S&P Global
Market Intelligence

Everest Re Group, Ltd. NYSE:RE

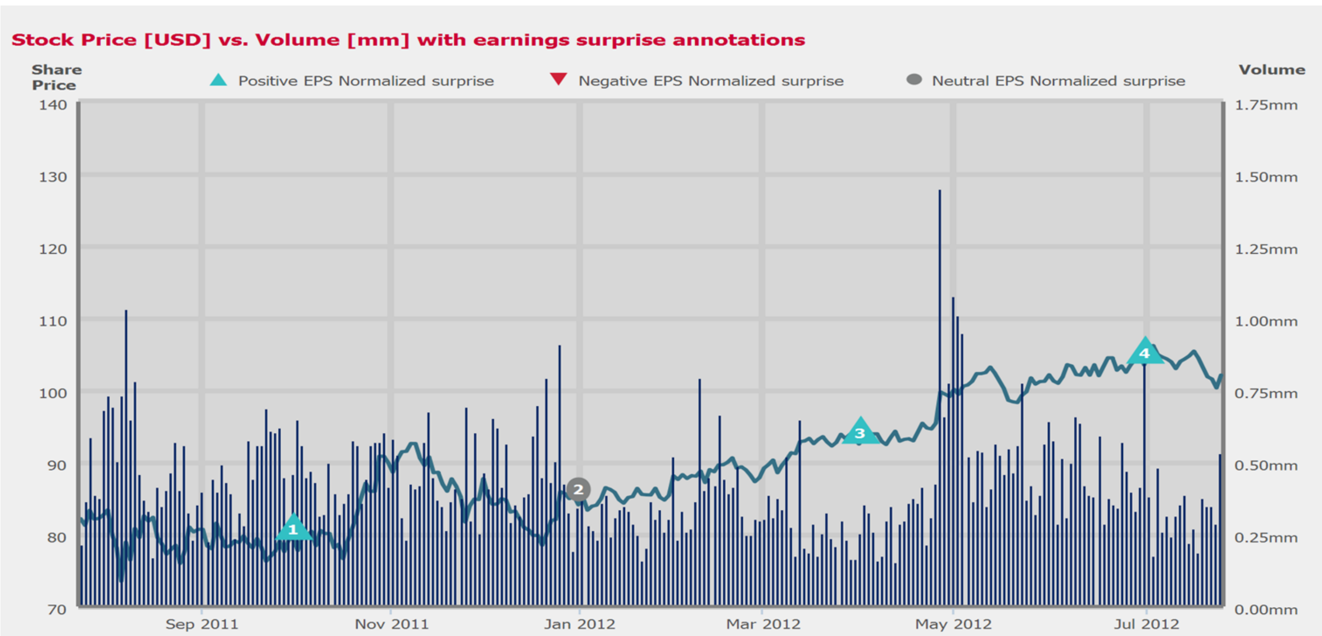
FQ3 2012 Earnings Call Transcripts

Thursday, October 25, 2012 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	3.44	4.05	▲17.73	3.40	15.67	13.49
Revenue (mm)	1131.52	1218.98	▲7.73	1088.75	4330.61	4450.25

Currency: USD
Consensus as of Oct-25-2012 7:50 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	2.03	2.70	▲1 33.00 %
FQ4 2011	(0.69)	(0.94)	NM
FQ1 2012	3.45	4.48	▲2 29.86 %
FQ2 2012	3.77	4.25	▲3 12.73 %

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Call Participants

EXECUTIVES

Craig William Howie
Executive VP, Treasurer & CFO

Dominic James Addesso
President, CEO & Non-Independent Director

Elizabeth B. Farrell
Vice President, Investor Relations

Joseph Victor Taranto
Chairman of the Board

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Amit Kumar
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Morgan Stanley, Research Division

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Barclays Bank PLC, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Presentation

Operator

Good day, everyone. And welcome to the Everest Re Group Limited Third Quarter 2012 Earnings Conference Release Call. As a reminder, today's presentation is being recorded.

And now for opening remarks and introductions, I'd like to turn the conference over to Ms. Beth Farrell. Please go ahead, ma'am.

Elizabeth B. Farrell
Vice President, Investor Relations

Thank you, Catherine. Good morning. And welcome to Everest Re Group's third quarter 2012 earnings conference call. On the call with me today are Joe Taranto, the company's Chairman and Chief Executive Officer; Dom Addesso, our President; and Craig Howie, our Chief Financial Officer.

Before we begin, I will preface our comments by noting that our 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 projections, 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 investors should consider in connection with such statements.

Now let me turn the call over to Joe.

Joseph Victor Taranto
Chairman of the Board

Thanks, Beth. Good morning. As we enter 2012, I indicated that I was optimistic about generating quality earnings for the year. So far through 9 months, it's clear that optimism was warranted.

Through 9 months we have generated $1 billion of comprehensive income for our shareholders, resulting in growth and book value per share, adjusted for dividends of 17.4%. The reasons I was positive continue and accordingly, I remain upbeat about our future. Let me go through that reasoning.

