S&P Capital IQ

CONTENTS

The Hanover Insurance Group, Inc. NYSE:THG

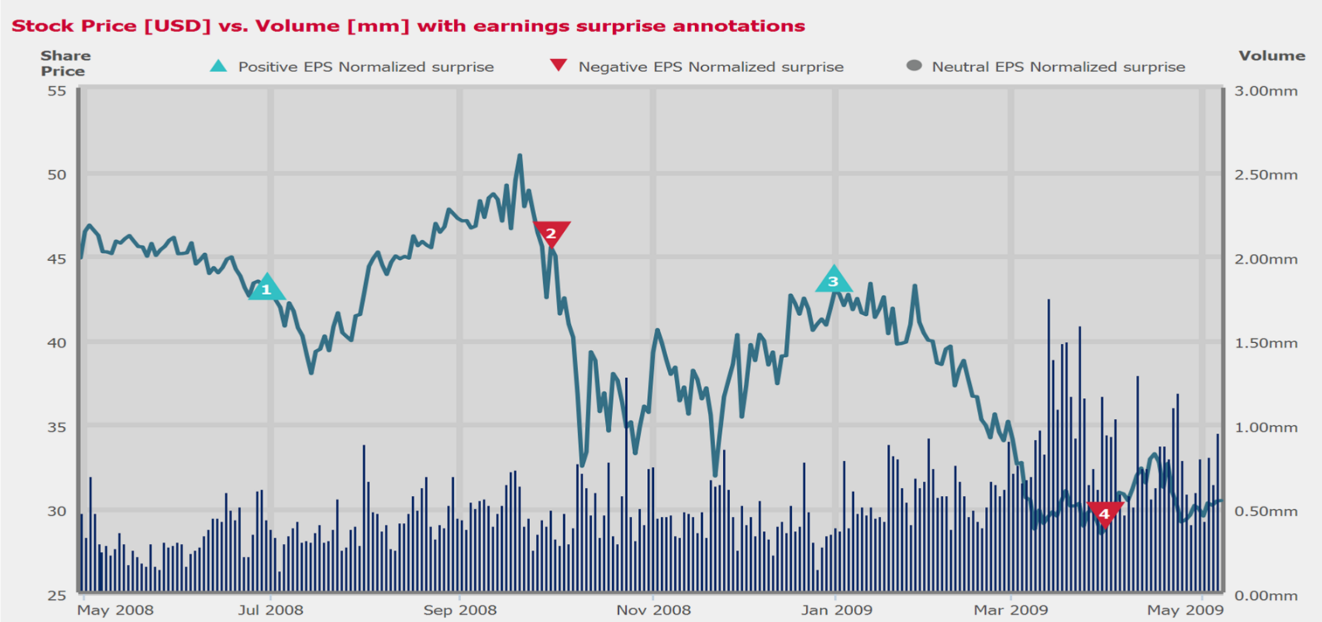
FQ2 2009 Earnings Call Transcripts

Friday, July 31, 2009 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.02	0.86	(15.69 %)	0.93	3.48	4.22
Revenue (mm)	657.20	663.10	0.90	673.55	2576.37	2666.07

Currency: USD
Consensus as of Jul-31-2009 5:42 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2008	0.96	1.07	11.46 %
FQ3 2008	0.01	0.07	(58.82 %)
FQ4 2008	1.13	1.16	2.65 %
FQ1 2009	0.44	0.39	(11.36 %)

Call Participants

EXECUTIVES

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Robert Myron

ANALYSTS

Lawrence David Greenberg
Langen McAlenney

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Sam Hoffman
ADAR

Sarah Dewitt
Barclay's Capital

Presentation

Operator

Good day, ladies and gentlemen and welcome to the Second Quarter 2009 The Hanover Insurance Group Inc. Earnings Conference Call. My name is Jonada and I will be your operator for today. [Operator Instructions] I would now like to turn the call over to Mr. Bob Myron, Senior Vice President, Finance. Please proceed, sir.

Robert Myron

Thank you, operator. Good morning, and thank you for joining us for our second quarter conference call. Participating in today's call are Fred Eppinger, our President and Chief Executive Officer; Gene Bullis our Executive Vice President and CFO; and Marita Zuraitis, President of Property and Casualty Companies. Before I turn the call over to Fred for a discussion of our results, let me note that our earnings press release, statistical 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. These include statements regarding expectations of earnings, pricing, accident year results, premiums, expenses and other projections for 2009. 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 to the forward-looking statements 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 total segment income, segment results excluding the impact of catastrophes, ex-cat loss ratios, book value excluding accumulated other comprehensive income and accident year loss 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 statistical supplement which are posted on our website, as I mentioned earlier. With those comments, I will now turn the call over to Fred.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Good morning, everyone and thanks for joining us. As usual, I will open the call with some perspective on our results as well as our current competitive position and prospects. Marita and Gene will follow, providing additional insight into our results and relevant trends.

The second quarter, while impacted by severe non-cat weather, leaves us pleased with the progress we are making on our journey. With the first two quarters behind us, we expect 2009 to be a solid year and a year that will position us very well for success into 2010. During the second quarter, we continued to build shareholder value in our company, significantly increasing book value, executing a successful tender offer and resuming opportunistic share repurchases. All in all, book value grew by $5.13 per share or by 13% since the end of the first quarter to $43.75 and an increase of 18% year-to-date.

And while it reflects earnings for the quarter, the biggest driver was the increase in the market value of our high-quality and very transparent investment portfolio. We are pleased to see that the unrealized losses that emerged in the financial crisis were indeed temporary. If you look at Slide 4 in our presentation, you will see that our book value at the close of the second quarter this year is higher than it was at the end of the second quarter last year. We are pleased with this accomplishment given the turmoil in the industry over the last 12 months. We have demonstrated that our balance sheet is as strong as anyone we compete with, and this should position us well for the continued disruption I see ahead.

