S&P Global
Market Intelligence

Markel Corporation NYSE:MKL

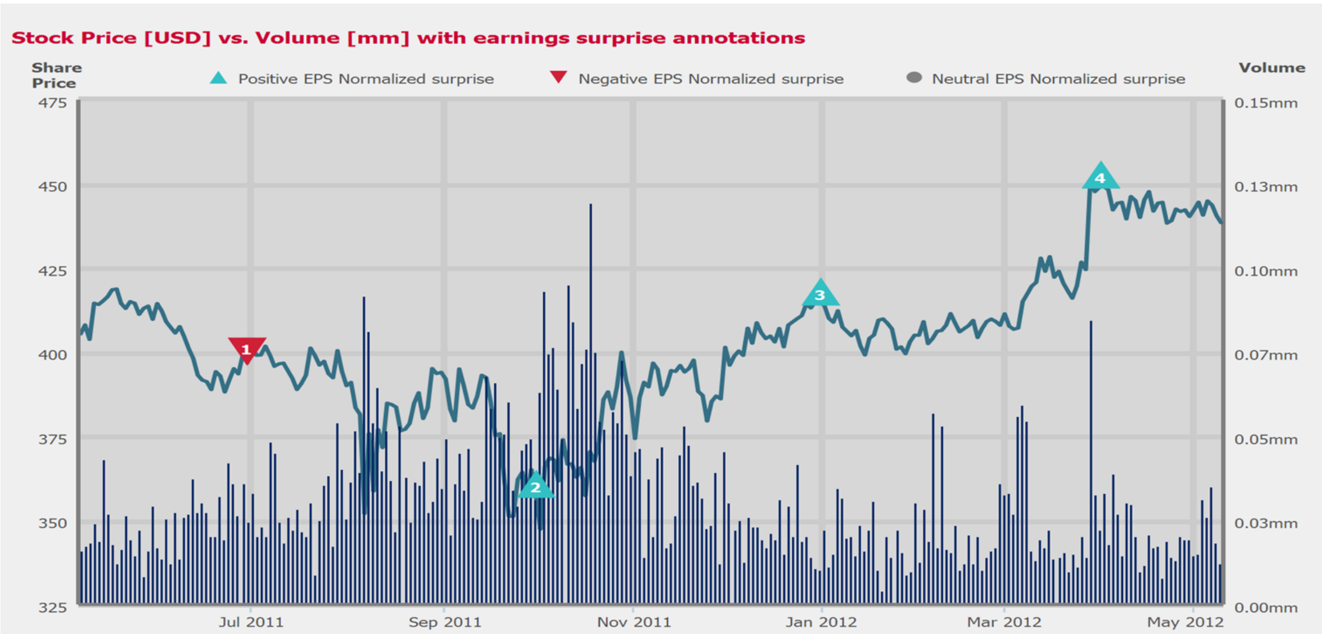
FQ2 2012 Earnings Call Transcripts

Thursday, August 09, 2012 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2012-			-FQ3 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	3.55	7.87	121.69	3.78	18.16	17.91
Revenue (mm)	699.97	693.25	(0.96 %)	715.77	2843.59	3026.24

Currency: USD
Consensus as of Aug-09-2012 2:11 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	4.06	2.99	(26.35 %)
FQ3 2011	4.04	4.41	9.16 %
FQ4 2011	4.29	4.43	3.26 %
FQ1 2012	3.99	4.97	24.56 %

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Call Participants

EXECUTIVES

Anne Galbraith Waleski
Executive VP & CFO

Francis Michael Crowley
Vice Chairman

Richard Reeves Whitt
Co-CEO & Director

Thomas S. Gayner
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Stifel, Nicolaus & Company, Incorporated, Research Division

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Presentation

Operator

Greetings and welcome to the Markel Corporation Second Quarter 2012 Earnings Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Tom Gayner, President of Markel Corporation. Thank you, Mr. Gayner. You may begin.

Thomas S. Gayner
Co-CEO & Director

Thank you, Manny. I appreciate it. Good morning and welcome everyone, to the Markel Corporation's Second Quarter Conference Call. We're pleased that you're joining us as we all look forward to sharing the good news of our substantial year-to-date progress in 2012 in building the value of your company.

Over the past several years, we've been telling you about the transformation underway at Markel. We've told you about the growth of our insurance operations through entry into new geographical areas, our new products, and our acquisitions. We've told you about our focus on improving the operating efficiencies in our business and how we've restructured the company to increase our revenues from existing customers.

We've also told you about our expanded investment activities through Markel Ventures which now owns controlling interests in about a dozen profitable manufacturing and service businesses. We've told you about how Markel has more ways and more flexibility to create value for our shareholders than ever before and it is now delightful to begin to show you the fruits of these efforts, rather than just telling you about them.

As is our custom, our Chief Financial Officer, Anne Waleski, will lay out the overall numbers from the first half. Then, my Co-Presidents, Mike Crowley and Richie Whitt, will discuss our domestic and international insurance activity. I will then cover our investment in Markel Ventures operations, and then we will open the floor for your questions.