First, the global reinsurance market in reaction to $100 billion plus of 2011 catastrophic losses, increased rates and tightened terms and conditions, our strategy was to benefit from these changes by increasing our potential profit margins without meaningfully increasing our PML's in our peak zones. Our team did a superb job of executing this strategy.

Now we have seen alternative capital sources entering the market, also looking to benefit from these improved terms. This additional capacity has stabilized the market at a reasonable level, so I continue to expect quality opportunities for 2013.

Second, we have a very clear underwriting philosophy that is solely focused on profit, not volume. It is also focused on portfolio management, looking for the best deals on which to deploy our capital.

Third, we continue to pursue opportunities where we possess the specialization to achieve superior results. For our insurance operation, this includes, crop insurance, medical stop-loss business, financial institution D&O and California workers comp.

Of course, the drought in the U.S. has produced losses for our crop book. We expect in any given year we will have losses on some portions of our book. But just as 2011 catastrophe losses increased rates and demands for catastrophe reinsurance, going forward, we expect we will see increased demand for crop insurance, and the government will include the 2012 results as part of future rate making.

Fourth, our $16.5 billion of invested assets continue to perform well given the current market conditions.

Fifth, our strong earnings will allow us to buyback more stock, which we expect will increase shareholder return. Through 9 months, we have bought back $250 million worth of stock or 5% of the outstanding shares as of 12/31/11.

We have also paid $76 million in dividends through 9 months. In the third quarter, we bought back only $25 million worth of stock, given it was hurricane season, plus we have Hurricane Isaac and the drought conditions.

Nonetheless, we increased our surplus by $368 million in the quarter and by $714 million for the year. What we didn't spend yesterday on stock repurchase is in surplus available for tomorrow's purchases.

Sixth, our management team is the strongest it has ever been. I would stack it up against any company in our space in the world. Working with Dom, John Doucette, Craig Howie and our other senior managers has been great. We've never been more focused and energized.

Now, I will turn it over to Dom for the report on operations and then Craig will give you the financial reports.

Dominic James Addesso
President, CEO & Non-Independent Director

Thank you, Joe, and good morning. As Joe mentioned, the results for the year have been quite positive and the third quarter has added to what was experienced in the first half. In addition, the operating earnings have improved quarter-over-quarter, which reflects the underwriting gain of $129 million this current quarter versus a $46 million gain in the prior year.

Underlying this is a pattern of continued quarterly improvement in the underwriting result. The year-over-year comparisons are complicated by the cat losses in 2011, but what is worth noting is the positive trend this year quarter-by-quarter in the attritional combined ratio, that stands at 84.9% in the most recent quarter.

This improved operating performance is due to the results in the reinsurance segments where the attritional combined ratio dropped to 77.9% and to a reported combined ratio of 80.1% including catastrophe losses.

After the cat losses of $25 million there was $157 million underwriting gain for the quarter. On the year-to-date basis the reinsurance underwriting gain was over $375 million, which includes $85 million of cat losses.

All this points to a portfolio that more recently has been repositioned to more of an excess of loss mix, which has the ability to generate healthy margins. Our year-to-date cat premium is approximately $1 billion, 3 quarters of which is written on an excess of loss basis.

As a result, the property lines in all regions continue to drive the improved results despite some slowing of the rate increases. Nevertheless, it was positive rate change during the third quarter. In particular, Australia saw improvements of 10% to 15% in rates during the quarter.

Casualty lines on the other hand, while seeing some improvement in rates are still not hard enough or moving fast enough to make any meaningful improvement in results. We continue to remain cautious on casualty reinsurance and while the shift from pro rata to excess in the property lines is improving the bottom lines, it has resulted in less premium growth than would otherwise be the case.

Turning to the insurance operations for the quarter, the results were mostly affected by the drought-related crop losses. The impact of these losses on the quarter was $20 million. The remaining portions of the book performed in line with expectations. In fact, excluding crop business, the attritional combined ratio for the year was at 99.2%.

The primary A&H, which is medical stop-loss business, is growing nicely and profitably. The casualty business, which is focused on specialty classes, is experiencing double-digit rate increases. And California workers' comp also continues at double-digit rate increases.

While the insurance marketplace is currently a challenging environment, the core businesses we are now focused on are trending nicely. We certainly expect the improvements to continue into the fourth quarter with ongoing rate increases, growth in our A&H business and an expected normal crop season for the winter harvest.

Overall, we continue to focus on ways to improve the underwriting margins, as investment income gains are difficult to achieve in this low yield environment. Despite this, we have done extremely well over the last 3 years in maintaining investment income.

We are pleased with the performance of our invested assets both for the quarter and year-to-date. And while the investment-- while investment grade bonds constitute the bulk of our assets, at 79% of the total, our asset allocation has become increasingly diversified.

This has allowed us to reduce the duration exposure of our assets, maintain an average credit quality for our fixed income securities of AA-minus and add investment income and total return beyond that of our investment grade bonds.

Our allocations to alternative fixed income securities and publicly traded equities have been accretive to investment income. As those assets carry an average market yield that is nearly 250 basis points more than our investment grade bonds.

