraitis.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Thanks Gene. Good morning and thanks for joining our call. Like Fred, I'm very pleased with our company's performance in 2007 both our Personal and Commercial Lines segments delivered strong results for the quarter consistent with our objective of growing while delivering solid returns. Additionally I'm excited with the traction we've gained in the business, which validates the success of our strategy and provides me with the confidence for continued success in 2008.

Our Property and Casualty business reported topline growth of 6% for the quarter and 5% for the full year and a combined ratio of 94% for the quarter and the year. These results line up well with our objective of profitable growth through the cycle. We have continued to maintain strong underwriting discipline while growing market share by leveraging our broad capabilities and agency partnership. Let me elaborate on this point.

Our Commercial Lines growth in the quarter was 11% but as Gene pointed out, this figure has some noise. So I'm going to normalize it for you. Our growth rate was impacted by the integration of Professionals Direct or PDI, our Lawyers Professional Liability Firm, into our books effective September 14, 2007. This added $4 million of PDI's net written premium into our fourth quarter growth. Excluding PDI and some reinsurance related adjustments in the prior-year quarter, our underlying growth rate for the fourth quarter of 2007 was about 8%. This growth came primarily from our Specialty business, which grew at a robust pace of over 25% for both the quarter and the year. As you have heard us say before we invested heavily in our specialty capabilities and these investments continue to yield results. In a more competitive market with price pressures, specialty lines provide us with better breath and diversification of our earnings base.

With over $300 million in written premiums, Specialty Lines now represents a mature book of business, supported by strong agency distribution and it constitutes about third of our Commercial Lines book in total. Thanks to these investments that we've made this business now has a strong distribution channel and it's managed by some of the best professionals in the industry.

And we continue to develop our capabilities in this area. Last quarter we closed PDI, which expanded our expertise into lawyers professional liability coverage and we recently announced the acquisition of Verlan Holdings Incorporated, a specialty company providing property insurance to small and mid-size manufacturing and distribution companies that are highly protected fire risks.

By broadening our specialized product and service capabilities to include Verlan's unique offering, we will provide our agent partners with even more tools to grow their businesses while improving our own competitive position. However, our traditional lines are more impacted by market conditions and we do feel the competitive pressures we have walked away from many accounts based on price but even with these market pressures we do see some positive momentum. This year we have done a tremendous amount of work, enhancing the product and operational effectiveness supporting our small commercial platform that allows for easy coding, issuance, and renewal of policies through our agency portal.

Beginning in the third quarter, we started seeing increased flow of new business. And we believe we are now well positioned to write more of this balanced flow business that has attractive economics as more of our partner agents adopt to our enhanced model in 2008.

So we have good traction and real positive leverage to profitable growth in 2008, giving me confidence that we should be able to sustain a mid-single digit growth rate for Commercial Lines in 2008. Additionally, we continue to monitor the quality of our business very closely using various metrics, including class mix, line of business mix, policy size mix and transactional quality, and I remain satisfied with the quality of the new business that we've written in during 2007. We will continue our disciplined underwriting approach and prudent agency management in 2008. Finally, as expected we are growing with our partner agents at a rate that is over twice the growth rate of our overall franchise.

Now turning to Personal Lines. We recorded at 2.5% growth in the quarter and 3.7% for the full year. This is in line with our guidance but on the low end of the range. Several factors in 2007 caused drag to growth in the year. As you may remember, we took actions to reduce coastal exposures in Cape Cod and Rhode Island, written premiums for the year also reflects the mandated 12% rate decrease in Massachusetts Auto. Additionally as we have talked about earlier, Michigan continues to pose a challenge with its weakening economy. However, we have stepped up our agency management efforts and we are working closely with our partner agents to retain and consolidate business.

