# The Hanover Insurance Group, Inc.
# NYSE:THG
# FQ1 2013 Earnings Call Transcripts

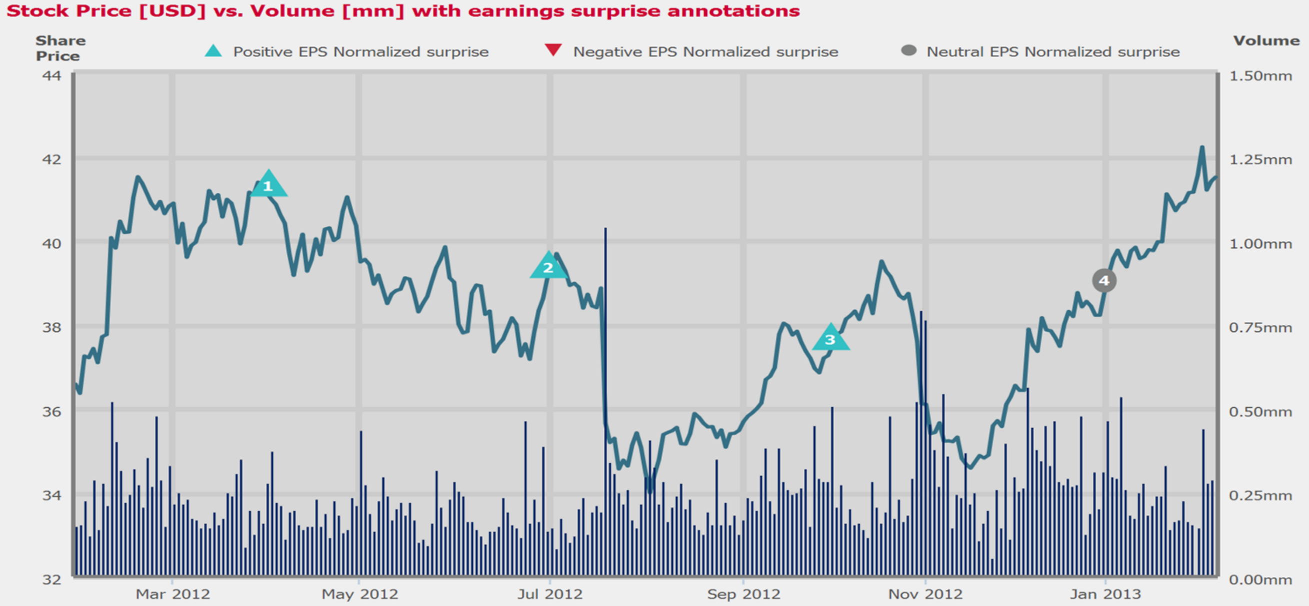
## Tuesday, April 30, 2013 2:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ1 2013- | | | -FQ2 2013- | -FY 2013- | -FY 2014- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 1.05 | 1.32 | ▲25.71 | 0.82 | 3.94 | 4.36 |
| **Revenue (mm)** | 1099.33 | 1076.70 | ▲(2.06 %) | 1238.43 | 4689.28 | 4811.18 |

Currency: USD
Consensus as of Apr-30-2013 2:23 PM GMT

**Stock Price [USD] vs. Volume [mm] with earnings surprise annotations**




| - EPS NORMALIZED - | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ1 2012** | 0.95 | 1.01 | ▲6.32 % |
| **FQ2 2012** | 0.19 | 0.22 | ▲15.79 % |
| **FQ3 2012** | 0.68 | 0.72 | ▲5.88 % |
| **FQ4 2012** | (1.80) | (1.65) | NM |

# Table of Contents

# Call Participants

## EXECUTIVES

**Andrew Scott Robinson**
*Executive VP, Corporate Development & President, Surety*

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

**Frederick Henry Eppinger**
*Former President & CEO*

**Mark R. Desrochers**
*Former Senior Vice President and President of Personal Lines*

**Oksana Lukasheva**
*Vice President, Investor Relations*

**Robert Arthur Stuchbery**
*Former Chief Executive Officer and Executive Director*

## ANALYSTS

**Daniel D. Farrell**
*Sterne Agee & Leach Inc., Research Division*

**Lawrence David Greenberg**
*Langen McAlenney*

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

**Raymond Iardella**
*Macquarie Research*

**Sarah Elizabeth DeWitt**
*Barclays Bank PLC, Research Division*

**Vincent M. DeAugustino**
*Keefe, Bruyette, & Woods, Inc., Research Division*

# Presentation

**Operator**

Good day, ladies and gentlemen, and welcome to First Quarter 2013 The Hanover Insurance Group, Incorporated Earnings Conference Call. My name is Gwen and I will be your operator for today. [Operator Instructions] As a reminder, this call is being recorded for replay purposes.

I would now like to turn the call over to your host for today, Ms. Oksana Lukasheva. Please proceed.

**Oksana Lukasheva**
*Vice President, Investor Relations*

Thank you, Gwen. Good morning and thank you for joining us for our first quarter conference call. We will begin today's call with prepared remarks from Fred Eppinger, our President and Chief Executive Officer and David Greenfield, our Executive Vice President and CFO. Available to answer your questions after our prepared remarks are Andrew Robinson, President of Specialty Lines and Bob Stuchbery, President of International Operations and Chief Executive Officer of Chaucer. Also participating on today's call and available for questions are Mark Desrochers, President of Personal Lines and Jack Roche, President of Business Insurance.

