S&P Global
Market Intelligence

Everest Re Group, Ltd. NYSE:RE

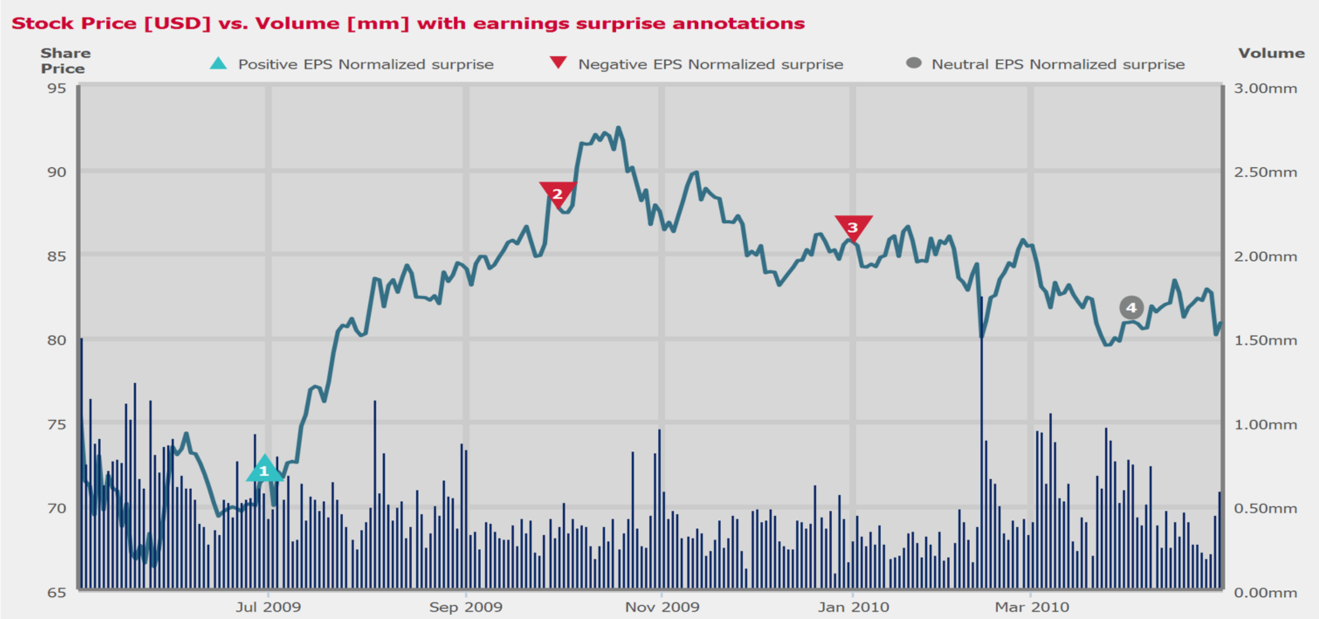
FQ2 2010 Earnings Call Transcripts

Thursday, July 29, 2010 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.79	3.18	▲13.98	2.14	6.47	11.15
Revenue (mm)	1009.35	989.90	▲(1.93 %)	1088.18	4143.32	4218.37

Currency: USD
Consensus as of Jul-29-2010 1:03 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	2.97	4.16	▲40.07 %
FQ3 2009	3.47	3.43	▼(1.15 %)
FQ4 2009	3.39	3.19	▼(5.90 %)
FQ1 2010	1.99	(1.25)	NM

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Call Participants

EXECUTIVES

Dominic James Addesso
President, CEO & Non-Independent Director

Elizabeth B. Farrell
Vice President, Investor Relations

Joseph Victor Taranto
Chairman of the Board

Ralph Jones

ANALYSTS

Brian Meredith
UBS

Cliff Gallant
KBW

Jay Gelb
Barclays Capital

Matthew Heimermann
JP Morgan

Ron Bobman
Capital Returns Management

Vinay Misquith
Creidt Suisse

Presentation

Operator

Good day everyone, welcome to the Everest Re Group Ltd second quarter 2010 earnings release call. Today's conference is being recorded. At this time for opening remarks and introductions I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead ma'am.