Turning to our results for the quarter, as you can see on Slide 5, we reported net income of 64 million or $1.25 per share for the quarter, compared to a net loss of 10 million or $0.20 per share in the second quarter of 2008. As you recall last year, we announced the sale of our run-off life business in the second quarter. And as a result, we took a significant write-off of the amount of 66.1 million.

Our second quarter segment income after tax was solid at 44 million or $0.86 per share, although, it was a lower quarter-over-quarter, primarily due to unusually bad weather principally non-cat related. Marita will review a slide with you that will go deeper into our view of the non-cat weather in our property business.

I'm pleased with our premium growth for the quarter, which was at the lower end of our four-year guidance of mid-single digit growth. This is particularly encouraging in light of the competitive market conditions and the economy. I am comfortable with the quality of our growth. Our business mix continues to improve due to the growing success of our strategy. And we are seeing significant momentum in the late part of the quarter and into July, generated by our investments in the business.

We saw pricing improved about 1% in our core commercial businesses during the quarter, and we believe that pricing will continue to slowly improve for us to the end of the year and into 2010. And in Personal Lines, the elevated property losses that we and others have experienced for the last 18 months while a drag on earnings, should provide the competitive environment that will allow us to achieve impactful rate increases.

Many of our regional peers will have to seek substantial increases in this respect due to their weakened capital position, lack of flexibility in raising capital and high-loss experience. This is going to be particularly true in the Midwest. As I reflect on the first half of 2009, I'm pleased with what we have accomplished. Looking ahead to the second half, I believe our competitive position in the market is excellent and solidifying. Clearly, the weak economy and the competitive environment continue to prove very challenging for many companies across the property and casualty marketplace.

While there has been some bounce back in investments, many of our competitors remain distracted and constrained by a variety of internal and external issues. For many, their strained capital basis will continue to create pressure from rating agencies. These companies will be precluded from investing in their infrastructure, people product and service. In some cases, this pressure already is causing them to reduce their presence in markets. While the impact of the disruption appears more incremental than many expected, we believe it is both real and significant.

We see the impact playing out over the next six to eight quarters. For us, given that we do not compete in the national account market, the impact of disruption has first been seen in our ability to hire talent from troubled companies. Clearly, a significant talent trained from the affected companies will further strain their ability to compete, because of this overall talent movement, there's a growing concern among winning agents, particularly the top 1,000 agents in the country. As a result, they are looking for additional strong partners with whom to place some of their best business. We believe we are one of the few companies in the position to capitalize on this need, particularly for more sophisticated mid-size to large agents that have broader product needs.

All that being said, the dislocation in the market has yet to fully play out. It's our own view, that if the current market challenges persist there will be an increasing delineation in the industry of the have carries with the financial wherewithal and the ability to adjust and respond to the opportunities in the market and the have-nots.

As we reflect on our own position, we are very confident that we have what it takes to compete and win over the long-term. The strength of our organization was acknowledged in May when A.M. Best upgraded our financial strength rate to A. And we are just beginning to see the momentum from this upgrade and from the recent investments in our platform. We are increasingly seeing excellent business from our partner agents and this is particularly true among those who are currently with more distracted carriers. We have stepped up our hiring of some talented people and we continue and invest in broadening our product portfolio, especially in our niches and Specialty businesses.

In Personal Lines, we continue to take two different approaches in our core states and our growth states. The primary goal in core states: Massachusetts, Michigan, New York and New Jersey is to focus on profitability. We have significant share in these states and we don't expect to generate substantial growth in these markets, respectively. Rather, we intend to maintain our market share for the most part, while pursuing our desired return. Toward this end, we are managing our core margins, serving our partner agents well and investing in product rounding that improves our mix and improves our partners retention. I believe we will see growth with our partner agents. But overall the growth will be modest.

In our growth states, we are growing share and scale. We are strengthening our partnership with any agents investing in products and infrastructures, so that we can be successfully with the best national companies and deliver significantly better offering than our regional competitors. We believe these investments will drive profitable growth, improve retention and generate increased to-count rounding.

The strategy is working well. In the quarter, we grew premium in our growth states over 5% and we expect it to accelerate this growth in future periods, as significant product enhancements were allowed during the third and fourth quarter. I believe we are building one of the best suites of value-added Personal Lines products for independent agents.

In Commercial Lines, and particularly in our specialty niches, we have achieved strong growth for the quarter, that 9%, in spite of challenging pricing environment and we continue to set the stage for a future profitable growth. We continue to make significant investments in this business both in our core products, as well as our new specialty offering. While these investments put additional pressure on expense ratio, they are essential to our overall strategy. We are willing to take this expense risk in order to take advantage of the disruption in the market.

As we discussed at length at our Investor Day conference in May, we view these investments as critically important. They do not only make sense on a stand-alone basis but they also allow us to grow our share with partner agents across all their lines of business, as we become more meaningful to each of them. Marita will talk more about the specifics of some of the investments we are making in both Personal and Commercial Lines.

Obviously, the turmoil in the financial markets and the disruption in our business are creating challenges for everyone, including us. But without question, we are confident we are up to those challenges. We have weathered the storms well and we are positioned to take advantage of the opportunities as we see them arise. We see the next six to eight quarters as a time of significant opportunity for us. We are more bullish and more confident today than at any time in our journey. We have the financial strength, the flexibility, the agent partnerships, the underwriting capabilities and the service platform needed to generate strong growth at solid profit margins.

Over the course of our journey, we have established a knit competitive position. As we have increasingly fulfilling our vision of being national company with a regional approach, the best of both that we talked about. The recent announcement of our westward expansion strategy is evidence of this. The targeted Commercial Lines and specialty expansion is the result of our building broad capabilities over the last few years, and winning agents reaching out to partner with us on some of their best business.

Lastly, as I indicated on our Investor Day conference, our long-term, enterprise-wide return of goal is 12%. We know the profit utilization of our excess capital is critical. As I said since we started this journey, our P&C company should earn over 12% over this cycle. We remain completely focused on this objective through a prudent balance of growth, margin focus, investments in our company and capital management actions to the extent we don't have visibility toward accretive deployment of the excess capital in our business.