Before I turn the call over to Fred, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors Section of our website at www.hanover.com. After the presentation, we will answer questions in the Q&A session.

Our prepared remarks and responses to your questions today other than statements of historical fact include forward-looking statements. There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and in this respect refer you to the Forward-Looking Statement section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as operating income, operating income per share, operating results excluding the impact of catastrophes and development, ex-cat loss and combined ratios among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release or the financial supplements which are posted on our website, as I mentioned earlier.

With those comments, I will turn the call over to Fred.

**Frederick Henry Eppinger**
*Former President & CEO*

Good morning, everyone, and thank you for joining our first quarter earnings call. Our results this quarter were strong and largely in line with our expectations, putting aside the incremental benefit of lower than expected cat loss. We delivered operating earnings of $1.32 per share which translates to an annualized operating ROE of 10% representing a solid improvement. Our book value increased by 2% to $59.58 during the quarter.

Most importantly, I am extremely pleased with our execution this quarter. The strength of our results and trends we are seeing support the confidence we have in our ability to further expand our underwriting margins and firmly positions us for strong performance in 2014 and beyond.

Over the last few years, we have completely changed our business portfolio and competitive position. Entering 2013, our leadership team created a clear set of priorities focused on leveraging this portfolio and improving our underwriting margins, creating a plan that drives us to our top quartile performance. I am pleased to see that our results this quarter track to our expectations and we continue to make progress on our strategic initiatives.

I will outline those views shortly, but first I would like David to review our financial results.

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Thank you, Fred and good morning everyone. I am very pleased with the results we achieved this quarter that reflected diversified and growing earnings power of our company.

Net income for the quarter was $66.2 million or $1.46 per diluted share compared to $49.7 million or $1.09 per diluted share in the prior year quarter. Our operating income this quarter was $59.9 million or $1.32 per diluted share compared to $46 million or $1.01 per diluted share in the first quarter of last year. This represents our best quarterly performance since 2007 and while lower catastrophe losses is a major factor in the earnings improvement, as Fred mentioned, we're also making important progress in our strategic priorities and have seen good results in the underlying trends.

Our combined ratio this quarter was 96.1% compared to 98.1% in the prior year quarter. Lower catastrophe losses was the primary driver of the improvement in both our domestic and international operations. Chaucer also had a lower incidence of large losses, while ex-cat results in our domestic businesses were fundamentally in line with our expectations.

Catastrophe losses contributed 2 points to our first quarter combined ratio compared to nearly 4 points in the same period last year; virtually all reported catastrophes this quarter originated in domestic businesses and relate to a handful of weather events including Winter Storm Nemo, the 3 day mid-February blizzard that affected the Northeast. The benefit of lower than expected catastrophe losses this quarter was partially offset by higher non-catastrophe losses from winter weather events in the U.S.

We usually anticipate a higher frequency in severity of weather in the first quarter given our geographic mix and this year was no exception. However, during the comparable period last year, the winter weather was unusually mild, which makes the quarter to prior quarter comparisons more challenging.

Overall, prior year reserve development for the quarter was favorable at $7 million or 0.6 points of the combined ratio. Chaucer generated favorable reserve development of $13 million which came mostly from property line in the 2012 accident year. It's worth noting that Chaucer's overall favorable development was somewhat reduced by the impact of foreign exchange movements this quarter.

In our domestic reserves, we experienced some continuing although abating development and bodily injury in personal and commercial auto lines. We also noted some physical damage and specific property losses from December that carried over into the first quarter. Our loss experience in workers' compensation continues to be favorable. Overall, the trends we observed are largely as expected and we continue to be comfortable with the overall strength of our loss reserve position.

Moving on to a discussion of accident year results, excluding catastrophe losses. As we consider the quarter-over-quarter analysis in the domestic ratios, the comparisons are impacted by 2 factors. First, as I mentioned earlier, non-cat weather returned to a more normal level this year compared to the unusually mild winter last year. This most directly impacted our loss ratio in homeowners, C&P and also auto, due to physical damage and comprehensive coverage loss experience.

Second, as you may recall, last year's first quarter accident year loss picks were subsequently re-estimated in certain lines, including personal and commercial auto, to reflect higher loss trends we observed during the balance of the year. We believe this makes the full year 2012 loss ratios much more relevant for analysis.

Keeping this in mind, the commercial lines' current quarter accident year combined ratio was 98.9% compared to 97.6% in the first quarter of 2012, but is 1 point better than the 99.9% we experienced for the full year in 2012.

In commercial auto, the current quarter accident year loss ratio was slightly higher than the full year 2012 result driven by an increase in frequency primarily in property coverages partly attributable to weather, while BI trends were largely as expected. The accident year loss ratio in other commercial lines has improved from year-end and is in line with expectations reflecting the effectiveness of our underwriting actions and our pricing strategy.

Our C&P loss experience was largely as expected as well with some impact from non-catastrophe weather and slightly higher frequency of large losses, which can be lumpy from quarter-to-quarter. We continue to generate a healthy margin in workers' compensation, which is benefiting from both rate increases and our focus on smaller accounts and lower risk classes. The commercial lines underwriting result also benefited from an improvement in the expense ratio, primarily due to earned premium growth and continued improvement in our operating efficiencies. We achieved an overall growth of 3% in commercial lines this quarter, driven by small commercial, as we continue to execute on our mixed management and pricing strategies. Adjusting for renewal rights transaction we executed in Florida, the commercial lines growth would have been 5%. As importantly better pricing trends and a continued shift to a more profitable mix provide us confidence in continued margin expansion in the long term. Our growth expectation for the year remains at mid-single digits for this segment.