Elizabeth B. Farrell
Vice President, Investor Relations

Thank you Michael, good morning and welcome to Everest Re Group second quarter 2010 earnings conference call. With me today are Joe Taranto, the company's Chairman and Chief Executive Officer, Ralph Jones, President and Chief Operating Officer, and Dom Addesso, Chief Financial Officer.

Before we begin I will preface our comments by noting that our SEC filings include extensive disclosures with respect to forward-looking statements. In that regard I know such statements made during today's call which are forward-looking in nature, such as statements about projections, estimates, expectations and the like are subject to various risks. As you know actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now let me turn the call over to Joe.

Joseph Victor Taranto
Chairman of the Board

Thanks Beth, good morning. We are pleased to have posted after tax operating income of $185 million for the second quarter even though we increased our provision for the first quarter catastrophes, particularly the Chilean earthquake. For the quarter the annualized operating ROE was 13.1%. This result demonstrates the underlying strength of our underwriting portfolio. We are also pleased to have increased book value per share by roughly $4.50 from $102.87 at year end to $107.31 as our investments performed well, and our share buybacks added value. Dom will take you through the financial highlights shortly. Gross written premiums increased 4% to roughly $1 billion. Adjusting for foreign exchange, gross written premiums were up 5%. Our growth came from our reinsurance operation, particularly our international operation. Insurance premiums were in fact down 4%. Although the markets remained competitive, we've been able to selectively grow our business by focusing on those markets with the best profit opportunity.

Ralph will take you through the underwriting particulars momentarily, including the July 1 renewals for both the international book and for Florida. In Florida, although catastrophe rates were down 10% to 15% for the industry we improved our overall portfolio, since most of our portfolio is pro-rata and our pro-rata clients have improved their position, because reinsurance costs are less, and because they've been granted meaningful underlying rate increases. Again, Ralph will get into this in greater detail.

In the quarter we repurchased 2.7 million shares at a cost of $200 million. This represents 4.5% of the outstanding shares at the end of the first quarter. 5.2 million shares remain available under the current authorization. In March 2009, we put out a tender offer for $0.50 on the dollar for $400 million of the hybrid bonds we previously floated in the market. They were trading in the market at $0.45 on the dollar, as there was much fear in the market. 40% of the holders took the deal. Today one year later these bonds are selling at twice the value. This transaction was a hard market transaction for us. I go through this example to let you know that I view buying back our stock today, much the same. When it comes to buying back our stock, it's a hard market. We will continue to invest our earnings into buying our stock. We will do it in a way where our capital and our ratings remain as strong as ever.

Last, I will be retiring, December 31 of this year as CEO. I will remain as Chairman of the Board. Effective January 1, 2011 Ralph will become CEO. I have had the privilege of working with many wonderful people at Everest over the last 16 years. Those people have helped me grow the company from a modest size to the global franchise it is today with over $6 billion of capital. I thank them all.

For the past two years I have with Ralph Jones, I have been impressed with his breadth of experience, his intelligence and his leadership. The Board and I are confident that Ralph and our team will continue to effectively grow Everest in 2011, and beyond. As Chairman I will help Ralph and Everest in any way that I can. Ralph.

Ralph Jones

Thank you Joe, I am thrilled at the opportunity to lead the Everest franchise next year. You set the bar pretty high during your tenure as CEO Joe. During the last 10 years the average growth and book value per share was over 14%. Even with all the challenges of the decade, from 9-11, to Hurricane Katrina, then financial meltdown, it's a pretty high standard of achievement in our industry. It's a great company, I like the people, I like our position of strength, and I like our prospects. Thank you Joe for the opportunity.

Overall it was a good quarter; we wrote just over $1 billion in written premium at a 93 combined. The largest segment is international which includes Canada, Latin America, Asia-Pacific, and the Middle East and Africa, which wrote in total $307 million in written premium for international in the second quarter, up 12% in US dollars and 9% in base currencies in the countries in which we operate. Much of the growth came from new business in Brazil, rate increases in Australia, and in Latin America, but mostly in Chile, and larger signings in Canada and in South Africa. Combined ratio for international was 106% in the quarter, and that included 26 points of the cap loss from the earthquake in Chile.