Before getting started with today's lineup, though, the rules say we need to repeat the Safe Harbor statement so here it goes. During our call today, we may make forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements as described under the captions Risk Factors and Safe Harbor and Cautionary Statements and our most recent Annual Report on Form 10-K and quarterly report on Form 10-Q.

We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures on our website at www.markelcorp.com in the 'Investor Information' section under 'Non-GAAP Reconciliation' and in our quarterly report on Form 10-Q.

With that, Anne?

Anne Galbraith Waleski
Executive VP & CFO

Thank you, Tom, and good morning, everyone. Before I get to a discussion of our financial results, I will point out a couple of accounting items new to the quarter and the year. First, I'm sure you have all noticed some changes in our statements this quarter.

Redeemable non-controlling interest is a new line item on the balance sheet this quarter. For all periods presented, we have reclassified amounts previously included in the non-controlling interest balances for relevant Markel Ventures affiliates to this new line item. This is required because some of the Markel Ventures' minority shareholders have the option to sell their shares to us in the future generally at a fixed multiple of EBITDA.

In addition to the reclassification, there is an adjustment recorded on these redeemable non-controlling interest balances. As of the end of each reporting period, the carrying value of the redeemable non-controlling interest is adjusted to the calculated redemption value if that price is higher than the current carrying value. The purpose of the adjustment is to record the potential cash obligations we may have to the non-controlling interest shareholders.

This quarter, redeemable non-controlling interest balances were marked up by $8.2 million. The adjustment is recorded to retained earnings and reduces net income to shareholders when calculating earnings per share. You can find the earnings per share calculation in Footnote 2 and additional information regarding our contingent obligations to the non-controlling shareholders in Footnote 8.

The second item I would like to point out was previously discussed in our first quarter conference call and filings, but I'd like to remind everyone that we chose to prospectively adopt the new DAC accounting standards. As of June 30, 2012, we have recognized approximately $35 million or 3 points of expenses related to the prospective adoption of the new standards.

Now that we have covered these new items, I will review the 2012 financial results. I will follow the same format in discussing results as in past quarters. I will start by discussing our underwriting operations, followed by a brief discussion of our investment results, and bring the 2 together with a discussion of our total results.

Our total operating revenues grew 12% to $1.4 billion in 2012 from $1.3 billion in 2011. The increase is due to a 10% increase in revenue from our insurance operations and a 30% increase in revenue from our non-insurance operations which we refer to as Markel Ventures.

Moving into the underwriting results, gross written premium for the 6 months of 2012 were just under $1.3 billion which is an increase of 9% compared to 2011. The increase in 2012 was due to higher gross premium volume in each of our 3 operating segments. Net written premiums were approximately $1.1 billion, up 9% through the prior year. Retentions were up slightly in 2012 at 89%. Earned premiums increased 9%.

The increase in 2012 was due to higher earned premium volume in each of our 3 operating segments. Increases in gross, net and earned premiums have all benefited from our recent insurance acquisitions in the Specialty Admitted segment. Our combined ratio was 93% for the first 6 months of 2012, compared to 107% in 2011. As a reminder, our 2011 combined ratio included $99 million or 10 points of underwriting losses related to the catastrophe events which occurred last year in the U.S., Australia, New Zealand and Japan.

Setting aside the impact of the prospective adoption of the new DAC accounting standard in 2012 and the effect of catastrophes in 2011, the improvement in our year-to-date combined ratio was due to a lower current accident year loss ratio and to more favorable development of prior year's loss reserves within the London Insurance Market segment compared to the same period in 2011. The improvement in the current accident year loss ratio was due to lower attritional current year losses in the Excess and Surplus Lines segment and the London Insurance Market segment.

Favorable redundancies on prior year's loss reserves increased to $191 million or 18 points of favorable development, compared to $151 million or 16 points of favorable development in 2011. The increase was primarily due to more favorable development of prior year's losses in the London Insurance Market segment. Favorable development on prior year's losses in 2012 was primarily on the 2008 and 2009 accident years and occurred in a variety of programs across our international division.

Now, I'll discuss the results of our non-insurance operations, which we call Markel Ventures. In 2012, year-to-date revenues from Markel Ventures were $191 million compared to $147 million in 2011. Year-to-date net income to shareholders from our non-insurance operations, Markel Ventures, was $400,000 in 2012 compared to $4.7 million in 2011. Revenues from Markel Ventures increased in 2012 as compared to 2011 primarily due to our acquisitions of Baking Technology Systems Incorporated and WI Holdings Incorporated in late 2011 as well as Havco in 2012.

Next, some information on our investment results; investment income was up 7% in 2012 to just under $144 million. Net investment income for the 6 months of 2012 included a favorable change in the fair value of our credit default swap of $12 million which compares to $600,000 in 2011. During the first quarter of 2012, financial markets improved and credit spreads narrowed which favorably impacted this credit default swap.

Net realized investment gains were $20 million compared to $13 million in 2011. Net realized gains for the 6 months of 2012 included $1 million of write-downs for other than temporary declines in the estimated fair value of investments, as compared to $5 million in 2011. Unrealized gains increased $194 million before taxes in 2012, driven primarily by increases in equity securities. Tom will go into further detail on investments in his comments.