Overall, although there's clearly more work to do in commercial lines, we are satisfied with the trends and the progress we've made. In personal lines, our accident year combined ratio excluding catastrophes was 91.8% in the current quarter, compared to 90.7% in the first quarter of 2012 and 92.8% for the year. In auto we're seeing improvement in accident year loss ratios attributable to the rate and other actions we have taken. Our loss ratio in the home owners line has improved over last year as well, reflecting the rate and non-rate actions we took, although the effect was somewhat masked by a higher level of non-catastrophe winter weather in this year's quarter, compared to the unusually mild winter last year.

We continue to execute on our exposure management strategies in the current quarter, which resulted in lower PIF and net written premiums for the quarter. We expect to see some fluctuations in the growth results quarter-to-quarter due to the timing of our actions, both this year and last. But we still expect overall personal lines growth for the year to be roughly flat to a slight decline. At the same time, we've noted improved rate activity and stable retention in personal lines which we expect will contribute to growth in our earnings power going forward. Chaucer once again produced a strong contribution generating $41 million of operating income before tax this quarter. The combined ratio of 86.7% included $2.6 million or 1 point related to catastrophe losses, which is much lower than our expected normal run rate. The ex-cat accident year loss ratio improved by almost 8 points compared to prior year quarter, and compared to full year 2012 the ratio improved by 2 points as we had fewer large losses.

Chaucer's expense ratio of 34.7% picked up a sizeable benefit from the weakening pound sterling against other currencies this quarter. Our expected long term expense ratio run rate for this business remains in the range of 37% to 38%. However you probably already noted the ratio can fluctuate from 1 quarter to the next. Chaucer's net written premiums were $252 million compared to $200 million in the prior year quarter, representing 26% growth which is mostly attributed to higher retained business at Syndicate 1084, as we did not renew certain quota share arrangements effective January 1. The increase in Syndicate participation will continue to drive growth of net written premiums through the rest of the year, however the earnings impact this year is expected to be marginal as we recognize the unwinding of this agreement overtime.

Moving on to a discussion of our investment portfolio; net investment income was $67 million for the first quarter of 2013 compared to $67 million earned in the prior year quarter. For the first quarter, the overall earned yield on our fixed maturity portfolio was 4.03%, down from 4.38% for the same period of last year. As new money yields continue to put downward pressure on our overall investment returns, we are employing certain portfolio management strategies intended to augment our yield without meaningfully increasing the overall investment risk in the portfolio. Notably this quarter, we have benefited from a modest portfolio of investment grade, mortgage-backed securities that we acquired starting in the second quarter of 2012. We will continue to prudently seek additional yield opportunities.

At the close of the first quarter, we held more than $8 billion in cash and invested assets with fixed income securities in cash representing 92% of the total. Roughly 95% of our fixed income securities are investment grade. The duration of our portfolio remains at approximately 4 years. The balance of the portfolio is invested in equity securities at 5% and 3% is primarily held in overseas deposits and partnerships. Before I comment on capital, I also want to point out that our effective tax rate on operating earnings was a bit lower this quarter by about 1 point. This benefit is driven by allocation of income derived locally in the U.K. and we expect that this will carry through for the rest of the year.

Our balance sheet remained strong, providing us with excellent financial flexibility. We ended the quarter with $2.6 billion in shareholders' equity and our book value per share was $59.58 up 2% from $58.59 at year-end and up 3% from the $57.65 in the past 12 months. During the quarter, we continue to pursue a diligent capital optimization strategy. As you recall, over the last 3 months of 2012 and into January, we opportunistically retired approximately $120 million in legacy debt assumed in various acquisitions in projects. In March, we issued a $175 million of subordinated debentures with a coupon of 6.35% due in 2053. The debentures are a more efficient capital instrument for us. We were able to successfully issue these securities in the retail fixed income market, which was a market that we had not previously been able to access.

During the quarter and through April 26, we also took the opportunity to repurchase 904,000 shares for approximately $43 million at an average cost of $47.23 per share. We have plans to continue to opportunistically repurchase shares to offset the impact of the additional interest expense from the subordinated debentures on our earnings per share. Our target spend for the year is approximately $70 million, including the repurchases we have already made. As a result of these actions, our unadjusted debt-to-total capital ratio increased to 27.2% at the end of the first quarter. However, the subordinated debentures are considered equity treatment by rating agencies and as a result become a more efficient instrument in our capital structure.

Our debt-to-capital ratio is well within our internal tolerances and rating agency thresholds for our current ratings. Holding company cash and investments were $295 million at March 31, increased due to the cash raised from subordinate debentures in last March. We also continue to maintain a $200 million credit facility that provides additional flexibility. So to sum up we had a strong quarter that was within our expectations and aided by low catastrophe activity. We feel good about our financial strength and our underlying indicators for financial performance. We are confident that we will be able to continue to leverage our position to deliver the projected earnings in 2013.

With that I would like to turn the call back to Fred.

**Frederick Henry Eppinger**
*Former President & CEO*

Our results this quarter provide us with continued confidence in future margin expansion and our ability to execute on our strategic and financial goals for the year. Our confidence is supported by progress in 4 areas of focus: continuing pricing improvement in our domestic businesses; continuing portfolio management actions; improvement in our domestic specialty businesses; and our strong diversifying affect of Chaucer. I will touch on each of this drivers and initiatives and how they manifested in the quarter starting with pricing. Simply put, we continue to see an improved pricing environment in virtually all of our businesses. You've heard extensive commentary about this in the P&C sector over the last year so, and although they was some concern in the industry about a slowdown in the trend, we continue to achieve meaningful increases in the first quarter of 2013.