The total return of invested assets has also been helped with the non-investment bond assets returning 200 basis points more for the quarter and nearly 600 basis points more year-to-date than investment grade bonds.

So while our investment bond portfolio continues to provide principal protection and predictable investment income, our alternatives have added to income and total return, while providing more diversity in our invested assets. While the investment in insurance markets may continue to be a challenge, we will benefit from our financial strength and the unique ability of our staff to seek out creative opportunities.

I mentioned on the last call that we had made some organizational changes, and the benefits are already being felt in the number and type of opportunities we see. Our security and experience has never been more highly valued. The combined ratio of 87.2% for the quarter is just one of those positive signs.

Thank you. And I will now turn it over to Craig.

Craig William Howie
Executive VP, Treasurer & CFO

Thank you, Dom, and good morning, everyone. We're pleased to report that Everest had another very strong quarter with after-tax operating income of $210.6 million, or $4.05 per diluted common share. I won't be comparing these results to last year, given the record catastrophes experienced in 2011.

Net income for the third quarter was $250.9 million or $4.82 per diluted share. Net income includes realized capital gains. On a year-to-date basis, operating income was $673.5 million or $12.78 per share. This represents an annualized operating return on equity of 15.3%.

Net income year-to-date was $770.2 million or $14.61 per share. These year-to-date results reflect a continued improvement in the overall current year attritional combined ratio, which has declined from 86.3% to 86.0%. This measure excludes the impact of catastrophes reinstatement premiums and prior period loss development.

The total reinsurance attritional combined ratio was 81.8% compared to 82.2% in the prior year. The insurance segment attritional combined ratio was 102.8% compared to 101.8% in the prior year. However, eliminating the effects of the primary crop book, this ratio would have been 99.2% compared to 101.3% in the prior year.

These improvements, both on the reinsurance book and the insurance book, should continue as rate increases earn in over time. Also providing better margins is the shift in our reinsurance portfolio from quota share to excess of loss.

Gross written premiums of $1.20 billion for the quarter were up 7% compared to third quarter of 2011. This increase was primarily due to the acquisition of Heartland. More on the crop business in a moment.

On a year-to-date business, gross written premiums were $3.16 billion. This represents an increase of 2% after adjusting for reinstatement premiums and the effects of foreign currency movements.

Earned premiums of $1.01 billion for the quarter did not change significantly compared to the same quarter last year, after adjusting for reinstatement premiums and foreign exchange.

Although we've achieved strong rate increases on portions of our book, especially on catastrophe exposed risks. Year-to-date earned premiums of $3.05 billion also have not changed significantly year-over-year.

However, the shift in capacity, away from proportional risks does mask this effect, as excess of loss business carries lower premium. These increases have provided significant margin improvement on a comparative premium base.

The reinsurance segments reported a year-to-date earned premiums of $2.4 billion, down less than 1% from 2011. The insurance segment reported $219 million of earned premiums for the quarter, which was up 1% over third quarter of 2011.

On a year-to-date basis, insurance earned premiums are $611 million or down 5% year-over-year. This is primarily due to the runoff of certain program business and lower crop earned premium in the current year.

Last year, the crop premium was earned evenly throughout the year as reinsurance premium. The insurance segment reflects $45 million of seasonal earned premiums from crop business in the third quarter, with $84 million now earned year-to-date. We expect full calendar year net premium from this book to total about $150 million.

We booked the primary crop business at 145% combined ratio for the quarter and 120% on a year-to-date basis. This represented a $20 million pretax underwriting loss for the quarter but there is still some uncertainty as crop yields and commodity prices are not yet finalized for the year.

However, the company does purchase stop-loss reinsurance coverage for its primary crop portfolio. The MPCI coverage attaches at a 110% loss ratio. Currently, the book loss ratio remains below 100% on a year-to-date basis.

We would need to see additional pretax losses of more than $16 million for the 2012 crop year before we would attach this cover. The insurance segment reported a $28.2 million underwriting loss for the quarter and a $22.8 million loss year-to-date. This reflects the crop loss I just discussed.

All reinsurance segments reported underwriting gains for both the quarter and on a year-to-date basis. Total reinsurance reported an underwriting gain of $157.1 million for the quarter and $375.8 million year-to-date.

The overall underwriting gain for the Group was $129 million for the quarter and $352.9 million for the year so far. Our reported combined ratio was 87.2% for the quarter and 88.4% year-to-date.

The commission ratio for the year is up 1.1 points compared to the prior year. This increase relates to a number of one-time adjustments and settlements and the change in accounting for deferred acquisition costs.

The 21.9% commission ratio for the quarter is within our normal range. The expense ratio for the year is up 0.5 points compared to last year. This increase primarily relates to the increased accrual for personnel costs and incentive compensation.

For the quarter, we reported $25 million of current year catastrophe losses. These losses are primarily related to hurricane Isaac in the U.S. this quarter. This brings our year-to-date gross cat losses to $85 million for 2012 or 2.8% of earned premiums.