Looking at our total results for 2012, the effective tax rate was 23% in 2012 compared to an effective tax rate of 14% in 2011. The increase is primarily due to anticipating a smaller tax benefit related to tax-exempt investment income as a result of projecting higher pre-tax income for 2012 than in 2011.

We reported net income to shareholders of $147 million compared to $39 million in 2011. Book value per share increased 8% to $380 per share at June 30, 2012 [indiscernible] at yearend.

I'll now make a few comments on cash flow and the balance sheet. Net cash provided by operating activities was approximately $105 million for the 6 months ended June 30, 2012. That compares to approximately $100 million for the same period of 2011. The increase in net cash provided by operating activities was due to higher cash flows from underwriting activities as a result of higher premium volumes in each of our 3 operating segments, partially offset by increased claim settlement activity during the first quarter of 2012, primarily in the London Insurance Market segment.

Investments in cash at the holding company were approximately $900 million at June 30, as compared to a little less than $1.2 billion at the end of 2011. The decrease in invested assets is primarily the result of acquisitions made during 2012. On July 2, 2012, the company issued $350 million of 10-year 4.9% unsecured notes for net proceeds of $347 million. A portion of the proceeds was used to redeem the company's 7.5% unsecured senior debentures due August 22, 2046, at a redemption price of $150 million. Remaining proceeds will be used to partially refund the repayment of the company's 6.8% unsecured notes due February 15, 2013.

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

Francis Michael Crowley
Vice Chairman

Thanks, Anne. Good morning, everyone. I'm pleased to report that the second quarter North American results were positive from a rate, premiums and underwriting perspective. When measured against the first quarter, our North American underwriting segment achieved better rate results in the second quarter, with rates increasing 4.5% on average versus 3.4% in the first quarter.

We believe that a better comparison of the progress made in our ability to increase rate is to look back at the same period in 2011. Last year the majority of North American business segments had rate decreases, and the total book generated a minimal increase through the first 6 months of 2011. We are making progress.

With regards to premium growth, the E&S regions grew by 4.1%, bringing growth year-to-date to 6.1%. The total E&S segment grew by 1.7% for the quarter and 6% year-to-date, the difference being the growth numbers for the E&S regions in the entire segment; the difference is the impact of exiting lines of business that were booked in 2011 for the same period.

The Specialty Admitted segment grew 25.5% for the quarter, is up 18.1% year-to-date over the same period in 2011. This growth is fueled by the addition of $26 million of THOMCO premiums and growth in the Markel FirstComp business. Our existing property and casualty businesses and our agribusiness also were up for the quarter and the year. Markel American, our personal lines division, generated 5.9% growth for the quarter and 5% year-to-date.

The combined ratios for all North American segments improved for the quarter versus the same period in 2011. The Specialty Admitted segment improved 5 points from 102 - to 102 from 107. E&S segment improved 5 points as well to 87 from 92 in 2011. The THOMCO transition, which we closed January 1 of this year, continues - that transition continues in a very positive manner. We still believe that we will book approximately $60 million on Markel paper in this fiscal year.

FirstComp is executing their plan for improved results through price increases, geographic analysis, and reallocating volume to favorable territories, plus expense reduction efforts. Cross-selling at FirstComp is showing improvement, with 145 agents completing their Markel producer agreements, bringing the total count of agents who have initiated this process to 602. In June, 89 Markel FirstComp agents requested a THOMCO producer agreement, bringing that total to 325 so far this year. In the E&S segment, binders increased at a higher rate than submissions, reflecting some improvement in the market as well as some benefit for our efforts - from our efforts to cull non-performing agents and reduce the receipt of submissions that offer little opportunity to Markel.

We completed and released Phase 2 of our broker portal in the E&S division, which included the addition of more than 120 property and casualty class codes in the quick quote rate function for rating, quoting and binding. Across all E&S regions, we conducted a total of 489 agency visits, hosted 3 producer events, and held underwriting conferences in 4 regions.

In addition, during the quarter we were pleased to announce several new promotions of significance. Jeff Lamb, who has been with Markel for 11 years, serving most recently as Head of Underwriting in our MidSouth region, was promoted to Executive Underwriter for the E&S Division. Evans Nash, who has been with Markel for 17 years, has assumed the role of Managing Director, Wholesale Marketing. Evans recently was in charge of our binding business. He replaces Wendy Houser who is transferring back to our MidSouth region to fill the senior position left over by Jeff Lamb's promotion.

I would like to point out that Wendy just did a terrific job in her role as Managing Director, Wholesale Marketing, and we expect the same results from Wendy in the MidSouth region. Each of these individuals brings a wealth of knowledge and talent to their respective positions. Our ability to promote from within is evidence of the depth of talent at Markel.

In summary, we're pleased with the performance in North America in the quarter, but we will not lose sight of the fact that continuous improvement is both necessary and possible.

I would like to turn the call over to Richie Whitt.