Finally, as we have discussed previously, the corrective actions we have taken on our Connections Auto book, aimed at improving pricing and mix of business are well under way. The mix improvement that these actions were aimed at such as increased proportion of multi-car policies and whole-account business that are consistent with our strategy have taken hold and should improve retention overtime. I believe we are now better positioned to gain market share in 2008. Additionally the outlook for Massachusetts is now positive. With managed competition in play, we have the freedom to set differentiated pricing. We have implemented a multi-variate product for use in Massachusetts and our new rate filing has been approved. We are excited to be a carrier in the state where we will now have the opportunity to bring our marketing expertise and our broad product and service capabilities to our partner agents.

We have positive moments in Personal Lines and the effectiveness of our strategy will continue to yield results. This is why I feel confident that we should be able to grow at a low-single digit growth rate in 2008. However as Fred mentioned, the first quarter will be more challenging as some of the negative influences on growth that we saw in 2007 and that I explained will still be running through our numbers. For example, the Massachusetts Auto mandated rate decrease will still be in effect until April 1, 2008 and the impact of out corrective actions will still be apparent in the form of a tough comparison to the first quarter of 2007. We should hit our stride going forward. I remain confident that we will grow at a low-single digit rate for the year. I look forward to our discussion on Investor Day where we will provide more insight on the priorities that will help us achieve our goals in 2008.

Before I turn the call back over to Sujata, let me give you an update on our reinsurance renewal. As you know our catastrophe reinsurance treaty renewed on January 1 and I am pleased with the results of that placement. As I mentioned earlier, we have an active exposure management program and with the many actions we have taken this year, we have been able to grow while reducing our aggregate exposure to catastrophes, which was a key factor in the favorable renewal of our catastrophe reinsurance program.

We renewed our cat occurrence reinsurance treaty similar in structure to the expiring program with the following changes.

We increased our overall program retention from $167 million to $197 million while increasing total limits from $600 million to $700 million. Our first layer retention increase from $90 million to $150 million and we now have a 47% co-participation on the reinsured layer that is $100 million excess of a $150 million and the program is now fully ceded for the layers of $450 million excess of $250 million. We believe our reinsurance program give us the right balance of reinsurance protection and economic benefit. With the higher earnings power we have sustained over the last three years and with increased capital levels in our P&C companies, it is prudent and economical to accept higher retention level. At the same time buying up the per occurrence limit is important to protect our capital from a significant event. With the new structure and our favorable risk exposure we were able to renew the new program at a cost savings of about $15 million.

And with that I'll turn back the call back to Sujata.

Sujata Mutalik

Thanks Marita. Operator, we will now open the floor up to questions.
Question and Answer

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Dan Farrell with FPK. Please proceed.

Dan Farrell
FPK

Hi, good morning.

Frederick Eppinger

Good morning, Dan.

Dan Farrell
FPK

Fred, I think you've mentioned that you thought you could grow earnings next year at a single-digit pace. Can you give a little more color around some of the other assumptions in terms of reserve development, some of your accident year picks, which were pretty conservative this year and may not have to be up that much next year and then also just assumptions for what the Life business can do in the run-up?

Frederick Eppinger

Yes, we are going to spend a lot of time on that at the meeting on 27th of February so I won't go in a lot of details but we have a lot of confidence that unlike others that are going to have decay in their accidents in the industry we don't think we're going to have that situation. And as we have said in the past, well, I think that the reserve releases will moderate they will continue. So in my view, I mean… and so it is going to be a similar story that we have had for last two or three years. One big difference this year is the maturity of our product set. I mean, we had a lot less certainty in the last couple of years, we revamped Personal Lines autos and Personal Lines [inaudible] and for Commercial and comp and we have a lot more transparency.

So what I would like to do on the 27th is actually is go to that in a lot detail. But the story is not a lot different, the magnitude of the different pieces are a little bit different but we feel pretty confident that we still have improvement left. In addition for instance, I think I had still haven't improved our expenses as I've have said to you in the past. So the story hasn't really changed but I want to make sure we have the time to go through all the specifics. So because it is somewhat complicated because of the mix change in the business.