We continue to consider these and other alternatives as we work toward delivering shareholder value and ensuring our ROE targets over the next six quarters or so. I continue to believe that holding excess capital now is prudent. Given the market uncertainty and the potential opportunities that could present themself. But we remain focused on this objective and confident in our ability to deliver. With that, I will turn the call over to Marita, for a review of our business.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Thanks, Fred. Good morning, everyone and thanks for joining us today. With what Fred, discussed as context, I'd like to review our underwriting operations, starting with the discussion of our overall P&C results on Slide 7.

Our second quarter produced 76.3 million of pretax segment income, compared to 94.2 million in the prior year quarter, non-cat weather was a big factor in the lower than expected earnings we generated in the quarter, particularly in Personal Lines. Additionally, the catastrophe impact in the quarter was somewhat higher than we anticipated. That being said, we withstood the weather. Catastrophe and non-catastrophe, relatively well, considering how much of an impact the weather had on the second quarter reported industry results so far.

Net written premiums for P&C topped 663 million in the quarter. This represents a 3 1/2% increase over the second quarter of 2008. The addition of our recently acquired program business fueled our year-over-year premium growth. The combined ratio in the second quarter was 96.4, compared to 94.8 in the prior year quarter. I'd like to discuss the drivers underlying these results in more detail, starting with Personal Lines.

Turning to Slide 8, our Personal Lines segment reported pretax earnings of 26 million in the current quarter compared to 39 million in the prior year quarter. Earnings in the current quarter were impacted by higher ex-catastrophe accident year losses, which were primarily weather-related, lower net investment income and higher underwriting expenses. In the second quarter of the year, we accelerated some technology, product and ease of doing business investments. We plan to continue these investments for the remainder of 2009. While these investments put pressure on our expense ratio in the short term, they will allow us to support our growth initiatives in our newer states and to more effectively preserve margin and market share in our core states. These initiatives should position us as one of the best agency carriers in terms of pricing sophistication and product versatility, and position us to profit from the disruption in the marketplace.

In the second quarter and also in the first half of 2009, we have experienced an unusually high incident of weather-related losses. Ex-catastrophe losses were 11 million or three loss ratio points higher in the current quarter when compared to the prior year quarter, primarily driven by higher weather losses in our Homeowners Line. Slide 9 graphically depict Hanover's non-cat homeowners weather losses as a percent of premium over the last 10 years. Note that the first half of 2009 has been the worst non-cat weather period for us in the period shown. The years from 1999 to 2003 represent an extended period of normal weather, while 2004 to 2007 were much better than or equal to average. 2008 and 2009 year-to-date have been significantly worse.

From an industry perspective, a recent study done by Munich Re showed that insured losses from U.S. thunderstorms in the first six months of 2009 were 1.5 billion or 30% higher than the trailing 10-year average. So clearly, our experience this year is not unique and has been an industry-wide issue. While it is obviously impossible to predict how weather will impact us in the future, we have taken this trend and increased losses from weather into account in our rate filings in the geographies that we're in. Specifically, seeking and taking increases that should allow us to be profitable in our Homeowners Line even when weather losses stay above average levels in future periods. Because many of our regional peers have experienced the same level and in many cases a higher level of weather-related losses than we have, we do not see our proactive approach to rate increases presenting a competitive issue. In fact, it could result in an advantage for us. Overall, the combination of increased rates to address the recent weather losses, along with our prudent risk appetite and underwriting practices, make us comfortable with the expected profitability of this business. Our business mix in Personal Lines continues to improve, driven by successful initiatives implemented last year to write more account business, to move away from higher risk drivers and to carefully manage our coastal property exposures.

Turning to Slide 10 to discuss our Personal Lines growth for the quarter, net written premium decreased 0.5% compared to the prior year quarter. On a direct voluntary basis, our growth was basically flat. This is notable since excluding rate changes, our average premium per policy declined when compared to the prior year quarter, reflective of plan changes in business mix towards lower risk policy holders. We are seeing sequential and year-over-year improvement in the growth of policy counts which is a better indicator of our growth trends considering the above mentioned mix shift. It's our intention to sustain this upward movement going forward as we anticipate better retention of this business due to the profile improvements.

Our growth strategy in Personal Lines as well as our top line results remained similar to prior quarter trends. We strive to preserve our market share and margin in our core states while growing in the states targeted for growth. This quarter, premium in Michigan grew slightly and PIF was relatively flat. In Massachusetts, premium shrank due to our change in mix while PIF continued to grow. We continue to manage these states carefully and we will not sacrifice margins for growth. On the other hand, that written premium increased 5% in the states targeted for growth with impressive momentum in states like Illinois and Wisconsin. As we look into the second half of the year, we have visibility into continuing profitable growth in Personal Lines which is supported by investments in product and ease of doing business enhancements, new book transfer activity and our commitment to the independent agency channel, which we know is very important to our partners.

Now moving on to Commercial Lines, pretax segment income in the quarter was 51 million, compared to 53 million in the second quarter of 2008. Catastrophe's were 7 million in the current quarter compared to 13 million in the second quarter of last year. On an ex-cat basis, the current quarter combined ratio was 89% or three points higher than the prior year quarter.

Our Commercial Lines underwriting expenses were higher in the current quarter compared to the prior year quarter, reflective of continued investments in product, distribution and infrastructure in new and existing lines of business and geographies in order to take advantage of the market disruption that we see. We have previously discussed some of these items with you. For example, we continue to build out our bond and in the marine platforms, we're expanding our niche product, such as our new Human Services offerings and specialty offerings, such as Management Liability.

Our planned expansion into selected western states leading with certain specialty and niche offerings and expanding to franchise agency relationships in select territories, was launched this quarter with the hiring of a new western states regional president. As we've discussed in the task, expenses were also impact by increased pension costs. Higher ex-catastrophe exit at year losses were also a driver for the lower current quarter results. The ex-cat, ex-development loss ratio was 46.6% in the current quarter, compared to 43.9% or 2.7 points higher. This increase was driven by a few large losses in our other commercial product lines, as well as the difficult comparison in that other commercial loss ratio, which was unusually low in the second quarter of 2008.