Regarding 2011 catastrophe losses we allocated another $15 million of the $50 million cap IBNR established at the end of last year to cover higher estimates on several 2011 events. We still have $15 million of this catastrophe IBNR remaining.

On reserves, our overall quarterly internal reserving metrics continue to be favorable. We are in the process of completing our annual loss reserve studies. The outcome related to these studies, if any, will be booked in the fourth quarter.

For investments, pre-tax investment income was $152 million for the quarter and $453.8 million year-to-date on our $16.5 billion investment portfolio. Year-to-date investment income declined $40 million from one year ago. This decrease was primarily driven by lower limited partnership income, which was down $19 million this year and by declining reinvestment rates.

Despite the declining rates, our investment portfolio continues to perform well. It is a conservative, well diversified portfolio with high average credit quality. The quarter reflected $62.7 million of pre-tax realized capital gains and $40.4 million of gains after tax. On a year-to-date basis, we had $144.9 million of pre-tax realized capital gains and $96.7 million of gains after tax. These gains are mainly attributable to fair value adjustments.

On income taxes, the 17.9% effective tax rate on operating income for the quarter reflects higher than expected income. And the impact of the realized capital gains this quarter on the annualized effective tax rate calculation. The 11.0% year-to-date effective tax rate on operating income is within our revised expected range for the year.

Turning to other miscellaneous items, the $703,000 derivative gain for the quarter relates to the rise in the equity markets offset by the change in interest rates during the quarter. On a year-to-date basis, we reported a derivative loss of $9.4 million compared to a loss of $19.3 million in the prior year.

Other income largely reflects foreign exchange losses for both this quarter and the quarter one year ago. On a year-to-date basis, we reported foreign exchange gains compared to foreign exchange losses a year ago.

Operating cash flows were $175 million for the quarter, compared to $208 million in the third quarter of 2011. Higher underwriting cash flows were offset by lower investment income receipts and higher tax payments in the current quarter.

We earned $407 million of comprehensive income this quarter. This primarily reflects $251 million of net income for the quarter, plus unrealized appreciation on securities of $118 million and foreign currency translation adjustments of $36 million. We now have $997 million of comprehensive income year-to-date.

Turning now to capital management, in addition to dividend payments to shareholders of $25 million, we repurchased 229,000 shares this quarter during wind season, at a total cost of $25 million.

For the year, we've repurchased 2.6 million shares at a total cost of $250 million. The company has 4.7 million shares remaining under our share repurchase authorization from the Board of Directors.

Shareholders' equity increased to $6.8 billion this quarter, up 12% from $6.1 billion at year end 2011. This is after taking into account, the $259 million of stock repurchases and the $76 million of dividends paid so far this year.

Book value per share increased 16% to $131.22 from $112.99 at year-end 2011. Our strong capital position leaves us with the capacity to maximize our business opportunities as well as continue share repurchases.

Thank you. And now I'll turn it back to Beth for Q&A.

Elizabeth B. Farrell
Vice President, Investor Relations
Catherine, we are now open for questions.

Question and Answer

Operator

[Operator Instructions] And we'll hear first from Gregory Locraft with Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

Wanted to just pursue the capital deployment side of things, can you comment on buybacks in the fourth quarter to date or have you been blacked out so far?

Joseph Victor Taranto
Chairman of the Board

No, we haven't bought anything so far in the fourth quarter, Greg.

Gregory Locraft
Morgan Stanley, Research Division

Okay. And what is your -- I guess you've said you're interested in doing it. It looks to me like between dividends and the repurchases to date, that's about $325 million or so. Yet, your after-tax op income for the year could approach $800 million if you do sort of consensus numbers in the fourth quarter. So that's even just not building a lot of excess, you need to do an awful lot of buyback this quarter. How do you think about sort of your appetite to buyback, and how should we be modeling that in this quarter?

Joseph Victor Taranto
Chairman of the Board

Well, your numbers are correct, Greg. And likewise, we see this as a very good year so far and with a good fourth quarter and it will be an excellent year. And you're right, that will give us great capacity to buyback more in the future and certainly in the fourth quarter. Third quarter is basically hurricane season that should be over in a couple of weeks. And I guess, I'm just going to the same place that I believe you're going that there should be ample available earnings and surplus that frankly we can buyback a fair amount in the fourth quarter and beyond.

Gregory Locraft
Morgan Stanley, Research Division

Okay. I guess it's just, it keeps building up. Is there any other way to deploy it organically and maybe perhaps, the question would be around the January 1 renewals, what are seeing? What do you anticipate on the underwriting side in terms of organic growth going forward?

Joseph Victor Taranto
Chairman of the Board

Well, let me first say the fact that it keeps building up in a big way is a good thing. That means that we are having very good earnings and our capital is increasing and we're very, very happy about that.

Gregory Locraft
Morgan Stanley, Research Division

Absolutely.

Joseph Victor Taranto
Chairman of the Board

And that's the main thing. And of course, that does mean that we have more available to buyback. As far as the future and January 1, we're not looking at it as if the market is going to change all that much from where it is now. It will continue to be ample opportunity on the property side and the cash side. We certainly are looking into some other areas.