Richard Reeves Whitt
Co-CEO & Director

Thanks, Mike. Good morning, everybody. During the first 6 months of 2012, Markel International's gross written premiums grew 7% to $514 million. Significant areas of growth continue to be in the marine and energy and our catastrophe exposed property lines, so treaty and open market property. We continue to see price increases on catastrophe exposed property and marine and energy business; however, as the years progress, these price increases appear to be moderating to some extent. Our overall average price increase on renewal business in the first 6 months of the year was approximately 5%.

Cat property increases have generally been between the 10% and 20% range, and energy has seen low single-digit increases. All the rest of our lines on the international side are relatively stable, maybe 1 point or 2 up, 1 point or 2 down, but pretty stable I would say. So, despite solid price increases in several of the lines of business in the first half of the year, there is still a pretty competitive market, and there is still quite a bit of capacity out there.

International's combined ratio for the first 6 months of 2012 was 86%. That includes 3 points of expense related to the adoption of the new deferred acquisition cost accounting standard that Anne mentioned. As opposed to the significant cat losses that we experienced in the first half of 2011, our first 6 months of '12 results really include minimal catastrophe losses.

In addition, Markel International's 2012 combined ratio included $86 million of favorable development on prior-year reserves. This included $18 million of takedown on 2001 and prior-year reserves. We always strive to establish reserves that are more likely redundant than deficient at Markel. However, the releases we experienced in the first 6 months are more than we would normally expect and are, as Anne said, are the result of favorable development across a number of product lines including that 2001 and prior reserve release that I mentioned.

I want to congratulate William Stovin and the international team on this really strong start to the year. Our goal for the second half of the year is going to be to continue to build on this positive momentum, continue to look for opportunities to profitably grow the international franchise.

Finally, switching gears, I'd also like to mention a significant accomplishment for our IT, Finance, Actuarial, and Information System teams - Information Management team, excuse me. During the second quarter, we went live with the first phase of a data warehouse which includes all of our Excess and Surplus Lines business.

We're already seeing the benefit of being able to better analyze our Excess and Surplus Lines data. We'll be able to provide our underwriters and product line leaders with significantly better information about production, profitable classes, classes that need corrective action. We believe that over time better access to this information is going to help us gain a competitive advantage.

With that, I'd like to turn it over to Tom.

Thomas S. Gayner
Co-CEO & Director

Thank you, Richie. As Anne mentioned earlier, book value per share rose to a new record high of $380 as of June 30. Our comprehensive income so far in 2012 of $279 million created an increase in book value per share of roughly $28 or 8% during the first 6 months of the year.

I'm happy with those results and I hope you are as well. I am also especially pleased that those results occurred even though we were not hitting on all cylinders. Specifically, while we enjoyed excellent results from our insurance and equity investment operations as well as positive returns from our fixed income portfolio, the results at Markel Ventures were below my expectations. The fact that we can hit new records in book value and compound capital at the rates we did, despite not hitting on all cylinders, is very encouraging to me. The reality is that it is highly unlikely that we will ever hit on every single cylinder at once.

That said, look at the returns we've earned given that fact. I'm encouraged by what we've built and are continuing to build at Markel. We've got more cylinders than we used to and more chances to keep the engine going forward. We'll let the politically minded of you debate whether we built that ourselves or not but the numbers seem to indicate that somehow or another Markel's long legacy of creating enduring value continues.

As to some details, during the first half, the total return on the investment portfolio was 4.5%. Equities enjoyed a return of 9.7%, and fixed income produced a positive overall return of 2.9%. Markel Ventures' consolidated results, however, as I said, were below my expectations for the first 6 months. On revenues of approximately $190 million, EBITDA totaled $9.4 million. This compares to revenues of $146 million a year ago and EBITDA of $9.9 million. As always, a reconciliation of EBITDA to net income is available on the website.

In the equity portfolio, our focus on high-quality securities paid off. During the first 6 months, we earned 9.7% compared to the S&P 500 total return of 9.5%. Over the last 15 years, a longer and more meaningful timeframe, we've outperformed the S&P 500 by 170 basis points per year.

We've also outperformed the Barclays Aggregate Bond Index by 220 basis points per year, which demonstrates the value we add to our shareholders by investing in stocks. Equities now represent roughly 60% of our total shareholders' equity, up from 55% at yearend. We continue to steadily and regularly add to our equity investment portfolio and we expect to continue to do so. Revenues are going up around here, and we've got ideas for where to invest the money.

In our fixed income operations, we earned a total return of 2.9%. Interest rates moved lower yet again during the second quarter, so we over-earned the coupon from our bond portfolio. Yet again, I continue to be amazed that this is happening and we remain ever more defensively positioned with that portfolio. Duration for the overall bond portfolio is now at a record low for us of 3. The perverse good news is that the opportunity cost of holding an ever-shorter duration bond portfolio is going down. Given the low rate at the front and long end of the curve, we couldn't stretch for yield even if we wanted to. There just isn't any worthwhile yield out there to be had.

As such, we have a portfolio where the differences between what one would call cash and equivalents and fixed income continue to diminish. That means, for all practical purposes, we have a lot of cash and all the options that go with cash, such as deploying it at higher rates of return as time goes by. It also means we are protecting our balance sheet against the rise in interest rates even more than last quarter and last year and I believe that's a good idea.