Large losses, as we've discussed before, can be lumpy in any given quarter. Our loss experience was favorable in the past several years and we expect it to come back to more normal levels going forward. Our review of second quarter losses does not indicate any emerging trends. Loss ratio trends and all other lines continue to be favorable, reflecting our underwriting discipline and prudent risk management. As we've stated many times before, we prefer to take expense risk over underwriting risk.

Now turning to growth on Slide 12, our 9% net written premium increase in Commercial Lines reflected the impact of our AIX acquisition, as well as growth in our Professional Lines and segmented middle market products. We are extremely pleased with the substantial traction that AIX achieved in the first half of the year, validating the synergies gained by combining our businesses.

Hanover's retail distribution are A rating and building of the Hanover franchise contributed to AIX's top line in the quarter. Also, AIX served to developed a very promising partnership with locked in companies, which we expect to allow us to underwrite business through several locked in affinity programs. These programs are expected to contribute to our premium growth in future periods and to help us build our franchise in the West, where we are expanding our footprint, as I mentioned previously.

Our other specialties continued to gain momentum, as well. Middle-market niches had a great quarter with growth of over 11%. Our Hanover Professional unit, which grew 60% in the quarter, continues to give us high-quality business from a limited number of committed agents with lawyers professional liability capability. Growth in our traditional Commercial Lines, however, was somewhat dampened by a slower than expected pricing recovery, as well as current economic climate. While our rates in small and middle market accounts were marginally positive in the current quarter, our conservative approach to evaluating risk and our higher margin standards put additional pressure on our business volumes in those areas.

Overall, putting aside the weather, an isolated large loss activity that I discussed, our Personal and Commercial Lines produced results in the quarter that is in line with our expectations and our long-term strategy. In general, we're satisfied with the direction the market is going and although we hoped for a relatively quicker turn in pricing in 2009, we do see a turn in the right direction based upon what occurred in the second quarter.

Also as Fred discussed, we're just beginning to see the benefit of the disruption in the marketplace, as well as a lift from the increase in our ratings and we believe we are extremely well-positioned to benefit from these factors. And with that, I'll turn the call over to Gene.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Thank, you Marita and good morning, everyone. I'll begin my presentation with a discussion of our full-year outlook. As we announced last night, our second quarter operating income was $44 million after tax or $0.86 per share. As Fred and Marita mentioned, weather played a role in our lower than expected earnings. And based on our year-to-date results and refreshed outlook for the remainder of the year, we are adjusting our full-year pretax segment earnings outlook to a range of $310 million to $325 million. Pretax segment earnings, excluded interest on corporate debt and realized investment gains and losses.

Our revised outlook reflects an assumption that the weather related losses we've experienced so far this year, are not offset by better than expected weather losses for the remainder of the year and therefore, will be consistent with our original assumptions. Revised outlook also incorporates an acceleration of certain product development and operating model expenses, expense initiatives we've undertaken. There are a number of other assumptions underlying our outlook. With the exception of the two I just mentioned, these assumptions are essentially unchanged from our previous guidance. That said, let me take a moment to cover several of the assumptions.

Combined Personal Lines and Commercial Lines, we expect to achieve mid-single digit net-written premium growth. While we still expect to improve our accident year loss ratio in the second half of this year relative to 2008 results, our full-year 2009 accident year ratio will likely be in-line with the full-year 2008 ratio, reflecting a higher than expected level of non-cat weather in the first half of the current year.

We assume full year catastrophes of 4.1% of net earned premium. We continue to expect lower prior year development, as compared to actual amounts in 2008. We expect an increase in our full-year total expense ratio of between a point and a point and a half, driven by increased pension costs and other investments in the business. We expect an effective tax rate of 33% and we are assuming average shares outstanding of 51.4 million.

I would now like to turn our attention to the balance sheet starting with a review of the company's investment portfolio. I'm now on Slide 14. As Fred highlighted earlier, our investment portfolio continues to be a source of strength for the Hanover. At the end of June, we held 4.9 billion in cash in invested assets, including assets in our discontinued accident and health business.

Cash and fixed maturities with a carrying value of 4.8 billion, represent 97% of our portfolio. Nearly all, a roughly 93% of our fixed income securities are investment grade and our below investment grade securities are principally, actively managed high yield corporates with very few fallen angels.

As we disclosed in our statistical supplement last night, at the end of June, we held a relatively modest position in CIT, which we sold earlier this month at an insignificant loss. Another asset class receiving attention is Securitized Commercial Real Estate. Recently, rating agencies have been forewarning taking certain downgrade action of CMBS. Those actions have had little to no effect on our holdings and we expect no material impact based on current available data from the rating agencies.

Net investment income from continuing operations in the second quarter, was 61.3 million compared to 63.8 million in the prior year quarter. The slight decrease in NAI this quarter reflects a combination of lower income due to bonds that defaulted in the second half of 2008, as well as lower partnership income and lower new money yields. The earned yield in our fixed income portfolio has remained relatively flat by 61 of the first of 2009 compared to 560 for the same period last year. New money yields offered in the first half of 2009 tended to be modestly lower, as our new money rates for the first half of '09 has been above 4 1/2%.

As we look to the second half of the year, we expect net investment income to be comparable to last year's second half results. While we have kept all of the usual investment portfolio disclosures in the presentation deck, I'll not go into the detail on every slide. Instead, I'll focus on some new disclosures on our municipal bonds since municipal bonds in general, is emerging as a point of concern for investors.

As of June 30, 2009, we held 776 million of municipal bonds with a weighted average rating of AA-. We are very comfortable with our municipal bond portfolio composition, as it's very highly rated and well diversified. Our portfolio is predominantly taxable munis as -- because we're in a rather large alternative minimum tax-carry forward position, we do not have an appetite for tax exempt bonds at this time. As a consequence, the vast majority of our bonds, our revenue bonds, as opposed to general obligation bonds, which or more of a tax exempt concepts.