Our management team, as we noted is very energized and we do expect to find some opportunities beyond the cat side. Casualty, Dom talked a bit about that where we're still in more of a wait and see approach than putting a lot more capacity into growing that end of the book. But many others are getting much more optimistic about it. We hope they're right. We hope rates continue to go up and frankly that we ultimately will be able to grow our casualty business in a very, very meaningful way. So, I look at 2013 as if it will be a good year. There'll be a chance for us to deploy, certainly the capital that we have, maybe some additional opportunities. But I don't look at as if the world is going to change so much that we won't, especially in today's prices continue to be very keen on buying back the stock as well.

Dominic James Addesso
President, CEO & Non-Independent Director

And I think that's, it’s about balance. And we look at our capital management as a long-term issue. We certainly will be looking at the opportunities in the fourth quarter. But also as you point out, Greg, we'll soon be approaching 1/1 and actually some of our underwriters are already into that. So we'll begin to access what 1/1 opportunities will be like in the next several weeks. And we do think there are opportunities to expand our presence, whether it would be in the U.S. or I mentioned some changes we've made in our management that will allow us to do some new and different things in Asia and Europe. And so there are some unique opportunities that we can pursue, but it will be a little bit of both.

Operator

[Operator Instructions] We’ll go to Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I want to ask some questions about the investment side of the story. There's been some movements as you mentioned that you don't think you're taking more basis risk. But it does suggest that from a rating agencies standpoint, there's a little bit more credit risk going on. And in terms of the balance of taking money out of equities, what is your market view for investment over the next 12 months, interest rates wise, marketwise what not?

Joseph Victor Taranto
Chairman of the Board

No. I don't know that we're all about trying to predict investment rates. We tried, as they try to portray and/or mentioned in my comments, we want to maintain some balance. We think what we've achieved in our portfolio to-date with an average credit quality of AA, represents a good credit quality. Even in the spaces in the alternative fixed income space, our average credit quality there is just one notch below investment grade. So it's overall still a high quality portfolio from a credit perspective. And as I've mentioned in previous calls, I tend to believe that corporate credits just as an overall market condition are generally underrated if you will. Corporates are well positioned with cash and in fact, one might postulate that they might even be better credits than some of the sovereign exposures. So it's not a risky bet. We're generally -- right now we are, as I said earlier, we've got investment and 75% of our portfolio is investment grade. We've got 13% of our portfolio in equities, including our limited partnerships. That's certainly within reason in terms of how the industry has invested over the long-term.

And our alternative fixed income portfolio is just slightly in excess of $2 billion, comprised of a mix of high yield, bank loans and emerging market debt. So it will maintain that relative position or at least our current thinking is that that's a reasonable allocation and how to think about our position going forward. That doesn't mean that next quarter, we won't modify that slightly. But I'm not anticipating any major shifts at this point. And from a rating agency perspective and that also gets into the capital management discussion. We maintain a sufficient level of capital to carry this kind of an asset allocation. So it is all part of the entire balance sheet management.

Joshua David Shanker
Deutsche Bank AG, Research Division

So, Dom, I'm not really trying to uncover. I was trying to understand, if we went back in time 3 months ago, you might have said the same thing about corporates versus sovereign. Is there anything different that happened in the past quarter, or merely you just had more cash deployed that cause the weight to move?

Dominic James Addesso
President, CEO & Non-Independent Director

The weight actually hasn't moved all that much, Josh. It really hasn't. The only thing that we've seen is obviously, the movement in interest rates. Obviously adjusted the back of market value of those securities, so that may be what you're referencing, I'm not sure. But that's really the only market movement that I can comment on. We actually have seen obviously a high yield, for example, certainly a compression in rates there. And we actually think that any additional allocation in the high yield space is less likely than not just given the fact that where rates have come in the high yield sector.

Joseph Victor Taranto
Chairman of the Board

The acquisition is something that's evolved over the last two or three years, no sudden changes in the last quarter.

Joshua David Shanker
Deutsche Bank AG, Research Division

All right. And then on the derivative mark, on the equities, I'm surprised it was marked down this quarter. It's obvious because of very difficult calculations. Can you walk us through it a little bit, this is a good quarter for equities, when did the market gone up or the interest rates overrode that, what exactly happened there?

Dominic James Addesso
President, CEO & Non-Independent Director

It is a complicated formula that we have to follow to come up with the result. And yes, you saw the stock market rise this quarter. So that you would suggest that it would have increased more than it did. But a big part of the calculation is interest rates which went down a bit. Now, interest rates in terms of settlements of these instruments ultimately don't come into play whatsoever. So as far as we're concerned, the stock market going up is far more important. But nonetheless, there is a set formula that we've been following for years, continue to follow and that's why you saw little change even though the stock market went up, because one offset the other.

Operator

And we'll continue on to Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just one question I guess. There was some movement. Second quarter looks like U.S. Reinsurance grew this quarter, but shrunk last quarter on a year-over-year basis, International, Reinsurance was down last quarter -- down this quarter, but grew last quarter.