Finally, let me address Markel Ventures. As I mentioned earlier, we breathe the same air as everybody else, and the continued passage is of caution in the overall economy caused several sales, large-ticket capital goods to be pushed out beyond original shipment schedules.

There is also some undeniable pressure on our order books and sales prices. Additionally and positively, we are undertaking meaningful expansions at several of our units, which means that we are incurring upfront expenses to build for the future. That said, I'm optimistic about the second half of the year. Our current shipment rates are encouraging. Seasonality helps us in the second half, and we should begin to see the beginning of the payoff in both sales and earnings from some of the major expansions underway at the Markel Ventures Company.

Additionally, we acquired a controlling interest in Havco late during the second quarter. Havco is the leading manufacturer of flooring for the trailers of the 18-wheelers you see out there on the highway. Subsequent to the end of the quarter, we also acquired Tromp, a Dutch baking equipment company, which will join our AMF Bakery operations; and IDRECO, a Dutch dredging manufacturer, which joins our Ellicott Dredge operations. These additions should begin to contribute to our second half results.

As we look out over the balance of 2012 and into 2013, I expect that the current run rate of revenues for the Markel Ventures companies should approximate $600 million and that they should produce double-digit EBITDA on those revenues. I look forward to reporting those sorts of results to you.

Additionally, let me take a few minutes to discuss our culture and history of being very conservative in our accounting judgments. As you've heard us say, we have a policy of our reserves being more likely to be redundant than deficient. You can see the evidence that we mean what we say in our history of reserve redundancy. During this quarter, new items called non-controlling interests, Anne referred to earlier in her comments, is yet another example of what I would consider to be extremely conservative accounting and financial presentation and I'd like to explain it as I see it economically. In many of the Markel Ventures acquisitions, we buy less than 100% of the businesses on day one. In each and every case, agreements with specific valuation mechanisms have been put in place, by which Markel will acquire additional ownership over time and move towards 100% ownership.

When we buy 100% of a business, the price we pay logically goes directly on to our balance sheet and consolidates into Markel Corporation's financial statements. Under accounting rules, which are confusing to me, if we buy, say, 80% of the business that amount goes on the balance sheet as you would expect. When we buy the remaining 20% that stub amount is expensed as a period expense through the income statement and doesn't get placed on the balance sheet as an asset. We've already done this once when we bought the additional 20% interest in AMF that increased our ownership to 100%. That transaction took place in 2010.

With this non-controlling interest item, we're essentially putting up a provision against our comprehensive income and providing for our expectation of what we will pay over the next several years for the additional minority interest we expect to buy in several of the Markel Ventures entities. I’m thankful for my accounting degree but I never expected to use it like this.

I don’t think the treatment follows economic logic but those are the accounting rules as they currently exist and we follow them conservatively. For additional discussion of this topic, I encourage you to read Page 15 of the 2011 Berkshire Hathaway Annual Report where Mr. Buffet writes about this exact issue in conjunction with the ongoing acquisition of additional percentage ownership of his Marmon subsidiary.

I apologize for spending this kind of time on these subjects as well as subjecting you to my philosophy about them, and I appreciate our dedicated and hard-working accountants that spend a great deal of time and diligent effort to understand and comply with the increasing codification of accounting rules. But, I think it’s worth covering. Unless we all understand and appreciate what goes into comprehensive income, accounting treatment and total economic returns, we won’t fully understand and be able to reasonably measure the economics occurring at Markel.

Over the years, investors have accorded Markel a premium multiple compared to many of our peers. I think this is the result of our history of producing excellent long-term returns as measured by the total comprehensive returns of the business as well as having confidence in the conservatism and the dependability of our accounting. A premium multiple also comes in the belief and faith that we will continue to be able to allocate our capital well in the future and earn above-average returns from doing so as we have in the past.

What makes me so excited is that we have more prospects and opportunities to effectively allocate capital than ever before in our history. We have the imagination, the creativity and the discipline of execution to make our dreams real. I like our hand. We are now all delighted to discuss our comprehensive results that we are reporting today, and we hope that you share our optimism about the future.
With that, Manny, if you’d be so kind as to open the lines for your questions. Thank you.

Question and Answer

Operator

[Operator Instructions] Our first question is from Mark Hughes of SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

In terms of pricing, it sounds like things are getting better in North America. In talking about the marine and energy and cat exposed properties, though, you did suggest that the pace of improvement has moderated recently let's say. What do you think about the broader P&C environment in the U.S.? Is this moderating as well? Or, are you continuing to see progress?

Richard Reeves Whitt
Co-CEO & Director

The thing I think you've got to recognize is those lines of business in London, they probably started strengthening before some of the other lines, some of the U.S. lines as an example. So, the price increases we're getting in energy and the price increases we're getting on the cat exposed stuff, that's on top of price increases we were getting last year.

So, it doesn't surprise me given that there is still a decent amount of capacity out there that we're not going to continue to see increasing price increases unless we start to have events or something else happens, capacity starts to leave. So that doesn't surprise me a lot. I think what Mike would tell you and what Mike said about the second quarter is actually we saw some incremental improvement in the price increases in the U.S.