The US Reinsurance business written premium was $268 million for the quarter, about flat over last year. Some of the growth came in the property segment but this was offset by a drop in the crop reinsurance line as we lost two treaty clients that were acquired. The combined for ratio of US Reinsurance was 79%. As respect to the marketplace we are seeing some good opportunities in property and have a strong renewal season in Florida, which came mostly on June 1. We renewed both of our large quota share deals on similar terms to last year, terms we like. As respects the excess of loss property CAT contracts, we non-renewed or reduced our overall limits exposed by about a third. Some of this reduction was targeted and some was in response to rate reductions we deemed as excessive.

Of the business we renewed, rate reductions averaged about 8%. On balance, we continue to support about 17 of the Florida insurance groups. New capacity available in the Florida wind business allowed the primary companies to see some benefit this year. This was also beneficial to our two quota share partners. On balance, between the quota shares and the XOLs, our aggregate exposure in Florida and the profit potential overall was about the same as last year.

Our specialty segment was up 15% to $65.8 million in the second quarter. The marine business continues to shrink, but we are up significantly in the accident and health book. This is a result of growth in the travel accident business, as well as several new self funded medical accounts. The combined ratio on specialty was 119% as a result of the reserves taken for the offshore oil rig in the Gulf. Our loss estimate of $22 million is about what we indicated it would be last quarter. This is for the property damage on the rig itself.

Our Bermuda operations, which includes London, Dublin and Brussels was $167 million, up 3% from prior year 75 combined. Not much new to report from Bermuda, except that the casualty market is soft, the dollar is strong and the CAT loss for Xynthia is less than we anticipated. And this, in part accounts for the very good underwriting result for Bermuda operations in the quarter.

Our direct insurance operations wrote $205 million in the quarter, down 4% over the prior year. We continue to face headwinds in the US casualty market which makes up most of our direct business. We are now down to six core programs in Everest National that gives us the prospect for an appropriate underwriting margin. Our shift in emphasis for the direct specialty lines continues. Our accident year run rate is about 101% combined. This quarter we ran at 105, due to the settlement of a few large claims for a runoff professional liability program for architects and engineers.

Rate increases held at plus 2% for the GL book and plus 9% for the California comp book, which I'm pleased with. I'm also pleased to report that Mark Herman has accepted the role of CEO for our insurance operations. Mark has been running our speciality operation in New York for the past year. He was formerly the President of Ace Bermuda, and brings a great underwriting track record to his new assignment. Darrell Bradley, our President of Everest National and Marketing will make a great leadership team as I begin to delegate this day to day responsibility.

Overall, we are making some money and we have our dukes up as we battle the marketplace, marketplace with more capacity than good opportunities in general. Over to Dom Addesso.

Dominic James Addesso
President, CEO & Non-Independent Director

Thank you Ralph and good morning. As noted, operating earnings for the quarter were $3.18 per diluted share. When combined with $0.48 per diluted share of realized capital losses for the quarter, it resulted in net income of $2.70 per share. The realized losses for the quarter were primarily a result of fair value adjustments on our equity portfolio, due to changes in the overall market during the quarter and not the result of losses on sales of securities.

The operating income reference for the quarter equals $185 million and was primarily the result of a pre-tax underwriting gain of $68 million and $166 million of investment income pre-tax. Other items on a pre-tax basis included foreign currency gains of $8 million, a loss of $22 million on the equity index put contracts and interest expense and other corporate expense totaling $17 million. The effective tax rate for the quarter applied to these items was 8.5%, resulting in $17 million of tax on operating income. The change in the annual effective tax rate from the 10.5% in the first quarter reflects second quarter actual results combined with the unchanged estimate for taxable book income during the remainder of the year.

The details on the underwriting gain for the quarter are as follows. A 65.1% loss ratio, a 23.9% commission ratio, and other underwriting expenses of 4.2%. This resulted in a 93.2% combined ratio for the quarter. Expense ratios for the quarter are generally consistent with other periods. The loss ratio has three distinct components. The current year attritional result was 59% for the quarter and 59.2% for the year-to-date, which is up over the comparable periods one year ago. This reflects events such as the Horizon rig loss and Tennessee floods, as well as higher accident year picks reflecting a slightly softer market offset by rate increases in certain segments, as previously outlined by Ralph.