Just trying to understand kind of, is there some strategy involved or some tactical reason for that, or does it just have to do with renewals and just kind of the movement of your book and then just one follow-up. Thanks

Dominic James Addesso
President, CEO & Non-Independent Director

Yes, Michael, this is Dom. There is a mixture of things going on. Let’s take the International, which is comprised of Middle East, South Africa, Latin America and our Asian portfolio. Most of what we’ve seen going on there is the shift from pro-rata to excess of loss. So that's what driving the results there. And in the U.S. we see -- we have some adjustments in our subject premium base on certain clients, which give rise to increased estimates as well as some increased shares on certain clients. For the quarter, it's a little bit of an anomaly and that should smooth out into the fourth quarter. And then in Bermuda, it's a reflection of some weakening and some casualty opportunities and so lessening of our cash portfolio in that space.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. Okay. Thanks. And then -- so I guess, I mean and maybe building on Greg's question a little bit from before. So you’ve got little bit -- it sounds like a little bit more cat exposure this year than last, more excess of loss, a bit of a move in the investment portfolio. Just trying to understand, what is the capital intensiveness of your book today versus a year ago? Is that -- have the changes subtle and maybe not and maybe less subtle? Have they had an impact on the capital that you need to hold in the business that maybe, we just can't see so well from our perspective?

Joseph Victor Taranto
Chairman of the Board

The answer is no. You mentioned our cat book. Really in terms of the peak zones, it really has been no meaningful increases. We may have expanded in some of the non-peak zones. But when you get back to the capital that we need, especially since we’re looking at a lower rate and tighter terms, I wouldn't tell you that we need any more today than we needed a year or 2 ago, which kind of gets you back to the fact that especially with surplus building quite nicely, we have a substantial amount of excess capital. Now, whether we can deploy that going forward into other opportunities, well we'll see what 1/1 brings. We do have some ideas for 2013 and beyond. Right now, I would probably say that those ideas don't take up all the extra that we have and that's why it gets back to stock buyback, particularly at today's prices as a very, very attractive alternative. So we'll do both. But it's not what that we need a great deal of extra capital today. I would say virtually none relative to a year or 2 ago. The investment side, yeah, there are some things that we've done there that we think will produce and have produced better returned. But frankly, I look at it, at least from a company management point of view is that, not putting all your eggs into -- in corporate bonds and taking 20%, and putting it into other items is frankly making it less risky as you diversify your portfolio. Could be some additional charges in the rating agency models, but nothing significant and again, we get back to the fact that we have plenty of extra surplus at this point.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. And I guess building on that, I mean, with yields where they are I mean another option certainly is to take advantage of that on the debt side, your leverage is lower. Is that a lever that at some point if your capital builds this way, or even if not, is that a lever that you're interested in pulling or is there a reason why you want to maintain just a bit lower financial leverage?

Joseph Victor Taranto
Chairman of the Board

I'll take that one and as it was mentioned in the past relative to that question, it’s -- we view this as really an arbitrage issue and it's a negative arbitrage. If we’ve raise additional debt, where would we invest it. It would be dilutive to earnings. We're already dealing with an excess capital position, so adding debt doesn't help that. It doesn't mean that we like having that we wouldn't in the future and that's always for discussion. But we like the flexibility of where we're at. And we don't have any immediate plans on that front.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. And then just last one quick one. I didn't understand Heartland the acquisition was accomplished, completed a while ago. The lift in gross premiums this quarter, I was just trying to understand just kind of the reason for that, did it have something to do with reinsurance or some other legacy relationship associated with that acquisition? And thank you for all your answers.

Craig William Howie
Executive VP, Treasurer & CFO

Mike, this is Craig. Basically what happened with the Heartland premium was you may recall in 2011 that premium was treated as reinsurance premium and that was earned unevenly throughout the year. So, in 2012, when it moved over to the insurance segment, it's now the gross written premium, is now premium before cessions to the government or third party reinsurers and now that premiums earned in on a seasonal basis. So, that's really the difference in the gross premium. If you look at the net premium for that business, it's relatively flat year-over-year.

Operator

We'll take our next question from Vinay Misquith with Evercore Partners.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

The first question is on the margins this quarter, they were very strong. The accident year loss ratio ex-cats was about 54.1 if you exclude the crop. Did this quarter benefit from abnormally low sort of non-cat weather?

Joseph Victor Taranto
Chairman of the Board

Absolutely, Vinay. I mean it's and the shift again from a movement from pro rata to excess of loss contracts is what's driving that.

Dominic James Addesso
President, CEO & Non-Independent Director

Vinay, I take your question to be if you take catastrophes out, whether everything was so good beyond that, that there was just a benefit to property beyond losses…

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Yes. Yes.

Dominic James Addesso
President, CEO & Non-Independent Director

The small losses were unusual. I don't think that's the case, no.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Okay. So, these quarters, I mean a true pro forma number that you had for the quarter.