Francis Michael Crowley
Vice Chairman

Yes, I agree. And, I think - I don't want anybody to think that the world isn't still competitive out there because it is. But, so far, we've been working hard to get rate and we've been successful in doing it. And I think you also have to keep in mind that the way we price our products, we're not - a lot of times we're not the cheapest guy out there, so we're starting from a different position than maybe some of our competitors are that might be reporting larger rate increases. But the market is fairly consistent. There are still some lines like the medical malpractice that are very competitive. But, we have been making progress.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Got you. The systems you talked about, the - how broadly are those going to be implemented? Is that across most or all product lines and then how much more granular or timely is your information going to be?

Richard Reeves Whitt
Co-CEO & Director

Well, right now it's across really the wholesale division and so it's all the systems. It aggregates all the information up there. Over time, we'd love to expand that to the Specialty areas as well. London has their own sort of systems in terms of looking at their information.

It's a good bit more granular than what we've had in the past. And, we were having to do a lot of work to combine the information. So, we're pretty excited about it. We're able to give our underwriters and product line guys a lot more to work with now to manage their portfolios. So, I think it's a real step forward for us.

Operator

The next question is from Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions; on the E&S business, the premium growth slowed pretty considerably from the first quarter growth rate. I'm wondering what's behind that.

Francis Michael Crowley
Vice Chairman

Well, we did have an earlier close this year than we did last year. That had a little bit of an impact on it. I'm not going to quantify that because we'll just have to deal with it next quarter if we did. But, I think the growth rate, we're comfortable with. As I pointed out, we've been working hard to reduce the number of - I wouldn't use the word useless, but the number of submissions that we get where in reality we have very little opportunity to write business.

And we've been more focused on spending our time on stuff that we really want to write, and we're starting to make some incremental progress there. Other than that, we feel very good about where we are in the E&S segment. We feel very good about our submission flow. We feel very good about our buying rates and are very optimistic about the rest of the year.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess it does jump around a bit quarter to quarter. If I looked at the first half results, is that a better indication?

Francis Michael Crowley
Vice Chairman

Probably.

Richard Reeves Whitt
Co-CEO & Director

Yes. Jay, this is Richie. We do have a - Mike just mentioned, we're constantly adding products, but at the same time, we're constantly looking at products that aren't performing and we'll discontinue those if they're not performing. We have a little bit of noise in the numbers around some of those exited lines, and so there is a little bit of lumpiness between the first and the second quarter. So, I think looking at the growth rate over the first 6 months is probably a good way to look at it.

Francis Michael Crowley
Vice Chairman

Yes, I agree.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Great. And, then the same question in London, I'm not sure if currency played a role here, but the growth rate had been double-digit and it slowed down to about 2% on a written basis.

Richard Reeves Whitt
Co-CEO & Director

We've got some seasonality obviously to the book in London. A lot of places - where we're getting a lot of the price increases as well as we were writing more premium is the cat exposed business and January 1 and April 1 are big dates for that but January 1 in particular. So, there is a little bit of seasonality there. But, again, I'd probably look at the 6 months' growth rate and that's probably a pretty good proxy.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

That's helpful. And then, the last question the tax rate, just given where you made your money, and a lot of it came in the underwriting side obviously given that huge reserve release, the tax rate to me seems a little low. And, I can talk offline about this but is there anything in the tax rate that distorted things at all this quarter?

Anne Galbraith Waleski
Executive VP & CFO

No, nothing unusual and I'm happy to take it up with you offline. But, there's nothing odd in it.

Operator

The next question is from David West of Davenport.

David McKinley West
Davenport & Company LLC, Research Division

Probably a question, one for each of you; first, Anne, on the accounting side, on the prospective adaptation of the new tax expense accounting, I think earlier you estimated about a $43 million impact for the full year. Is that still a good estimate?

Anne Galbraith Waleski
Executive VP & CFO

That's correct.

David McKinley West
Davenport & Company LLC, Research Division

Okay, great. So, we'll - and it'll still be primarily third quarter - more third quarter than Q4?

Anne Galbraith Waleski
Executive VP & CFO

Right. It'll - it's front-loaded. In the first half of the year, you'll start to see the quarter number come down and the whole year should be about $43 million.

David McKinley West
Davenport & Company LLC, Research Division

Great. And then, Tom, when I look at the cost basis of the portfolio, I guess June 30 versus year end, it looks like fixed income basis is down, short term down, but equity up. Is that more of a conscious acceleration of monies toward the equity portfolio?

Thomas S. Gayner
Co-CEO & Director

There is a mild acceleration but it's - I think actually if you look at that pattern, you'd find since the first quarter of 2009 we've steadily dollar cost averaged our way into bigger and bigger equity position and where you could really track that if you wanted to is to look at exactly that, the cost basis.

And that's a reasonable number to look at because our turnover compared to the high-frequency guys at night, we're the low-frequency guys at Markel. Our turnover businesses are very low. So that would be a relatively accurate way of seeing the dollars we're putting in the equity portfolio.