Financial guarantor insurance enhanced municipals represent 335 million or 43% of this portfolio. The overall credit rating of our insured municipal bond portfolio, given no effect to the insurance enhancement, is A-. Our muni portfolio is very well diversified, both by geographic region and on a state level, also by municipality and project type.

As you can see on the slide, California bonds represent only 4% of the overall muni portfolio in our all investment grade. They predominately represent obligations of local level municipalities, which are generally in a better financial condition compared to California State Government. Also, we are very comfortable with our municipal bond holdings. Overall, we're very comfortable with our municipal bond holdings and we intend to add to our taxable muni position in coming months, as we see value in this market. In the longer term, as AMT (Alternative Minimum Tax) credits are utilized we will consider additional tax-exempt bonds.

Moving on to a discussion of our unrealized losses for the quarter on Slide 20. During the second quarter, we saw a significant improvement in our net unrealized loss position by over $190 million to $72 million at June 30. Improving credit spreads, combined with relatively stable treasury rates helped boost market values, within our fixed income portfolio.

Our net unrealized loss at the end of the quarter, includes $45 million of losses identified as other than temporarily impaired. As required, we adopted FASB's new accounting standard in the quarter. As you can see on the slide, 33 million of a $45 million of OTTI carried as unrealized losses, reflects the cumulative effect we recorded upon adoption of the new standard. The other side of a $33 million entry is an increase in retained earnings, so it had no impact on our book value.

At the end of the quarter, the only security classes within our portfolio that had notable net unrealized marks were our CMBS holdings and below investment grade bonds. We have done numerous sensitivity tests to determine default probability in all of our fixed income corporate holdings. Based on our analysis, even our most conservative assumptions indicate defaults below those implied by the current marks. Our CMBS holdings exhibited a positive trend versus the market in the past several quarters due to the relatively high quality of our portfolio. And we remain confident that over time, the market prices will reflect the economic value of our CMBS holdings.

Turning to Page 21, for a discussion of our lease and capital management actions. Our strong capital position allowed us to undertake several capital actions in the second quarter. We successfully launched and completed a Tender Offer to repurchase a portion of our outstanding debt. Through that offering, we bought back 77 million par of our senior debt and 69 million of capital securities.

Separately, we were holding 65 million par of our capital securities, which we had previously repurchased at a discount in the open market. As a result of the tender and the retirement of the debt that we already owned, we realized that after-tax gain of $22 million or $0.43 per share in the quarter. We repurchased the debt in order to reduce our debt cost rather than delevering the company.

We received approval of our membership in the Federal Home Loan Bank of Boston last evening. The cost of money we expect to borrow through the FHLB is attractive compared to the debt we repurchased. We expect this interest cost savings to be about $4 million annually, assuming equivalent borrowing levels.

We also repurchased company stock in the open market during the quarter. In June, we bought back approximately 192,000 shares for about $7 million. Additionally, since the end of June, we have bought back another 110,000 shares of common stock for $4 million through a 10b5-1 plan. This plan expires today leaving us approximately 29 million remaining on the current share repurchase authorization of 100 million. Looking ahead, it is our attention to be opportunistic about further share repurchases.

On Slide 22, we've displayed changes in our book value, which improved by 13% in the second quarter of 2009. The improvement was primarily driven by a decrease in net unrealized losses in our investment portfolio of $191 million or $3.76 a share, as well as segment earnings in realized gains from the completion of the tender.

On Slide 23, we have some few metrics that highlight the strength of our balance sheet. Our GAAP equity grew 13% in the quarter to 2.22 billion. Our debt to total capital came down during the quarter, resulting from the debt repurchase, mentioned earlier and is now at 12% giving no equity credit to the capital securities still outstanding. You should see that rise back to the high teens through borrowings through the FHLB facility.

On the liability side of the balance sheet, our loss in LAE reserves remain strong. We believe our loss fix are properly conservative and we also continue to report a margin of about 5% between carried reserves in our actuarial indications. Holding company cash and investment securities was approximately 193 million at June 30. The reduction in holding company liquidity reflects the debt repurchase and retirement during the quarter. As I just mentioned, we expect to relever with FHLB borrowings and add to our holding company resources through the reallocation of capital from our operating subsidiaries.

In summary, our goal is to use our capital as effectively as possible to strengthen our organization, take advantage of growth opportunities and ensure that we are positioned to win in the long-term. With this, I'll turn it back over to Bob.

Robert Myron
Thank you, Gene. Operator, that concludes our prepared remarks. So, could you please open the line to questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Michael Phillips with Stifel and Nicolaus (sic) [Stifel Nicolaus].

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

How does your Commercial Lines grow compare in your states where you are only Commercial Lines versus -- or your both Commercial and Personal?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

It's a good question. I don't think we see a substantial difference. It depends on the makeup of the individual agency. Those agents that are franchised agents for us we, obviously, use both Personal Lines and Commercial Lines together to create a complete value proposition. But in Commercial Lines, our offerings are pretty robust when you add them all together with our niche offerings, our new specialty offerings, as well as what we've built and invested on the core commercial side. So, it really does depend on the makeup of the agent. We're not seeing a huge substantial difference between Commercial Lines growth when we combine it with Personal and when we don't. If you look at Texas, for example, our growth numbers are very good in Texas and that's a place where we don't offer Personal Lines. So, we really tailor our offering based on the agent and bring a pretty good value proposition to them, whether we offer the Personal Lines or not.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