In addition, we are optimistic that we will continue to see solid pricing increases as we move forward in 2013. In the first quarter, we achieved positive pricing momentum in all lines of our domestic book. We saw 9% increases in Personal Lines, 9% increases in core Commercial and 14% increases in our domestic specialty business. In the current dynamic market and pricing environment, which has been disruptive to agents, it is important to stay focused and targeted when it comes to rate increases.

Our sophisticated underwriting and pricing models as well as our strong position with our partner agents allows us to be very targeted in our pricing approach and managing the balance between pricing and retention. It also allows us to continue to improve our mix and the quality of our overall portfolio as we grow with our partners.

In addition to pricing, we made very good progress on improving our portfolio through some targeted mixed management actions. As we previously discussed, we believe that we must assume that the more challenging weather conditions we have seen in recent history is a permanent condition and we must respond with pricing and targeted portfolio actions.

We continue to manage our book of business to improve the quality of our mix and reduce our volatility by lowering property concentrations in certain geographic areas and by exiting businesses where we felt we cannot get appropriate pricing for the risks we are taking. Last year we began a very targeted effort shedding less attractive business.

In 2012, we shed about $120 million in premium, much of it by eliminating non-partner legacy agents. This year we are targeting an additional $175 million in premiums. Although we will somewhat temper our top line expansion this year, this is the right trade-off to make for improving our long-term returns.

Notably in the first quarter we undertook the following initiatives. First, we executed a renewal rights transaction that moved to Florida based book of commercial business. This book came with our AIX acquisition. Second, we continued to aggressively manage our Personal Lines exposures in targeted geographies. We made excellent progress reducing our micro concentrations in a number of areas, which will reduce our volatility over time and allow us to shift capacity to higher margin business with our partner agents. Third, we are actively executing about a half dozen target program proven initiatives in core Commercial Lines in order to reduce potential volatility from weather and driving less profitable business out of the book.

All in, we have reduced premium by about $40 million in the first quarter. These actions combined with our pricing give us confidence that we are building a very attractive stable portfolio for delivering future financial returns.

Outside of these targeted actions, we are seeing strong business momentum. Our retention rates are holding at desirable levels and business submission flow continues to be very robust. Our value proposition is well understood and supported, and we are gaining market share and agency shelf space in very attractive areas from their partner agents.

As we prepare for our annual agency partner meeting beginning tomorrow, I'm especially pleased with the position we have built with the best and strongest distributors in the U.S. Our agents are impressed by the talent we have added to our already strong team as well as our broad and relevant product portfolio.

Another source of our confidence comes from our profitability and growth outlook in our domestic specialty lines. As our businesses mature and we are making the necessary changes to our portfolio, we have visibility into a solid margin expansion in our newer specialty businesses going forward. Additionally, we believe we have substantially dealt with some legacy items in this book, notably surety where we have improved performance and now have a more balanced and attractive book of business.

Overall we are pleased with the margin improvement embedded in our results and are confident that our overall portfolio will increasingly benefit from growth and higher margins that this business has the potential to deliver.

Expense ratio improvement is another source of margin expansion in domestic specialty businesses. While we will continue to make investments in our products and operating model, many of our larger infrastructure and technology investments from building out our portfolio are behind us. Additionally, we are gaining operating model efficiencies and scale as we continue to grow these businesses.

Of note and related to all our segments, I should emphasize that we're on track with our expense targets for each of our businesses. We are committed to ensure that every investment we make improves our ability to sustain proven margins.

Chaucer continues to be an important part of our improved portfolio, bringing strong underwriting performance in critical specialty areas. It is also an important component on our path to a more balanced book of business with this attractive mix. As last year proved, our international platform allows us to be more resilient to U.S. weather patterns and events.

As David indicated, Chaucer had another quarter of strong earnings contributing $41 million on a pre-tax basis. The absence of catastrophes, lower large losses benefited this quarter's results. Chaucer has had strong performance over the past year, but our long-term expectations for this business continues to be around 94% to 96% combined ratio.

Overall, the trends we're observing in our results for the quarter and the progress we've made in our planned initiatives gives us continued confidence in meeting our 2013 whole year estimates and position us for additional improvement in 2014 and beyond. As far as 2013 guidance is concerned, given that we are just 1 quarter in to the year, we believe it would be premature at this point to adjust our full year outlook to reflect lower level of catastrophe losses we experienced this quarter.

Before I open the call for questions, I want to emphasize that every member of our team is focused on improving our underwriting margins and establishing a business portfolio that ensures our improving financial and strategic position. We are just as committed to efficiently managing invested capital as evidenced by actions David outlined earlier. Our focus over the next 2 years is to march toward top quartile returns and a strong strategic position. We are driven to provide products and services that add value to our clients while generating an acceptable return of capital for our shareholders. We have a sense of urgency to succeed at both and we're pleased by the progress this quarter demonstrates.

I want to close by taking a minute to wish our colleague, Marita Zuraitis, much success and some luck on her next venture as a CEO of a public insurance company. We are all excited for her. Marita has been an important and valued member of our team as we have been on this journey together for the last 9 years and she will be missed by all of us at the Hanover.
Operator we are ready to open the lines for questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from the line of Sarah DeWitt with Barclays.