David McKinley West
Davenport & Company LLC, Research Division

And, it's also just a reflection of the alternatives with the low interest rate environment as well.

Thomas S. Gayner

Co-CEO & Director

Yes. But, I would say it is really more driven by the fact that we see equity opportunity. We think that's where we get the best long-term total return over time and we have the balance sheet and the business flow to do it.

David McKinley West
Davenport & Company LLC, Research Division

Right. And, Mike, turning to FirstComp, the premiums written there have increased year over year. The losses that have been recorded this year are also higher than last year. Are those still running within your range of expectation?

Francis Michael Crowley
Vice Chairman

Yes, they are, David. And, FirstComp, as I said, we've given FirstComp a plan and they are executing the plan right on target with our expectations. As I mentioned in my comments, they are getting rate increases.

They are focusing on a geographic analysis, working on moving to areas where there's more opportunity for better business and moving out of some areas where historically the performance has not been good. Last year, we added a couple of states. We added Alaska. We added Louisiana. They are focused on their expense reductions, so we're very comfortable that they're executing exactly like we want them to.

David McKinley West
Davenport & Company LLC, Research Division

Are you continuing to move away from California?

Francis Michael Crowley
Vice Chairman

Well, parts of California, but there are parts of California that we're comfortable with and they are restructuring their book in California.

David McKinley West
Davenport & Company LLC, Research Division

All right, very good. And, Richie, on the international side you mentioned in the Q that 2008, 2009 were the years for the favorable development. You mentioned it extended across a lot of product lines, but could you add a little bit more color to that? Were there any particular lines that made a meaningful contribution to that favorable development?

Richard Reeves Whitt
Co-CEO & Director

Yes, David. It really was across product lines there. I know that it sounds like a copout but it really was. I think part of the issue is we've been very concerned about how the market has been - was declining in those years, but we were very cautious in how we established the reserves.

And we've had some pretty darn good developments the last few quarters. So, it really was pretty much across. It was professional liability; there was actually some in the property with marine and energy.

It - and then, of course, there was some 2001 and prior where we've been incredibly cautious with those reserves because that's the old legacy business that came to us when we purchased Terra Nova, so we've been very cautious with those and have got to the point where we could release some of those reserves. So, it was a really good quarter. The only thing I'd say is that it was a really good quarter and I wouldn't take that into numbers in the third and fourth quarter.

Operator

The next question is from Scott Heleniak with RBC.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

I was just wondering the THOMCO book, you said you expect $60 million in premium this year and was wondering if you had a target you might be able to share for next year, for 2013? Is it - are you going to get to the - eventually get to the $150 million?

Thomas S. Gayner
Co-CEO & Director

They - the $60 million is a number that we feel we'll book this year. Obviously, THOMCO writes a lot more business than that but we are also transitioning the business to Markel paper from other carriers and so the ability to forecast exactly what the slippage might be there is not something we want to do at this point. But, their volume was considerably more than $60 million.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then I just want to touch on the Markel Ventures. Tom you mentioned some investments that you're making there. I was just wondering if you could elaborate in maybe some of the areas. Is that across the board or was there a few specific divisions you can talk about?

Thomas S. Gayner
Co-CEO & Director

It's across the board. In each of the companies, there are some pretty dramatic opportunities to expand. There are competitors who have more leveraged balance sheets and are having competitive difficulties that give us the opportunity to pick up the businesses. So, we're undergoing fairly dramatic physical expansions in a lot of the different business units.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then just one other one too on Markel Ventures; you acquired 2 Dutch companies in the quarter. Is that - was that sort of one-off? Or, should we continue to expect to see international acquisitions at Markel Ventures?

Thomas S. Gayner
Co-CEO & Director

Well, the - my insurance colleagues were hanging around Holland, so we were in the neighborhood. No, that just sort of happened to be the case. No, the Markel Ventures Company in fact is - Ellicott is the most dramatic example, but they do 80% of their revenue outside the U.S. It's a global company and has been so for decades. AMF, at the time we purchased it back in 2005, might have been 10% or 15% international; probably that's more like 35% or 40% these days. So, a lot of these businesses are seeing international expansion opportunities, and we don't plan on geography. What we plan on is trying to find what the best business opportunities are and going there.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. That's helpful now that you explained that correlation there. The other one is I just wanted to ask about the foreign government exposure you have. Could you just kind of remind us what exactly you have most concentrated, which countries, and whether you've reduced any exposure to any of those - any countries at all this year, whether that's changed much this year?

Thomas S. Gayner
Co-CEO & Director

Well, the good news is that the exposures haven't really changed because we did not have too much in the way of countries where we didn't want to have exposure that you would read about in the headlines now. What we do is we try to match the liabilities of our insurance policies and the - we take in premiums in euros or sterling and we're going to make a claims payment in one of those currencies.

We buy bonds in that currency to the best of our ability to match that liability and we buy the very highest credit quality we can. And, we take the results as they are. We don't try to engineer our results that would be better than what the natural circumstances would create.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay.