That's a great question, Mike, because I think that it -- what has fundamentally changed in the last 12 months is that we hit critical mass and breadth of product in Commercial Lines, right. Before, five years ago, we are essentially a small commercial writer, classic regional company without a lot of diversity and capability in commercial. We now have a breadth of middle market niche, specially capabilities that make us very important to all the good agents. So we have gone to be able to position ourselves with just mid-sized agents to some of the real significant agents, winning agents. And so as you look at us, the reason I'm more aggressive about thinking about states where we don't have Personal Lines now is we have plenty of product that's distinctive for the top 1,000 agents in the country. So, you didn't see a lot of that previously. It's in Marita's point. In Minnesota, it was Texas, it was a pretty narrow group of states that we did that in. We are now very, very confident in our ability in both ways to be relevant to the best guys and get preferred shelf space.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Which is why the timing of our "Go West" strategy is perfect, because now with that robust Commercial Lines offering we can go west initially, without Personal Lines and get the growth commensurate with that kind of investment.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. So when you say "Go West", how do you define? What's the threshold of how far west or not west you're going? Midwest, all the way out west?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes. Essentially, all the square states in California. So we are picking up -- January 1, is really when the full complement of products are going to be available. And so essentially, it's all the states you can think of. I mean, it could have eight or 10, most significant ones is where we're starting. But it's essentially our ability to go across the country now. So, again we will -- some of the smaller ones, we're not going to do Montana right now or stuff like that. But the significant states we are going to go. And again, what's interesting about it is that this isn't something we've not thought about since the beginning, right. We have reached out and then talk into the winning agents in those states and have a very specific game plan. And frankly, many of them reached out to us three years ago and started talking to us about this. So, we feel that we are very, very prepared and ready to go into those states and get books of business moved our way with very good margin, day one. So, I feel very, very comfortable with where we're going and how we're doing it.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

A two-pronger on your core states. One in for Michigan and one for Mass. Are you seeing any changes, I guess, i.e. improvements in personal auto loss trends in Michigan? And then on Mass, any pressure on market share there for auto?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Yes, I mean there's been a lot of talk in the industry and I know you've seen some of the results, as well as far as less miles driven and less driving occurring in Michigan. What we're seeing across the board in Michigan are relatively flat trends. It's a very profitable state for us, it remains a very profitable state for us. We obviously manage it very closely vis-à-vis what's going on in the economy. But it's been a good source of earnings for us and the trends have been relatively flat there.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes, and in Massachusetts, I think, you've seen the data that came out from the state, we are significantly better. I think we're the best significant player, as far as margins in Massachusetts. We've done very well as far as our mix and is transitioned to competition. As far as share of Mass in Marita's point, we believe we're going to be able to hold share in Mass. Although, what I think is going to happen, is we're going to grow with our core winning agents that sell value, and then in some of our more traditional agents that we've had historically, I think we'll shrink some share as they become more price sensitive with the entry of GEICO and some of the other folks. But to date, we've had actually a very significant, probably unique approach as we help agents kind of move their books to us. We've been reaching out to their customers and cross selling and up selling and what we're seeing is both a rounding impact but a pretty significant retention impact. So, we've actually got something that we are packaging, if you will, and going through the rest of our states. We've been able to help agents sell value and protect themselves from aggressors. So, we continue to do well in Massachusetts. I think there's maybe one other agency carrier that has grown like we have, as far as market share so I think we're as good as anybody that exists right now in Massachusetts and I feel that's going to hold.

Operator

Your next question comes from the line of Sarah Dewitt with Barclays Capital.

Sarah Dewitt
Barclay's Capital

Could you elaborate on what the response has been from customers and agents after the A.M. Best upgrade? Are you seeing much more in terms of business flow?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes. Again, it's really -- it's funny because in some ways, it feels like forever but we got it in May. So what's fascinating about it is, those renewals are prepared for people 70 days in advance. So what's really been interesting is, I think that everybody knew we were going to get it eventually. I also think that people know our story of how much stronger our balance sheet is and how we've been upgraded by all these rating agencies against the wind. But for me, it was the biggest thing I've ever seen in the industry as far as agents reacting to something. We got hundreds and hundreds of e-mails about it. If you talk to our folks, it's because of the contrast of what's going on. I think it's less than A- to A than it is the fact that everybody else seems to be going in the opposite direction. We have been able to get tremendous positioning. We have some of the best agents in the country. And again, so I would tell you that from a business perspective, it has given us a lot of confidence in what we're doing on the Specialty Lines, particularly cash, D lines, et cetera. And so we are just seeing the impact. I mean, we saw in July 1 renewals, we saw it in June as far as what we're seeing and how many agents are approaching us for bigger partnerships. But again, I don't think anybody didn't expect it. I just think that it has -- people said it was a big deal given where we are in the marketplace. I would also say that an A is more important today than it was 12 months ago. I mean, people are concerned about, for obvious reason, financial stability of companies and so they're looking for additional partners. And so this happening at this moment in time has really helped us. And I would also say that it's helped us tremendously in recruiting the folks we're recruiting in Specially Lines of business, particularly in places like bond and some of the real estate areas, because it obviously is much more important in some of those segments. So I think we're just seeing it. As I said in my prepared remarks, what's fascinating about it is, I think people thought with the big disruption of the big companies, everything was going to change immediately. Our business is slower than that. Except for national accounts and things like DNO which moves a lot quicker, what you're seeing is a steady shift of share just and again, I would say this quarter picked up more than the first quarter as people are looking for a better diversification of their risk, agents are with some of the stronger players, particularly in what we do in the middle market accounts and the smaller accounts, it's just now I think it's starting. So again, I think this is a fundamental shift for us and an ability to kind of position ourselves as one of a handful of alternatives that have this breadth of capability for the top 1,000 agents in the country. So again, I think it's a big deal and it became bigger because of what happened in the marketplace in the last 12 months.