Dan Farrell
FPK

Okay, that's helpful. And then just an additional question on the Life segment. Can you just expand a little more on what you think, some of the strategic options could be for that and then also you're getting… you said you can realize most of the tax attributes in 2008, does that imply that you can get more than say, $20 million, $25 million in '08 that you can accelerate that versus what you pulled out this year already?

Frederick Eppinger

Yeah. So, as you know, the difference from stat and gap essentially one of the biggest differences is the tax attribute, there’s other things but that is one of the biggest one. And then as we have always said, what we try to do is assess the value of the Life company every year and the net present value and said some of these tax carry forwards, we would have lost if we had done anything like sell the remaining business. So we decided to maintain it and as I look forward, one of the tax attributes we would lose are used up this year… this calendar year. So because of that it is important for us to now start to thinking about alternatives for the Life company which includes selling some of the run-off businesses and my belief is that they are a lot less risky obviously, a lot less volatile to what we had before and so that there is a market for those and so we have to be thoughtful and make sure we get the right kind of value. But we don't give up as much as we did couple of years ago when we had over $100 million of these tax carry forwards that we would have lost if we have sold it. And as you know, I think from the tax accruals as long as we own portion we get this year's credit for that as along as the P&C company continues to earn money, which we expected to do.

So if you know, we as again, we will go over some more detail of that at the meeting but I believe that essentially that is if we pursue strategic options around liquidating some of that… those assets during their week of free up additional capital. I mean it’s obvious I think to all of you that growing concern would not having an RBC that we have. I mean, our RBC is at an incredible high level because it’s a run-off business. Any other entity that would hold that would have a normal RBC, which obviously would treat as an arbitrage opportunity there between the capital we would have to carry to run it and they would run it. So there is obviously an opportunity to free off some capital, which is exactly what we want to pursue.

Dan Farrell
FPK

Great. Thank you very much.

Operator

Your next question comes from the line of Cliff Gallant with KBW. Please proceed.

Cliff Gallant
KBW

Good morning. Good quarter.

Eugene M. Bullis

Thanks, Chris.

Cliff Gallant
KBW

Just a quick question, on the buyback, could you talk a little bit more about the strategy how going forward and I think, I heard that you said you bought back $10 million worth of stock in the quarter?

Eugene M. Bullis

Actually, we programmed the date of $10 million where I think we had about $1.5 million in '07 and a little bit more activity in January. We have a 10b-5, we did put a cap on it because we went through a quite period and didn't have any control over what happened. So that just kind of ran it's course up to the cap.

Cliff Gallant
KBW

Okay.

Eugene M. Bullis

So that's what happened in the month. We want to be careful. We have certainly some strategic competitors for growth. So we want to make sure we have the capital to support that. On the other hand we think that buying back collectively and prudently is smart, and that's why we have the program in place. But we don't expect to… we will be using it in a week or a month. We want to be cautious about the pace at which we consume a $100 million.

Cliff Gallant
KBW

Okay. And Marita, you mentioned that the… I think you already said that the partner agent growth was twice that of the overall company does that mean the partner agents are growing in the mid-teen range?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, it does. In Personal Lines it's about 1.5 times and in Commercial Lines it's twice the growth of the other agency plan. I mean we continue to add agents to that list as we go through a pretty robust planning process with those agents.

Frederick Henry Eppinger
Former President & CEO

And Chris, one of the most important points we tried to make is that in this kind of market you are seeing tons of people… earnings growth are shrinking of earnings, because the new business pricing is quite different from renewal pricing and many other segments. And one of the things we tried to do with partner agents obviously is that we give them a robust portfolio of special kind of products and offerings. We get them to shift share to us without that same kind of new business penalty. I mean, that's the whole game we play, right. That's… the partner agents are incredibly important to us. We give them some of these distinctive things to sell, to compete in a marketplace and then they help us with some of our growth that doesn't come with the same kind of new business penalty you have in this kind of market. It's competitive, we have good prices, but we don't have that same kind of seven people competing crazily for some of this business. And that's a big part of what we see happening in the next two years.