Thomas S. Gayner
Co-CEO & Director

Let me come back to your THOMCO question. I'm going to give you a little more clarity on looking forward to - when we acquired THOMCO, the prior year they had placed over $160 million of premium. There are a couple of programs that THOMCO wrote, a couple of their smaller programs, that we probably won't move to Markel paper because it's a different underwriting appetite than what we have. And so that could give you a little more clarity on THOMCO.

Operator

The next question is from Ron Bobman of Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had a question on E&S and Aspen. On the E&S front, I was wondering if you would - you touched on you're happy with your - I think it's sort of app counts and your buy-in rates. Would you give us some metrics on how those 2 stats compared Q2 this year versus Q1 this year?

Thomas S. Gayner
Co-CEO & Director

Slightly better. It was not a lot of difference.

Ronald David Bobman
Capital Returns Management, LLC

Okay, marginally better but not all that dramatic.

Thomas S. Gayner
Co-CEO & Director

Yes.

Ronald David Bobman
Capital Returns Management, LLC

And, then I had a question about Aspen and changes there. Will Aspen in - I wonder if you could share with us California rate changes for Aspen of late and....

Thomas S. Gayner
Co-CEO & Director

I don't have those in front of me. We'd be happy to talk about it but it's not inconsistent with our rate increases elsewhere, which has been in the neighborhood of around 5%.

Ronald David Bobman
Capital Returns Management, LLC

Okay. And, will it be - should we think of Aspen shrinking this year compared to last?

Thomas S. Gayner
Co-CEO & Director

No. You mean in California?

Ronald David Bobman
Capital Returns Management, LLC

Well, either way. Yes, I was thinking California.

Thomas S. Gayner
Co-CEO & Director

At this point, they're not shrinking in total.

Operator

[Operator Instructions] And the next question is from Meyer Shields of Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Two quick questions, I think, if I can; one, on the international or the London side, we saw the expense ratio up 300 basis points sequentially. Is that a consequence of the reserve releases?

Thomas S. Gayner
Co-CEO & Director

It's 2 things. It's the deferred acquisition accounting which - how many points is that?

Anne Galbraith Waleski
Executive VP & CFO

In London?

Thomas S. Gayner
Co-CEO & Director

In London. Anyway, we'll find that. The other thing is with the significant reserve releases, we've got better bonus accruals going up so it's interesting there. We - you put up - you have prior-year reserve releases but there's no such thing as prior-year bonus expense that goes against this year's bonus - this year's expense ratio. So, a little bit of a mismatch when you think about it.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And, when we calculate the tax rate for the London segment, should we be using U.K. corporate tax rates?

Thomas S. Gayner
Co-CEO & Director

Can you say that one again? I'm sorry.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes. I'm just - if we try and break up the expected tax calculations based on the geographic regions [indiscernible]. I guess, is that reasonable? Should we use U.K. corporate tax rates for the London Insurance Market segment?

Thomas S. Gayner

Co-CEO & Director

No, the way that U.S. works is it taxes you at 35% on everything you make in the world. So, I mean really the thing you should think about probably is we pretty much have a 35% rate other than our muni portfolio which is not taxed.

Operator

Our next question is from Adam Klauber of William Blair.

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

What's your overall loss trend in workers' comp for 2012? And, I guess what's that trend in California, workers' comp?

Thomas S. Gayner
Co-CEO & Director

I don't have those with me. I don't have that information here.

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

Okay, that's fine. As far as THOMCO, what - are those programs rolling right now, the programs you're keeping, the main ones?

Thomas S. Gayner
Co-CEO & Director

They are pretty stable. They are in the transition. We're being very careful and trying to be efficient in what we're doing because we are transitioning from another company's paper to our paper, which requires notices and everything else. But, they are very stable.

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

Okay. And, then finally on the Lloyd's reserve release; you have had significant redundancies but this is a bigger number. Could you do some review or why was the number that big this quarter?

Thomas S. Gayner
Co-CEO & Director

Well, really we didn't do anything differently. We've - like I said, I think we were probably - if anything, we've been fairly cautious the last few years given the decline in the market. And, 2008 and 2009 have gotten to an age now where you can believe what you're seeing in terms of development. And that really drove it more than anything.

We are very, very consistent in terms of how we work with reserves and put up the margin in safety in terms of those reserves. So, nothing really changed other than just we've gotten to a point on those 2 accident years where you can believe what you're seeing.

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

Okay.

Thomas S. Gayner
Co-CEO & Director

And I want to just emphasize one point about the reserve release discussion. We're talking about geography on the right-hand side of the balance sheet in terms of accounting, whether it's in the loss reserves or retained earnings by the time reserves are released.

The good news is that over on the left-hand side of the balance sheet, the assets, the number is unchanged. The cash was collected a long time ago; it's in the investment portfolio. It's making money sort of no matter what geography you have it on the right-hand side of the balance sheet. And, I think that's a fundamentally important point that goes into the comprehensive economic thinking of the way we run things around here.

Operator

Thank you. We have no further questions in the queue at this time. I would like to turn the floor back over to management for any closing remarks.

Thomas S. Gayner
Co-CEO & Director

Thank you very much. We're glad you joined us. We look forward to seeing you again soon. Thanks. Bye-bye.

Operator
Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.