Sarah Dewitt
Barclay’s Capital

Can you also outline how you expect to get to your mid-single digit growth target for '09 given you're running about 2% for the first half of the year?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes. Again, as we said, it was a couple of reasons for that. Clearly, I believed when we set the guidance at the beginning of the year, this was going to build. We were anticipating the rating increase. We we're anticipating our building out of some of our niches which we've launched a number of things. We had a lot of new product offerings. We had teams, as you know, that we had acquired, that we had built out and got the operating model in place. We had transparency of more book thinning and book we're all building from the year. And so we believe our momentum will continue. I think in Personal Lines, I think it's going to be harder. You're going to see continued increase in the growth states but I think you're going to see continued flatness because of the economy in some of our core states. And the growth states, I think you'll see momentum on the growth. And in Commercial, I think we're going to continue to build. So I think again, we're going to be around, as we've guided, around that mid. And again, I'm not -- if some of this takes an extra quarter, we're going what's right to margins. But what I see is, I have a lot of transparency to the kind of quality of business we're seeing and what's happening in Specialty. As I said, we have a lot of products. We talked about it at Investor Day, we have a lot of products that are new to the market in the last 12 months that we have built or we used from the acquisitions we did that we now have in place and an operating model and are reaching out to our partners. So I feel good about it. Again, the trends are very strong and very visible for us. And I don't know, Marita, is there any other thing that you mentioned...

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

No, I mean, the fact that we already have a 9% growth rate in Commercial Lines that will continue to ramp up with what we've built in that space and then combined with the Personal Lines investments we've made in product and ease of doing business. And also some investment in the small commercial space, that's going to begin to get traction, as Fred said, and begin to ramp up and combined with that already strong growth number that we're seeing in Commercial Lines. So no reason why the trends won't continue to move forward.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

And again, the one place and we've been very explicit about it, forever, the way we think about Michigan and Mass in Personal Lines is that we're going to take rate. We're going to be at the returns we need. If the market doesn't react, will it shrink little bit, sure, but we'll hold our margin and we'll be fine. But our expectation is because, and particularly in Michigan and the full Midwest, the regional companies took huge shift. Most of the people we compete against in those locations, our regional companies are in two states, a lot of those folks are running 117s, 120s they have to take rate which gives us the ability to do because they were way behind us on rate. And so that gives us, in our view, the ability both to hold share and either hold or increase margins, so I feel relatively confident that we'll see that.

Operator

You're next question comes from the line of Larry Greenberg with Langen and McAllen.

Lawrence David Greenberg
Langen McAlenney

Can you give us a distribution for your cat losses and could we assume that the non-cat weather kind of track that pretty closely? And then secondly, can we get what partnership investment income was this quarter versus a year ago?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

I mean I'd be glad to talk a little bit about the cat, non-cat issue and I think this will address your question. We've previously disclosed how we think about cats and what goes in that cat bucket and we would include PCS cash plus any event that's over 5 million for us. On the non-cat weather, you could imagine that, that requires an individual claim review and what we do is we look at weather related claims were the approximate loss of the claim was due to weather in that time period where the weather occurred and add that together. In our systems and as we review these, it's easy for us to look at what weather-related losses drove that loss. So, that would be anything that wasn't included in that cat definition that we've previously disclosed.

Lawrence David Greenberg
Langen McAlenney

Marita, I was actually looking for geographic distribution.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

I'd say it's roughly what it was with cats. So the second quarter, it's a little lighter in New England because if you remember, the first quarter we had that -- the freeze and in to the second quarter, it was midwest, some Massachusetts got some hailstorm activity, but it was essentially the midwest and throw in Arkansas -- it was kind of Arkansas, Indiana, Illinois, Michigan, Ohio obviously got hit.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

It was an interesting combination of midwest tail and northeast thunderstorms, and just an awful lot of weather activity...

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

But it did carry well. We can actually look at that and see if there's any, but I don't think there's any aberration, I think it's very similar to what the cats were because in essence it's some of those states, we just had a lot of, what I call kitty cats just hail event, after hail event, right. But it was pretty spread and again the reason -- the one thing I feel good about the weather, five years ago if we had this kind of 12-month period, we'd look like some of these regional companies that are running 116, but our book is so much better diversified now both geographically and line of business. It wasn't as impactful, because it was bad. This last 12 months has been really an amazing weather period.

Lawrence David Greenberg
Langen McAlenney

Some would argue 18 months.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

I think you're right, you're absolutely right. If you look at 18 months, I think that's right. And that's why, by the way and Marita said on her script, it's really important for you guys, we're not assuming that this isn't going to continue. So, what we're trying to do with all rate increases, we're assuming this higher level will continue, I don't think it will, but that's what we're going in with this because it has been 18 months, right. So we are being very aggressive. And again we've started this 12 months ago, so I feel pretty good that we'll be able to continue to just keep pushing through rain.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

These are partnership income, these are very tiny investments. And as you know, this income can be pretty lumpy, and this year was essentially zero. We wrote-off a small balance and last year we had a little bit, so the swing might be $1 million between periods.

Operator

Your next question comes from the line of Sam Hoffman with Lincoln Square.

Sam Hoffman
ADAR

I just wanted to cover a couple of issues that were noise in the quarter. First is the pension costs, and how did those differ from the first quarter? And what pension costs are you assuming in your guidance?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

The pension cost is really flat period-to-period because you really set your pension cost at the beginning of the year. It's running about 8 million a quarter higher than last year which is consistent with our Q disclosures and that's the level of pension that we reflected in our guidance.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

So, again, we were almost very close to completely funded and obviously the financial market, what happened in that third and fourth quarter affected the spread and you see it in our AOCI, too. Now the good news is that when we reset it at January things hold where they are now, a lot of that is going to come back because our amortization schedules are relatively short, but it is what it is, we had it. Now, we don't dwell on it because I believe that we have to vantage around it, we got to figure out ways to cut other costs to get there. So -- but it is a significant number this year for us because of the big changes in the market. And again, most of our pensions, as we've closed to being funded -- 55% of our pension assets are bond, because that's some great bonds. So the spreads had an enormous impact on it, but again, the good news about that is they're back. So when we reset it in January, I feel that we'll get some portion of this back but it is a big number.

Sam Hoffman
ADAR

Do you have any sense of how the 190 million would be if you begin next year today?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

The 190 million refers to...

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

[indiscernible] (1:11:22.0) is that what you're saying?

Sam Hoffman
ADAR

Yes.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

I would say it would be down by about a third.