The next largest component of the loss ratio was attributable to CAT losses. This represented 7 points or $70 million for the quarter. The dominant driver of this amount was the change in our estimates for the first quarter CATs with an increase in our loss estimate for Chile, and reduction in our loss estimates for Xynthia, and last years Turkey floods. The net effect of these CAT losses in the quarter after taxes reinstatement premiums was $52.4 million or $0.90 per share. The current estimate for Chile, which totals $400 million were $306 million net of tax and reinstatement premium is the result of updated reports from ceding companies in addition to our management estimates. These ceding company loss reports were verified by our claims staff who visited six out of our seven pro-rata clients in Chile.

While it is still relatively early in the adjustment process, these numbers compare to market loss estimates which are now in the $10 billion to $12 billion range. As we evaluate potential future emergence, if any, for this one event we do consider our overall CAT reserve position. When combined with reserves on prior year CATs for which we have seen limited activity, we are reasonably reserved for any future movement on prior CAT events.

The final piece of our loss incurred amount for the quarter was $10 million or 0.9 points, just under 1 point of favorable development on prior year attrition reserves. This was primarily due to favorable emergence in our reinsurance operations coming from our international businesses.

Net investment income for the quarter was $166 million compared to $167 million in last year's quarter. The decline from the prior year was due to lower income from limited partnerships. On year-to-date basis however, net investment income was up significantly in 2010 over 2009 to $327 million. This was due to a loss in 2009 from those limited partnerships of $73 million during the first quarter 2009.

Income from fixed maturities and equity securities have increased year-over-year, due to investing of our short-term and cash balances, as well as increases in invested assets arising from positive cash flow from operations of just under $500 million in 2010, compared to $284 million in 2009. The increase in equity income was due to increased allocations to dividend yielding equity securities.

Unrealized gains net of tax for the quarter of $113 million flowed through other comprehensive income as declines interest rates continue to positively influence the value of our bond portfolio. Offsetting this in other comprehensive income is translation losses from net assets held abroad in other than US currencies.

Total comprehensive income for the year-to-date was $229 million, and when combined with dividend of $56 million in the six months and share repurchases of $247 million, results in total book value at June 30 of $6 billion or $107.31 per share. This represents an increase of over $16 per share or 18% from June 30 of last year. This book value growth leaves us well positioned for market opportunities, as well as continued share repurchases.

Beth thank you and I turn it back to Beth for Q&A.

Elizabeth B. Farrell
Vice President, Investor Relations
Michael we are ready for questions and answers.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Mr. Cliff Gallant from KBW. Please go ahead.

Cliff Gallant
KBW

Two questions, one yet a notable competitor in the California Worker's comp market, who took reserve charges this week and I was curious as to what you are seeing in terms of your lost trends there. And then secondly, I wanted to ask about your dividend. You were pretty aggressive with capital management this quarter and I think your dividends been flat for awhile. Any thought to increasing that?

Ralph Jones

On the California comp book, we are pretty pleased with what we are seeing. We have about a $230 million annualized book of business, it's roughly kind of a third of our insurance operations. We've filed for rate increases and we're actually getting what we are looking for. So, through the first six months its just under 10% rate increase and the reserved position looks good. So, I don't know, I think you might be referring to Seabright, but I don't know what their issues are, but we are very comfortable with what we got and how the market is playing out.

Cliff Gallant
KBW

I think they were talking about things like, because of the economy people were filing their claims longer, staying on worker's comp longer than as opposed to returning to work. So you are just seeing a change in the activity of claimants?

Ralph Jones

The Only thing we see that kind of dampens to some degree the impact of the rate increases is that the audit premiums that we get have tailed off, because the payrolls are down. So, as you project some of these audit premiums for some of the clients and their payrolls are down that becomes less income to you over time. But that really impacts the volume as opposed to the margin. So that's the trend we are seeing.

Dominic James Addesso
President, CEO & Non-Independent Director

What we are seeing is relatively stable, but we do have to consider the factors that you mentioned as we think about our IBNR estimates. And those are all factored into our management estimates of reserves.