The other thing that I would like to tell you about partner agents, you will see in my view the next three quarters and a number of these regional companies have real problems. They have run out of balance sheet flexibility. And if you look at their mix of comp and their mix of long-term liabilities that they went into may be 4,5,6 months or six quarters ago, to make up for their lack of growth that stuff come in home to roost. So what you're going to see is some re-underwriting at these regional companies which again forces that business into the marketplace for our partner agents, they need to find a home and stable home and we think it basically bodes well for us to be able to grow without an enormous new business penalty. So, we see this beginning of some of that and we think the next three, four quarters you are going to start seeing some real activity among the weaker regional companies.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

And for these partner agents we look pretty unique on their shelf space for a regional company with the capabilities we've built and the operating models that we've put in place, we really sit there as a pretty strong super regional company with a lot of these agents. We will give you a lot more transparency around the partner agencies at Investor Day there will be a big part of what we talk about with you then.

Cliff Gallant
KBW

Okay. Thank you very much

Frederick Henry Eppinger
Former President & CEO

Thank you.

Operator

Your next question comes from the line of Ron Pai [ph] with Banc of America Securities. Please proceed.

Unidentified Analyst

Hey, good morning.

Frederick Henry Eppinger
Former President & CEO

Good morning, Ron.

Unidentified Analyst

Hi, the first question is for Fred I guess. I think you've made your second acquisition now with Verlan, how do you envision operating these companies. Are they going to be run independently under The Hanover umbrella or do you see them as becoming more integrated into your overall business?

Frederick Henry Eppinger
Former President & CEO

Yes, that’s a great question Ron and everyone is a little different. I mean what you see is that since I have joined the company four years ago, we started trying to pursue teams. And at the beginning it was more teams without balance sheets and now… because the pricing has come down and some of the smaller companies reinsurance costs are such that it’s real value for us to be able to buy the team and the balance sheet. But what we try to do is that for a lot of these, it is about professionals, right. I mean what we're trying to assemble is distinctive professionals that have a specific confidence. So in the example of PDI that is really our platform now for professional liability. So you'll see that team be able to help us acquire other professionals to go into architects and engineers etcetera. So it is separate from a professional team point of view but our reinsurance purchasing and financial management is one, risk management is one, much of our operating model they have been brought in because of most of these companies are small face value. So one of the big value creators we are doing is a lot of these companies with small face value policies have a lot of manual work. So our imaging processes, our back office processes make them a hell of a lot more efficient and keep their professional focus.

But if you think about what we do, we keep the professional underwriting often together. So you will do… there are some of companies that have a philosophy of being a holding company, keeping these things separate. We will not do that. We will have professionals act as professionals but you will see our financial controls, our operating model be brought together but the professionals will be treated like special teams. And again now, is there exceptions to that. Sure, I could imagine the more you go towards say the E&S part of the market, the more they would look more separate. But we're very thoughtful function by function. In addition, on branding what you saw with PDI was branding it under The Hanover professional liability umbrella and we will do that as well with most of these we will brand them underneath The Hanover but we might have product branding depending how distinctive it is in the marketplace.

So again, this is one of these competencies that I believe that not many insurance companies have built. We have put together a whole integration and development team that is top notch and we are going to do this extraordinarily well, because it is all about growing it after you get here and making sure that the margins and controls are in place to do that effectively well. Now it is obviously easier when they are small, which is where I’d focus. I like small teams that are dedicated in our kind of value system. But I think it's again, at the Investor Day, one of the whole presentations I want to give is on how value creation is done appropriately in our business when you bring on teams and I think you'll be impressed with the thoughtfulness we give that just like the thoughtfulness we give to proactive marketing with our agents.