**Sarah Elizabeth DeWitt**
*Barclays Bank PLC, Research Division*

First on the reserve strengthening that we saw in personal auto and commercial auto and other commercial, and clearly slow versus the prior quarter, but could you elaborate on what's still driving that and when you think that that will ultimately be behind you?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

No, sure, I mean I think as you pointed out, it’s certainly a slowdown from what we've been discussing over the course of 2012. I think the amounts involved are relatively small or minor adjustments. We typically make each quarter 2 reserves, so you can see pluses and minuses in lines. Particularly as it relates to auto, I think we have been pretty clear on all of our calls that there are still some industry issues that are working through the system, but we are seeing on our book of business obviously very good rate movement, very good results in the underlying auto lines both personal and commercial. But nevertheless as we go through our quarterly reserve analysis, we find opportunities where we want to add some additional reserves. And again I think these are very modest amounts compared to what we've talked about previously and really no change in trends or underlying expectations.

**Frederick Henry Eppinger**
*Former President & CEO*

And I would say a couple of things, one we feel terrific about where we are with our balance sheet and our assumptions there's really been no surprises this quarter from what we are planning for as we look forward. So I think we are in a very good position against our expectations in our plan for the year.

**Sarah Elizabeth DeWitt**
*Barclays Bank PLC, Research Division*

And then just on the ROE, you've given that 11% to 13% long-term guidance before and so could you just walk us through how you believe you can get there in terms of how much margin improvement we would need to see and share buyback, I assume those are your 2 major levers?

**Frederick Henry Eppinger**
*Former President & CEO*

We worked hard to get the portfolio where we think it is very sustainable. We’ve got a mix of business over the highest 4 years and changed the mix of business. Our position with our partner agency is the best it's ever been. What we are seeing is really good growth of the best business with the best agents and the ability to get price and retain the business.

So if you look at it obviously we need 3 or 4 points more out of our combined ratio. We think that we can get that to the mix and pricing work that we're doing and that we think we are going to have good solid advances and growth again in mid-single digits or so as we’ve talked about. So I think combined we think that we have lots of levers that are working in our favor to get to those extra points.

And again, we worked hard in commercial for example on the expenses and we feel good that we're going to continue to get what we need. So when you look at it, we really like where we are for this year's plan and we really love what we’re setting up for ’14 and so everything is falling in place nicely.

As far as capital management activities, I think that's on the margin, I think we will continue as David said, to do some of that, but we believe right now that there's a lot of available business, it's very attractive at the pricing levels and that our ability to continue to position ourselves and be like the lean player with a lot of these agents in these categories just sets up our ability to increase margins. So I think we are in a very good place and we just got to stay focused on it.

**Sarah Elizabeth DeWitt**
*Barclays Bank PLC, Research Division*

Okay. Is there a timeframe for that ’11 to ’13?

**Frederick Henry Eppinger**
*Former President & CEO*

Yes, as I said I think we are making great progress in ’13 and we are going to be a lot better in ’14. So we all know that yields are the headwind. And I am not smart enough to know how long this continues, but obviously the yields are the headwinds, so what we will see is we'll see significant improvement this year and next year in our returns and so I am not going to set an exact date because of the yield change, but again as I've said over and over again, I feel very good about where our returns are going to be in ’14, given what we're doing.

**Operator**

Our next question comes from the line of Vincent DeAugustino with KBW.

**Vincent M. DeAugustino**
*Keefe, Bruyette, & Woods, Inc., Research Division*

I just wanted to start off on the $175 million of business that you mentioned regarding just shedding that, would you happen to have the loss ratio that that $175 million's been running at?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Yes, what you got again is a bit of mixed bag a little bit, right? Because part of it is because of our concentration and really the tail that it drives. So the marginal cost of that business because it's in the northeast or in a zip code that's quite concentrated it is kind of on the margin not attractive, but we make a lot of that business we make a marginal contribution. We think the trade-off is right, because it reduces the volatility, but there is a number of that business. If you remember last year toward the end of the year just before the Sandy Storm we did a renewal rights in New Jersey, Connecticut, with a number of legacy agents that we -- and New York too excuse me, that we shed. On the marginal basis that business contributed, but if you took the total cost of capital in the way we think about the tail, it made a lot of sense to get rid of, so about 1/2 of the business we're shedding has that as a characteristic.

The other part of the business is that when I look at some of the business we're getting off is particularly true in commercial; our expectations for weather and the losses from weather, and the volatility from weather, that was more attractive business than our view is today. And so given our new estimates of what kind of non-cat win related losses is going to be as part of our losses, we view that as going forward very difficult to get the kind of pricing we need in some of those geographies so we're making the moves on that.

So it's hard to meet a pick of exact loss ratio, but what I can tell you is that in every case we believe that over time these are businesses that would not allow us to get to the 11% or 13% return through the cycle and so that by getting rid of these it gives us less volatility and more certainty as well as higher margin. But every business we looked at is a little bit different; some of it is for the tail, some of it is the short term volatility and then some of it is just chronically under-priced, so the Florida business as an example we just felt we couldn’t get the adequate price for that pool of business. It wasn’t that it was too property centric or whatever. It was just a pool of business and we felt given where the market was in that type of business that we couldn't get to the margin.

So I apologize it's not one thing but it's a bag of things that allows us to believe that the market gets -- it significantly enhances our future margin particular for '14 as we work through kind of a transition of expense et cetera that occurred this year.