Ralph Jones

On the dividend question Cliff, there is no plan to modify it at this point. We did change it rather significantly a couple of years ago. We pay about at the 2.5% dividend on the stock price which is a healthy dividend, and frankly I think I find it better to take any extra money and put it into share repurchase at this point. So, I think it's a good dividend and right now the plan s to keep it the same.

Operator

We'll move on to our next question from Jay Gelb with Barclays Capital. Please go ahead.

Jay Gelb
Barclays Capital

Ralph I want to focus on a big picture item now that you are taking the position over as Chief Executive, can you give us your thoughts on strategy, execution. And Everest historically hasn't been too active in mergers and acquisitions but I just want to get your thoughts on that as well.

Ralph Jones

I wouldn't describe it as steady as she goes Jay. The results have been very good over the ups and downs of the market cycle and that's a direct result of very disciplined underwriting, particularly on the treaty side. So, don't expect any major changes there. We are constantly looking for opportunities, but we can take those opportunities as the market yields it to us. And given the current outlook in the insurance market the way the pricing trends are going it's probably has headwinds over the next couple of years.

On the insurance side, I think we have a decent business, but it hasn't performed particularly well. We are working very hard to have that perform in a way that's commensurate with the reinsurance company, which is very strong. And all hands on deck to make that happen. I think you could see the trend that we've been defining over the last year which is an emphasis more on direct specialty lines that present a margin where underwriting expertise matters, versus a more of the commodity, property casualty, or let's say mostly casualty MGA model. We are happy with the six partners that we have. We are down from a larger number a year ago, but we're very happy with the six we have. And we'll continue in that business. We are happy with the California comp play that we are making and Mark Herman and his leadership will be a big boost. And he has more of a specialty lines background, a lot of depth in the professional liability side of the house. So, we'll kind of work to have that perform better.

Jay Gelb
Barclays Capital

And then separately on share buybacks, the $200 million repurchased in the second quarter is probably the largest of any quarter since at least 2005. And I'm just trying to get a sense of how fast we should expect the pace buybacks be going forward? Thanks.

Ralph Jones

Well, it's probably the largest in any quarter ever. It tells how strongly we feel about that as increasing value for shareholders. Having said that, we will continue to not forecast what we plan to buyback something that we preferred to feel the process as we go through the quarter. Taking into account all the issues, including hurricane season, including stock price and everything else that needs to be taken into account when you get into share repurchase. So, the plan is to continue to purchase, including in this quarter. And the plan is to purchase going forward, because certainly at today's price we think it's a great thing to do. But we are not going to put dollars onto it right now.

Operator

[Operator Instructions] Our next question comes from Matthew Heimermann with JP Morgan. Please go ahead.

Matthew Heimermann
JP Morgan

A couple of questions. First, with respect to the insurance business, now that you scaled down the MGA relationships and given that you are going to have more of a direct focus going forward, how should we think about the expense structure in that business? Both acquisition and MGA.

Ralph Jones

Well, the expense model for MGAs is relatively high, because you are paying a commission and then you are paying an MGA fee. And that fee is roughly, on average 7 to 10 points over the underlying commissions. And you are going to need that same kind of framework to deal in the specialty lines, because you are focused on building the appropriate teams for the appropriate opportunities. So, I expect the expenses to be down somewhat over the course of time. And not immediately.

Matthew Heimermann
JP Morgan

With respect as to how you are deploying your capital by geographic risks, can you give us a sense, and I guess to some extent I am hoping you'll dig in a little bit what happened at 71 as well. But, just major geographies around the world whether or not your PML is up or down, relative to last year.

Ralph Jones

Well, in general the PML is about the same. On a overall basis we see good opportunities in Asia-Pacific. We had strong growth in the quarter in Singapore and that book came principally from Australia, as I mentioned. We saw strong growth in Canada, and see good opportunities coming out of Canada, which we book in our international line. And we saw probably, fewer opportunities in Europe. We have an office in Brussels that deals with the continent and those opportunities were fewer. So, if you kind of go around the world and look at the aggregate exposure, particularly for CAT exposure on the one in 100 or one in 250 PML. We saw it down in the European crosswind, we saw it about the same in Florida as I mentioned in the second quarter in the US. We saw it down in Latin America, principally because of reactions after the Chile earthquake. We saw good rate increases in Chile, on the order of 70% to 80%. Of the renewals that we had coming on July 1, we renewed five out of the six. One we didn't and that was kind of a significant PML reduction because of that. But the ones we renewed we are happy with, and we are happy with the rate escalation.