Joseph Victor Taranto
Chairman of the Board

Yes. That's the way we look at it, yes.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Okay. That's interesting. And in terms of cats, what sort of cat loads should we be looking at normally for this business?

Joseph Victor Taranto
Chairman of the Board

We generally have given guidance that our cat losses at least for this -- for the past year or 2 have been around 9 points.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Right. Great. And do you think that to move the excess of loss would mean that it should be slightly higher now than the past?

Joseph Victor Taranto
Chairman of the Board

Not, not. No. Not that in and of itself would not drive that number.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Okay. All right. And the last question is on margins actually for next year. You had rate increases for workers compensation come through, the transition to excess of loss, which has helped to your margins. So, as you go into next year and there'll probably be some pricing pressure on prop cat excess of loss. How do you see margins next year versus this year?

Joseph Victor Taranto
Chairman of the Board

I'll start. I mean on the cat side, I kind of said, I -- there is some leveling that's taking place and I do think you'll see that into 2013. I don't know if there is so much pressure that you will see rates come down in any sort of meaningful way. I am not anticipating that. Again, I think when you get back to our position with A plus paper and the security and the clients that we have around the world, I kind to look at our portfolio at least in terms of rate quality on the cat side it will be about the same as it has today. We are hoping on the casualty side and for other pockets that there is continued improvement. You mentioned California comp, where we continue to get rate increases. But our GL business we continue to get rate increases. Some pockets of the casualty we're still not getting as much as we would like. But we are hopeful that again some pockets of the casualty continue to do well into 2013. So again, just forecasting a year out, I'm not thinking that margins will be a whole lot different than they are today when you put it all together.

Operator

And we’ll take our next question from Jay Gelb with Barclays.

Jay H. Gelb
Barclays Bank PLC, Research Division

Thank you. I wanted to touch base on prior year reserve development. It's been notably absent for the past 3 years and I'd like to better understand, how your reserving process is somewhat different from what we’re seeing from other companies in the rest of the industry that have been releasing a lot of reserves?

Dominic James Addesso
President, CEO & Non-Independent Director

Jay, its Dom. I really can't speak to how other companies reserve. But obviously, the mission and the objective is to have an adequate reserve position, not to be deficient or redundant. Of course, the reserve estimation process is difficult as you know. And I do think we've done a great job historically. I mean the reserve charges that Everest has had prior to 3 years ago were really one-time unusual events and I think it points to the fact that our core reserves development has been frankly, favorable over time. And so I don't know if it's much different than many other folks. We attempt to reserve conservatively and what goes into that is an attempt to pick the current year accident your year of loss pick is so very important to that. As I've described many times on calls, we have a multi-pronged process for going through that, which involves the prior year loss reserve review and baking on top of that loss trend and as well as taking note of any rate increases or decreases that are going on in the marketplace. And we think that has given us the opportunity to have an appropriate and adequate loss reserve position. And I think that's demonstrated itself as you point out over the last couple of years and frankly even prior to that, but certainly for sure over the last 3 years.

Jay H. Gelb
Barclays Bank PLC, Research Division

And then on a separate topic, the U.S. insurance underlying combined ratio excluding cats and prior development ticked up again in 3Q now running in about 101 and that excludes the impact of crop as well. What would it take to get that back well into profitable underwriting territory?

Dominic James Addesso
President, CEO & Non-Independent Director

Well, as I pointed out it was running at a 99.2 for the quarter ex those items. And so it's trending in that direction. And so as I pointed out in my comments earlier increased growth in our NH portfolio, continued double-digit increases in work comp, you are seeing rate increases on casualty and continued deployment of our professional lines which is also tracking nicely. So, all of our core portfolios are moving in the right direction and that so it is trending towards that currently.

Joseph Victor Taranto
Chairman of the Board

And of course crop has become a big part of that book. So clearly, we're hopeful for a very good year in 2013 as opposed to what we've had this year.

Jay H. Gelb
Barclays Bank PLC, Research Division

Right. And on a normalized basis, the net to gross premium percentage in U.S. insurance, it looks like it was mainly influenced by the crop result in 3Q. What's the normalized result going forward since it's been kind in that 80 to 85 range in the first half?

Craig William Howie
Executive VP, Treasurer & CFO

That's about right. But you'd have to realize that historically that number has moved around a bit in the insurance operation, because of some of our program business that was a much bigger influence in the portfolio a couple years ago. So, if you're looking at it historically, you've to recognize some of those differences in the portfolio.

Jay H. Gelb
Barclays Bank PLC, Research Division

Right. Fourth quarter a year ago, net to gross of 77%, is that a seasonal issue or is that should we expect it to be more in the 80s going forward?

Craig William Howie
Executive VP, Treasurer & CFO

I don't know that I can answer that precisely for you right now, Jay. It’s, call it 80.

Operator

We'll take our next question from Matt Heimermann with J.P. Morgan.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

The first question I have is just with the remixing of the portfolio from [indiscernible] to excess of loss. Can you give us a sense of where you think we are in that process both with respect to the U.S. and international?