**Vincent M. DeAugustino**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay perfect, that's actually real helpful. David, if you can maybe just talk about some of your comments on the year-over-year comparisons and if I can maybe frame some timelines around that, just as we think about the stronger rate increase over loss cost trend in the margin expansion then that would imply as we roll forward into the next few quarters. Should we, I guess start to see much better margin expansion as we're making comparison to second half '12 estimates, which is I think at that point started to reflect some of the higher loss picks, so all is equal net to assumption just under the timing to be roughly appropriate?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Yes, I think, Vincent that's exactly right. And as I said in my comments, the first quarter comparisons are complicated because of those things. As we look out for the rest of the year, all of the things we've discussed, both Fred and I and we've been talking about over the last several quarters, will play out and we'll see better ratios on a quarter-over-quarter comparison. Obviously, we upped our ratios in the second quarter last year as we mentioned and we did that also in the third and fourth quarters and as we look out the rest of 2013, when we look at those comparisons, they'll still be a little bit noisy but they're going to be better overall across all the lines of businesses and across the segments.

**Frederick Henry Eppinger**
*Former President & CEO*

Okay, so you'll get a more standard. Again the combination in that first quarter, we just, we had one of those non-winter winters last year, which made all our property businesses look a lot better, plus as you know, our pick for '11 in particular was too low at the early and when we made the adjustment. So those comparisons year-over-year are going to start looking good starting next quarter and you'll be able to see the improvements in the accident years in almost all the lines; I am sure and as David said, there might some noise here or there, but the reality is that you are going to start seeing the improvement through and that's how we got by the way to our overall range and pick for the year.

**Vincent M. DeAugustino**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Perfect and then I just -- to wrap up I wanted to offer my congratulations to Marina and also inquire in to whether we might be able to anticipate hearing a little bit more from Mark and Jack going forward on the conference calls and just a little more regularly?

**Frederick Henry Eppinger**
*Former President & CEO*

Yes. Absolutely we had I think as people know, we have organized around the businesses for a while, and what you will see going forward is their participation, both in the calls and the outreach. We've started that this year and as far as the calls go, you will see in the future that they will be available and more active in the questions absolutely.

**Operator**

Our next question comes from line of Matt Carletti with JMP Securities.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Just had a few questions, first just a quick one, has there been any change to your Sandy estimate whether gross or net over the last quarter?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

No change at all. We're tracking very well to our estimates. You'll recall, we took a little bit time before we announced our number last year and we are thoughtful and thorough in our analysis, I think we have a really good number for Sandy. And this quarter, nothing occurred this quarter that caused us to be concern about the estimate we have, if anything it gave us a lot more confidence and so, no adjustment whatsoever with Sandy estimate.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Okay. Second question just so we can talk about the debt issuance a little bit. It seems like the talk in subsequent quarters and particularly last quarter was a lot focused on debt-to-cap ratio declining. I was a little bit surprised to see kind of the reissuance of debt which took you, well within your bounds but back towards a couple of points back towards where you had been. I understand there's an opportunity to buy back stock, but your guidance doesn't suggest that you are going to be maximizing it in that way. Seems a little bit of a course reversal, is it more growth than you've expected and therefore need the capital to support it, or could you just kind of talk us through that process little bit?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Yes, sure Matt. I think you're right about the comments we made. Both Fred and I have said previously we would like to get our debt-to-cap ratio down in the mid-20s. But what you can't see on the surface of this is a bit of the difference between the 27% debt-to-cap ratio that you can see on the financial statements with the fact that on a rating agency basis, I'm actually better today on my equity capital than I was previously. So this instrument and the opportunity to issue this instrument was perfect for us. It added a $175 million to equity capital from a ratings perspective to strengthen our underlying capital for that purpose; it gave us a 40 year maturity at a price that was very hard to ignore at 6.35 basis points. So on all of those measures it was a good trade to be done and it also, as you now know, opened up the opportunity for us to buy more on the equity shares because of the equity credit that I get from a rating agency standpoint. So from my perspective on all sides this was a perfect trade for us to execute; even though the comp now we've seen in the comments we have previously made about leverage. And the last thing I will say is, our leverage at 27% is well within all of our tolerances; well within industry levels if you will. We're not at all worried whatsoever about that metric.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

That makes sense. And then last question just relating to Chaucer and in particularly we saw strong growth with the non-renewal of the quota share. But specifically U.K. Motor, maybe could you update us on your views in that line? I know it's a line that has had a lot of focus, kind of a negative headwinds, if you will, of late. You guys have guarded it pretty well at least in this quarter. Could you update us on your view there and what might make Chaucer's book different than others?

**Frederick Henry Eppinger**
*Former President & CEO*

Yes, and I'll have Bob comment too. Obviously as we said to you it's kind of a specialty book for us. It is the small and it's got some specialty aspects to it the way the trounces of business. We have had a previous couple of years great action that has earned its way in, it has been very successful and profitable for us and continues to show very good signs and performance. A lot of the growth we've had in that business has been the rate earning and from the previous couple of years of rate. But we are very happy with the performance of the business and feel very good about it right now. There's also some interesting reform things that have happened in that market that give us some positive feelings. But Bob is there anything we should make sure we mention?

**Robert Arthur Stuchbery**
*Former Chief Executive Officer and Executive Director*

No, just comparing to the same quarter last year, we have these back a touch in that quarter until we saw some of those rate increases kick in. So it's more reflective as compared to what we've seen in the last couple of quarters, and you're right some of the legislation changes here particularly around [LASBOF] which is a change to the legal aid in banning of referrals fees. We expect that to impact favorably on loss ratio. So it’s still although we're seeing some underlying rate reductions from high peaks, it still looks like a good opportunity in that area.