Sam Hoffman
ADAR

Can you provide more color on the moderate increase in large losses in Specialty Lines? It looks like you had a 9.5% increase in the loss ratio. So are these one time items, or is it something that we should factor in going forward?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Yes, I mean that's a pretty difficult comparison quarter-over-quarter. As I mentioned in my script, there was some loss activity in that other commercial bucket. But as we grow that and it becomes substantially bigger, it's hard to compare that over the prior quarter last year.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

We don't see patterns of it, there was a few and -- but it wasn't anything of any significance and we don't think it's going to be.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

No. No emerging trend, nothing in that, that showed us any concern when we went through the individual losses in the quarter. A really more geography of where it's located than anything else.

Sam Hoffman
ADAR

So you would consider that to be a new run rate?

Marita Zuraitis

Former Executive Vice President and President of Property & Casualty

From a loss perspective, no. From a premium perspective, yes. That's a premium that we're seeing in that bucket should continue, no reason why it shouldn't, we're getting good traction in those businesses. From a loss perspective, a little lumpy in the quarter. And as we've said before, large loss activity tends to do that in some of these smaller buckets. But nothing that is bothering us from a loss perspective in those buckets.

Sam Hoffman
ADAR

So the 49.8% loss ratio, you would consider that to just be, it was a tough comp and so maybe -- and plus it was a little bit worse than expected?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

That combined with the non-cat weather that we've talked that's included in that, that would be correct.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

I'd be more -- tend to focused on the year-to-date.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Actually, you're going to focus on the quarter.

Sam Hoffman
ADAR

Your paid to incurred losses were a 111% in the first quarter and 107% in the second quarter which I guess, relative to other companies is quite high. Can you just comment on that as to whether you expect that ratio to go down, and also what's causing that?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

It's consistent with our patterns. It's driven by the fact that we tend to have lots of winter weather claims and it affects the -- we have relatively short key alliance, it just turns out that way relative to our historical claim payment pattern.

Sam Hoffman
ADAR

And then slightly, there are two items on your income statement called other P&C income and other expenses which over the last -- each of the last two years added $11 million to your earnings and this year so far, has subtracted 8 million. How should we think about those two lines going forward in terms of their expected contributions to earnings?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Look at the quarterly patterns in Q1 and Q2, and that's essentially the run rate that we're at. Recognizing that a big piece of that other expense is a portion of this pension item you were asking about earlier. Well that could get normalized as we look out longer, but this year just the pattern should be consistent [indiscernible] (1:14:52.7)...

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

The other thing is, we did, [indiscernible] (1:14:54.8) if you recall, we sold the AMGRO. So, the other thing that we answer that line historically was AMGRO, which was our premium finance company, which we sold just been a little bit over a year now. So, those are the two, to me, those are the two biggest changes that have gone through that other line.

Sam Hoffman
ADAR

So, basically the revenue should remain roughly where it is and the expense will relate to the pension, and then...

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Yes, that depends on your modeling horizon.

Sam Hoffman
ADAR

In your comments, you had talked about the objective to reach a 12% return on equity. And I guess that had been for the six quarters, now it's over the next six quarters or possibly even longer, is the delay in timing due to the fact that you've had a book value increase because of investment?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

No. Again, at the Investor Day, I've been very clear for last year, it's six quarters. And why is that, is we're going to be a run rate in six quarters. And the reason that I said it exactly that way is the notion of what I'm trying to do with the excess capital. We have about 400 million of excess capital. And I'm trying to make sure that I am being prudent about seeing opportunities and holding it to see if there is opportunity's that our shareholder value are positive. So, I think that's the issue that I'm trying to convey. Most of the businesses that we're investing in right now, I can see the IRRs are very positive of the incremental investments we're making and I can see them in 2010 at the 12%. So, it comes down to really two things, one the view of how we use this $400 million of excess capital and can we deploy it or do we give it back, and when? And the second point is just this weather point. If you believe that weather is going to be as bad it is now, forever it's going to take me a little while to earn that back in. If it goes back down a little bit or toward normal, that will come quicker. But those are really the only two uncertainties for me, as far as this. But again, what I've said is run rate of six quarters because of that transparency to the 400 million of that fixed capital. And again to me, if things change, I could accelerate my view of what we do with that capital. It's just that right now, we're seeing so much activity and so much potential opportunity for the company that I'm trying to be thoughtful about it and not rush to it. Now, what you saw this quarter is -- what has happened is I'm starting to get more pick up -- more clarity with the rating and of what excess capital really was. And so, we started being more focused on these capital actions the refinancing, the opportunistic share buybacks. As you will see us be able to do more of that now because I have more transparency to the rating and where we are. So, we're not going to do nothing but I'm just saying, that I am being a little prudent in my direction about holding on to some of the excess capital to look for opportunities. And again, my point of view is, is that what's happening is profound. It may not look as fast and big to a lot of people but the share shift that will occur and with a lot of folks in the next six quarters, it's going to be meaningful. And you're already seeing some very large players lose share and lose people significantly, which is creating some interesting, instantly accretive opportunities that I just want to make sure that I don't miss because I was a little hasty in getting right out of some of the excess capital, and that's really the point. But again, I understand the need to get the 12% quickly, and that's why we booked the business the way we have.

Sam Hoffman
ADAR

And is your view of the weather that's incorporated into your ROE and earnings guidance the type of weather that, I think people will generally think that we're in right now, kind of an elevated type of storm era, kind of a 2,000 type of era, or do you need to assume that we go back to a kind of 1990s and 1980s?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

No. We have assumed an elevated level, that's what I'm saying. We have tried to price based on an elevated level, particularly, looking at what's happened over the last couple of years. My personal opinion is that, I'd be surprised if that level continues but what we felt it was only prudent to try to think about pricing that way. So, our assumption on pricing is to think about elevated levels of weather, not average levels.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

And all of our rate filings contemplated a more elevated level of weather as we move forward.

Operator

At this time there are no further questions. I would now like to turn the call back over to Bob Myron with any closing remarks.

Robert Myron

Well, thanks to everyone for your participation today and we look forward to speaking to you again next quarter.

Operator
Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect, have a great day.