So it's a great question and I really think it is some thing that is worth some real-time at Investor Day because I think in this kind of marketplace, I keep telling the story, there is 500 subscale companies that shrunk in total $50 billion in the last decade. And this is the kind of market where a lot of these folks that are very good just or not at the scale to be sustainable because their operating model, the reinsurance costs, and their ability to keep the ratings and in my view this is a big deal for companies like us. They can thoughtfully assemble these small specialty teams and use them against their agent partners.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

The only thing I would add to that is we have put together a strong M&A integration team and many of us have a lot of experience in our past doing this well and we really think it's all about balance being able to obviously the reason we purchase these is to add capabilities to the independent agency system and continue to add to our strategies. But it is also about the fact that these are growing profitable little companies and we want them to be able to continue to grow profitably. So as Fred said, we can talk about this in a lot more detail on Investor Day.

Unidentified Analyst

Thanks, Fred, Marita for the details. I'll save any follow-ups may be for Feb. 27. I guess, Marita just or may be Fred too, just one thing what is the profile of your bond book of business and then I guess I am -- the concern would be if we do head into an economic slow down, is that exposure say that we need to be concerned about?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

You know like the rest of our portfolio, our bond business, I won't call it boring, but that is probably an appropriate word. It matches the small to mid size mix of the rest of our business, it is not significantly heavily weighted in contract surety. It is a nice mix, it is just the size of our agents and the size of our portfolio. It certainly has some economic trends that you watch, but it is not as significantly impacted as the book of business that would be heavily weighted in large contract surety. We don't write P&C business for large contractors. Our percentage of P&C business in the whole contracting segment is extremely small and actually quite different than the majority of our regional counterparts. So we watch it carefully. We have very high underwriting standards from a financial underwriting perspective. We have a very seasoned group of professionals running this business and we feel very confident that we got a good handle on what it is, and its a nice solid mix for who we are and what we do.

Unidentified Analyst

So it is primarily a contract book as opposed to a commercial surety?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Correct. I mean it is not heavily… it is a nice mix but if you are worried about heavy commercial surety exposures that’s not what this book is.

Unidentified Analyst

Okay, okay. That's the only two questions I had. Thank you.

Frederick Henry Eppinger
Former President & CEO

Thank you.

Operator

Your next question comes from the line of [inaudible] with Lehman Brothers. Please proceed.

Unidentified Analyst

Hi, good morning.

Frederick Henry Eppinger
Former President & CEO

Good morning.

Unidentified Analyst

Could you discuss your outlook for continuing to improve the expense ratio about a point a year, given that you have accelerated some of the investment spend in Specialty Lines and in Mass Auto? And then as the book shift more to Specialty Lines, does that put upward pressure on the expense ratio?

Frederick Henry Eppinger
Former President & CEO

Absolutely. I mean what… the way I think about the expense is… it is actually a great question. As I said before this year if you look at our run rate, we clearly were able to take a point out and I would say our run rate in LAE is about 0.5 point from 11 to about 10.5 going forward. So I feel good about our run rate. I think there is another point combined or so coming out probably next year. The issue is just what you said. If Specialty grows nicely for us, if we were able to grow Specialty and things like HPR, the ratio of expenses to losses is different in Specialty businesses. So you have a different mix. That is not… that does not say though when I look at my core businesses, we can't get another point out of our core businesses, we obviously can't. But total number is affected by your mix just like it is math right. So if you are in a business that has a much higher expense ratio because it is engineering oriented while spending is going to change.