**Operator**

Our next question comes from the line of Dan Farrell with Sterne Agee.

**Daniel D. Farrell**
*Sterne Agee & Leach Inc., Research Division*

I was wondering if you could just update us a little bit more on surety. I saw in commercial auto where I think most of all if not all of that businesses in there were some nice sequential improvements in the loss ratio. Where do you stand in that turnaround? I think you've talked about being able to get to underwriting profitability on that. Were you there this quarter and is there further improvement that can be driven?

**Frederick Henry Eppinger**
*Former President & CEO*

I think we feel very good about the progress we've made. As we had said, yes there was a lot of noise in the last 2 quarters that we are getting behind us last year; it is in a much better place. I would also say though it will be better in ’14 and ’13. We are still improving in that line, but we feel very good about the mix and it's coming out just as we expected. So we had a set of plans; we addressed kind of the run-off business; and it’s kind of unfolding the way we expected. I don't know Andrew if there's anything additional we should make sure we comment?

**Andrew Scott Robinson**
*Executive VP, Corporate Development & President, Surety*

No Fred I think you got it. Dan I would just say it is as Fred described. It’s largely unfolding as we expect and much of what we are doing right now is very much around positioning us for ’14 which we feel very good about.

**Frederick Henry Eppinger**
*Former President & CEO*

So it’s good. There's no surprises.

**Daniel D. Farrell**
*Sterne Agee & Leach Inc., Research Division*

That's great, and then I apologize if I missed this but within personal lines do you have the rate increases for auto and home.

**Frederick Henry Eppinger**
*Former President & CEO*

They're about the same, about 1 point different Mark?

**Mark R. Desrochers**
*Former Senior Vice President and President of Personal Lines*

Probably, yes, probably maybe 1 point higher in home and 1 point less in auto.

**Frederick Henry Eppinger**
*Former President & CEO*

Yes, so we did good in both, where we are nice and solid [indiscernible]

**Mark R. Desrochers**
*Former Senior Vice President and President of Personal Lines*

[indiscernible] One's a little lower, one's a little higher.

**Frederick Henry Eppinger**
*Former President & CEO*

Yes, so we are feeling pretty good and pretty consistent across the board.

**Operator**

Our next question comes from the line of Ray Iardella with Macquarie.

**Raymond Iardella**
*Macquarie Research*

I just wanted to maybe touch a little bit more on Chaucer and I know David, you spent a lot of time walking through sort of the non-cat weather on the domestic side and sort of throwing off the year-over-year comps and I know Chaucer benefited from some lower large losses, I guess in the first quarter of this year. But is there is anything else we should think about in terms of the year-over-year comparison, I guess first quarter to first quarter or is the right way to think about it, 2012 the full-year relative to the first quarter?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Well I think 2012, let me start with, first quarter to first quarter there was a higher incidence of losses last year which I mentioned and that has to factor in. Probably would say ‘12 is more normal than ‘13 in that regard if you will. The other problem I think ‘12 for the year is worth looking at, but remember that ‘12 for the year was also very positive for Chaucer in terms of low level of losses across the entire year. So we've been cautious about this and as Fred said, our long-term expectations on this business is in the around 94 to 96 combined ratio and that’s what I would use as sort of your balancing point and then each quarter we’ll try to be as clear as we can on what's happening in the underlying business.

**Raymond Iardella**
*Macquarie Research*

Okay, that’s helpful. I know you worked sort of hard to optimize the capital structure over the past couple of quarters. Is there anything sort of left in terms of the way you are thinking about the capital structure that you guys feel like you can do or is this going to be it you think?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Well, I like where we're today, but there is still more work to be done or can be done. I mean there are some things in the debt structure that I would look at in terms of liability management but nothing's imminent in my mind in terms of what we would do there. I think we'll be less active than we have been in the last few quarters, but nevertheless, we're very focused on obviously making sure our capital structure works for the organization we are today and it provides the businesses sufficient capital to meet their needs as they grow.

**Raymond Iardella**
*Macquarie Research*

Okay, that's helpful. And then maybe the $70 million I guess you threw out there in terms of sort of the way you think about budgeting the repurchases for '13, I mean what sort of the governer there in terms of that number, is it just offsetting the incremental interest expense or is it other capital needs in terms of growth?

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Well, couple of different ways to look at it, Ray. First and foremost, I want to make the transaction neutral to our financials, so we didn't issue the $175 million to be dilutive to our results. So my first and foremost goal is to obviously neutralize the impact of that which is what the $70 million represents from that standpoint that might be a little extra in there for it, but effectively that's my first goal.

As I think about capital management going forward, the way we think about it is 3 different elements of how we're focused on it. We have a very good and strong dividend policy. We also want to make sure that we have sufficient capital to meet the needs of our businesses and the opportunities that they have to take advantage of it and then we have share repurchase in our toolkit to be able to utilize.

And I think the share repurchase, if you look at our recent history, has been muted by the fact that our earnings have been lower. So I need to get more earnings into the results, in which case then I can deploy the capital in the ways that I just described to you. So we'll be more active as we have higher earnings in that front, but again that will be in concert with making sure we're supplying enough capital to our businesses for their growth plans.

**Frederick Henry Eppinger**
*Former President & CEO*

And obviously the other thing that the theme has been, what we did with the debt retirement before is we unlocked some debt that was buried in the insurance companies, we've given ourselves more flexible, we have equity credit and we have positioned ourselves to have some flexibility, if growth unfolds the way it could, right?