Joseph Victor Taranto
Chairman of the Board

Well, I'll put it in terms of cat premium, okay. We've -- as I mentioned again in my comments. We had $1 billion of cat premium through the 9 months and 75% of that was XOL. And that's I would think we're probably about where we're going to be in that regard into next year.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Okay. So, no further shifts 1/1 even on the international side then?

Joseph Victor Taranto
Chairman of the Board

No. And that could change modestly from year-to-year or quarter-to-quarter depending on what opportunities we see. I mean don't get me wrong, we're not necessarily opposed to a pro rata business, but it has to be at the right terms and conditions.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

And then how about like just qualitatively on some of the other property exposed lines, things like marine or energy or aviation. Has that bias kind of spilled over into those lines too or that’s you're not seeing any noticeable trends one way or another.

Joseph Victor Taranto
Chairman of the Board

We're not a huge market participant in those lines of business. Yes, we do have marine and aviation business. But we've been relatively conservative given rates and experience frankly in the marine and energy space.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Okay. And then just with respect to I guess Joe or Dom when you think about I guess how would you -- if casualty does get better how would you think about how the demand for-- might kind of play out from the ceiling perspective. There's obviously quota share that you do on companies XOL portfolios for them to manage, they are not which I would assume would pass through. But more from kind of historical surplus relief just capacity to expand, do you foresee a lot of that? I just ask because it doesn't -- from a balance sheet perspective the industry nobody seems to be starving for capital at least as a generalization.

Joseph Victor Taranto
Chairman of the Board

I think that's a good point. And I will agree with that and as casualty improved dramatically to the point where most of the world thought it was doing quite well. I would imagine at least some of the bigger companies might not be looking for more quota share reinsurance, maybe some more XOL. Some of the smaller companies might be looking for reinsurance as their capital might get tested. So we might see some more opportunities that way. But I think a lot of the opportunities might be on the insurance side. We've been talking about things like California comp where there was a time a few years back when we wrote 4 times what we're writing today. And we'd love to have the opportunity to do that again. But we don't think the market is positioned for that right now. But, so I think a lot of the areas on the casualty side if they improved dramatically where we could do more. I think it would be as important for our insurance operation as it would be for our reinsurance operation.

Dominic James Addesso
President, CEO & Non-Independent Director

Well, also Matt, we're not totally dependent upon a market expansion, if you will, for us to expand our casualty writings. In the U.S. for example, it certainly leverage our property opportunities and where we write a meaningful portion of property business for students into a casualty opportunity. Especially, if they want to improve the credit quality of their panel of reinsurers, so those are where the opportunities might lie. Europe, might be some opportunities portion side, casualty, as companies are having difficulty with their capital positions. But it doesn't necessarily require terrific expansion of demand, if you will, from a market perspective for us to increase our casualty.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

That sounds a little bit more like -- I mean that seems very company specific though in terms of kind of -- I will put it another way. It sounds like your outlook for your own prospects is probably a different answer than you might gave for the industry overall, when demand and opportunities for say.

Operator

We'll take our next question from Amit Kumar with Macquarie Capital.

Amit Kumar
Macquarie Research

I guess just 2 quick follow-up questions to the prior questions. First of all just under discussion on capital management. I'm somewhat curious what is your view on possible special dividend, since you're approaching the fiscal cliff?

Joseph Victor Taranto
Chairman of the Board

Well, up until now we certainly have preferred stock buyback over increasing the dividend or special dividend. Now, we're focused on what's going on. And if indeed we start to believe that the taxes on tax treatment of dividends will change dramatically then clearly I think we'd have more conversations amongst ourselves with our Board as to whether or not special dividend might make more sense as a way to give back to shareholders. So, our eye's on what's going on and again if we see that as be in the case then we'll talk quite a bit about it.

Amit Kumar
Macquarie Research

The only other question I had is I think in the opening remarks you mentioned about an impending reserve study. And I was curious, does that -- I'm sure you look at the best of reserves to in other areas. Do you have sort of an early view on that or is it I guess too early?

Joseph Victor Taranto
Chairman of the Board

Well, in terms of the study, this is the study that we do every year-end. And we do a study every quarter but most companies like ours tend to do a more comprehensive study if you will at the end of the year. No, I wouldn't say that we have anything to report to you unusual at this stage, but really those studies will be taking place between now and the close of the year.

Dominic James Addesso
President, CEO & Non-Independent Director

And we have other metrics that we follow during the year, before we actually have reserve studies on some of our major lines. And we do reserve studies on the smaller lines throughout the year and they have all been favorable. But we also have other metrics we look at and those again are all pointing to no surprises.

Amit Kumar
Macquarie Research

No surprises. Okay. That's what I was looking for.

Operator

Thank you. And ladies and gentlemen, that's all the time we have for questions today. I'll turn things back to our speakers for any additional or closing remarks.

Elizabeth B. Farrell
Vice President, Investor Relations

I'd like to thank everybody for participating on the call. And if you have any questions, please feel free to call. Thank you.

Operator
Thank you. And ladies and gentlemen, that does conclude today's conference. Thank you all for your participation.