But that doesn't make you less competitive it just means your mix of business is different. But we are very convinced that we've built this the ability to scale our businesses pretty effectively until we have transparency next year going through the continued efficiency improvements in our business, that’s breakup point. But again I wouldn't also turn away from doubling our Specialty capability and run our business just because it changed my mix and my expense ratio obviously. So we have pretty good transparency that we have more efficiency next year, and I think we have more in ‘09 because as you recall particularly in claims we have another big year of implementing our new claim system, alright. That's the one last big project we have left that had this year was the first year and this year we are in now… right now is the next big tranche to implement our new claim system across our system. So I see more transparency both this year and next year on efficiency.

But you're right what happened this year and I think you all know what we do, we had a lot of transparency in beating our targets and I accelerated purposely the Massachusetts investments so we could be the most sophisticated player on April 1 which we will be, as well as we saw a great traction in some of our Specialty businesses that we wanted to accelerate some infrastructure stuff so that we could capitalize and keep that going with good margins for the next couple of years. So again it's one of the things we do, right. We look at the NPV as a stuff and try to manage it appropriately but I think I have a lot of transparency to increase improvement and efficiency of our operating model which makes me feel good about going into a couple more years difficult pricing.

Unidentified Analyst

Okay. Great.

Frederick Henry Eppinger
Former President & CEO

Thank you.

Unidentified Analyst

And could you provide us with some more color about your discussions with the rating agencies and when you think you could get an upgrade from the other agencies?

Frederick Henry Eppinger
Former President & CEO

I wish I was as smart as I know when they comes, I’ll let Eugene, if he had a lot more intelligence on this, with Gene around I can give this some, but obviously, we have positive outlook from all three and I am thrilled about it. And their written guidance would say, once they give you positive outlook it’s something like a 12 or 18-month period before they go to the next step. So I'm very confident given we keep beating our expectations with them and our financial results are better than we show them every year that is inevitable.

We have got Moodys today, which I am thrilled about and I would hope that in the next 12 months, we would get the others to move in that direction given their guidance as they… the proper guidance of how long they have you in positive outlook. How they think about it though is really a [inaudible] for me, clearly the financial sector is an amazing sector right now. They are all scared about the financial sector, investment portfolio, it's a little amazing that they were getting upgrades and positive outlooks in this kind of environment just because of our financial strength.

So I'm confident we will get it. I'm not as clear exactly when it is as you saw from the write-ups from both the rating agencies when they did the positive upgrade it really isn't about capital anymore, we have plenty of capital, we have a very good balance sheet, it really in a lot of ways, in my view I describe as time. At some point they get comfortable in doing it, but I think we have done it, we have done all the right things. I think we have in my view assembled almost excess capital from what we need for that upgrade. So I feel very confident it's going to come. I just can pick the time. Gene, I don't know if you have a different point of view.

Eugene M. Bullis

Well, that's exactly… every issuer or company believes that their metrics is strong as per the rating agencies. So we are in that same position but there are… there is the reality that we have there is a necessary passage of time between a few things that have happened in our past and we think we are well beyond that and certainly our business profile and our financial strength will reflect that but we have to address that. As we move forward I think that we will continue, we are in positive outlook and we will expect to on the two that still have a slow investment grade on the debt side and we expect to execute and perform with awareness and visibility to what their expectations are. We have to contemplate that how we run the business, because we do want to get an upgrade but we can't let it drive our strategy because we have to also grow. So…

Frederick Henry Eppinger
Former President & CEO

And we've had terrific conversations with both.

Eugene M. Bullis

Sure.

Frederick Henry Eppinger
Former President & CEO

To me, it really is just some passage of time I think and I feel great about it and I think it's going to be a big deal. I think it is going to help our business when it happens and it's going to happen. So I feel good about it.

Unidentified Analyst

Great, thanks for the answers.

Operator

At this time, there are no further questions. I would now turn the call back over to Sujata Mutalik for final remarks.

Sujata Mutalik

Thank you Maria and thank you everyone for joining the call and again we look forward to seeing you in a month for our discussions on the Investor Day.

Operator
Thank you for your participation in today's conference. Ladies and gentlemen, all parties may now disconnect. Have a great day.