So we are -- the disruption in the marketplace, we're being opportunistic, it's been balanced with this other portfolio changes, but we have given ourselves more flexibility here as we look forward depending on what the market opportunities and business opportunities that present themselves.

So the way I think about it is we've given ourselves flexibility, we'll continue to be opportunistic beyond that number, if it's the right thing to do and as we see the changing market environment, but right now I really liked the flexibility that we've created.

**Raymond Iardella**
*Macquarie Research*

Okay, that's helpful. And then lastly, maybe Fred for you, in terms of the exposure management actions, I guess on the Personal Lines side and then I guess a little bit on the Commercial Lines book with the program business in Florida, I mean how are the agents responding sort of to your wanting to back off from some of these concentrations that you guys have, I mean how are those conversations going with the agents?

**Frederick Henry Eppinger**
*Former President & CEO*

What's great about our strategy and again what's happened in the last 4 years with this portfolio change and our success out west and our success with Chaucer et cetera is we have been able to just put our strategy a little bit on steroid. So one of the things we are able to do is I still have some legacy agents that aren't real partners in the sense of the partners we have going forward.

If you look at these actions 80% of these actions to-date have been essentially with legacy agents we're eliminating. So what happened is we have more capacity to actually give to our partners, so we're shifting our share and the mix to the folks that we have more success and more of a future with.

So it hasn't been that problematic, now there is 20% of it and some tweaking. We have done some LRO work and flat roof work in some geographies around the Midwest, right? And we've done some work in Personal Line, it's a model line business, but we work very carefully with agents. For instance, we are doing a model line thing where we found another carrier where we're doing a deal and we're moving that business to another carrier that the partners have accepted.

So far so good I mean because what people see is that we're committing capacity to them, there is lots of growth opportunity, the mix is better and we're shifting it away from my view some of the legacy positions that we still have remaining in the business, that are essentially around Personal Lines oriented smaller agents that don't have the same portfolio that we now have going forward.

So I feel very good about it and explained we have our agency meeting tomorrow, the rest of this week and if you looked at the growth we have with our partner agents and their mix, it’s just extraordinary. So what that's like we think we have a ton of momentum going forward both in margin and growth as we go forward here as we get some of these actions behind us. So, so far so good.

**Operator**

Our last question comes from the line of Larry Greenberg with Langen McAlenney.

**Lawrence David Greenberg**
*Langen McAlenney*

And I think you probably answered this one question ago when you were talking about Chaucer, but it really just relates to the fact that we've now had 4 quarters where underlying combined ratios at Chaucer have really been in the low 90s, 90 to 92, 93, I would say. And the question was, are you starting to believe that that's really more representative of a run rate as opposed to?

**Frederick Henry Eppinger**
*Former President & CEO*

Of course the 2 quarters before we bought them, they didn't quite have that.

**Lawrence David Greenberg**
*Langen McAlenney*

That's fair.

**David B. Greenfield**
*Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President*

Yes, let me make a comment, then Fred will jump in or Bob, I mean we've said this before Larry and we believe it, I mean Chaucer is a very good strong underwriting organization and I think we're being very careful not to believe that this last 4 or 5 quarters of great loss experience is real and that it will continue in perpetuity. I mean you can go back to sort of ’06-’07 when the industry had a very low level of losses in cats.

And then as Fred pointed out, you can go to a couple quarters and point to some bad outcomes, but I think broadly speaking, the Chaucer portfolio is managed very, very well. It’s a very good book of business and we're quite proud of it and we think it’s great for our business, but we also don't want to set an expectation that we are going to hit 90% every quarter.

**Frederick Henry Eppinger**
*Former President & CEO*

And so what we did, and as you know Bob we brought into the family too, what we did obviously as a track record of about 94 over a 10-year period, we also took a lot of volatility out of it when we put the 2 companies together we got out of some fact reinsurance. We tried to focus the effort and the portfolio on stuff that fit our combined companies a little bit better. So we are very convinced that we will get the kind of returns that we're targeting over the cycle, but I think it is not appropriate for us to assume the last couple 3 quarters or if you sustain it at this level. Bob, I don't know if there's any comments you want to make about the franchise?

**Robert Arthur Stuchbery**
*Former Chief Executive Officer and Executive Director*

No, I think you said it all. There have been good quarters, but we're not getting too ahead of ourselves. We are in the risk business.

**Lawrence David Greenberg**
*Langen McAlenney*

Hey, Bob, any thoughts on Berkshire's quarter share through the Ion[ph] vehicle?

**Robert Arthur Stuchbery**
*Former Chief Executive Officer and Executive Director*

We're watching it very, very closely. It’s an interesting transaction. I suppose we could expect to see some impact on signings, but I think that's probably going to be more noticeable for smaller syndicates in the market and those that don't have a strong leadership position and therefore don't have closer relationships with their insureds. All in all, we've got an excellent relationship with Ion and we're constantly continue to look for ways of developing that relationship further. So it might have an impact in a couple of classes, but we're really watching what the development as it unwinds.

**Operator**

I would now like to turn the call back over to Oksana for closing remarks.

**Oksana Lukasheva**
*Vice President, Investor Relations*

Thank you all for your participation today. And we are looking forward to speaking to you next quarter.

**Operator**
Ladies and gentlemen, this concludes the presentation. Thank you for your participation. You may now disconnect. Have a wonderful day.