We didn't see a broader rate escalation outside of Chile. Particularly little bit stronger demand, a little lower supply in some of the other Latin American countries, but not to any great degree that we had kind of expected because of the size of the industry loss there. But by and large, the PML aggregates overall are about the same.

Matthew Heimermann
JP Morgan

And then, for Dom I guess just in the alternative portfolio, most other companies that have reported strong numbers have pointed to real estate and private equity. I was just curious if you could give some color on the strong gain there.

Dominic James Addesso
President, CEO & Non-Independent Director

Well, the strong gain year-over-year was essentially due to as I mentioned due to our limited partnership income which the economy has been approving. And all of those limited partnerships are subject to marks every quarter. And most businesses are improving in many of the sectors that we're in, whether it's real estate, or healthcare, or infrastructure most of those sectors are all coming back. Therefore, the marks are improving in those sectors.

Year-over-year our limited partnership was $31 million of gain, almost $32 million of gain in the six months of 2010. And a year ago we had a $53 million loss. And in the second quarter we had $16 million of gain; compared to a year ago the second quarter was about $20 million of gain from our limited partnership investments.

Operator

We'll move on to our next question from Vinay Misquith with Creidt Suisse. Please go ahead.

Vinay Misquith
Creidt Suisse

My first question is on the growth in the international. Was that mostly from rate increases or was that also from new client growth? And if you could explain to us how you are getting that growth and who are you getting it from?

Ralph Jones

Yes, again a lot of these treaties come up on January 1 Vinay. So, you could see in the first quarter some of that growth was as we defined and as we expected through the course of the years and treaties come out and it is very similar pattern to the way we described it in the first quarter.

Canada is very strong. We see good opportunities in Canada. Some of that is rate increases, particularly for CAT programs in the Western part of the country. We saw strong rate increases in Australia, partly because of the CAT losses in Australia. We saw rate increases in South Africa, and some of that Middle East and South African business which we kind of put in that bucket was up. So, it's I would say equal between rate increases, larger signings on current customers and some new business. But it was really, pretty broadly spread on those four parts of the world.

Vinay Misquith
Creidt Suisse

Okay, and could you help us understand how the PMLs have stayed relatively flat despite higher unit count?

Ralph Jones

Well, the number of customers is approximately the same. I'm again going back to the international question. So, the number of customers came about the same, but you've got the remember that within the international segment, we had the new office in Brazil last year which is going to write between $80 million and $100 million this year. And that is principally new property business that's quota share, that's not subject to CAT exposures like other parts of the world. So, a lot of the growth that you see comes from that new operation in Brazil, which is kind of earning its way out in 2010. Which is not CAT exposed.

Vinay Misquith
Creidt Suisse

And the margins this quarter were really very strong. Did you see a very low CAT quarter, extra large CATs within these property lines in your international books?

Ralph Jones

There was really no other CAT activity other than the movements that we mentioned. Chile was up a bit and Xynthia was down, but other than that there wasn't a lot of activity outside of the US. Some of the US activity was floods in Nashville, but that really came in as under the attritional column for US reinsurance.

Vinay Misquith
Creidt Suisse

Last question is on the tax rate. We've seen a very low tax rate this quarter. Should we expect that same level in the future?

Ralph Jones

Yes that's an annualized effective tax rate based on the projection of taxable income for the remainder of the year. Of course that can change relative to what kind of CAT events if any we have in the third and fourth quarter. That's the big swing there.

And we have assumed some level of CATs in our estimate for the remainder of the year. So, if there are none, then that's obviously a good thing for operating earnings, but of course then the effective tax rate would move up. But net-net it would still be a positive earnings story.

Vinay Misquith
Creidt Suisse

So the second tax rate would be about 8.5% going forward, right?

Ralph Jones

For the remainder of this year, correct. If in fact the level of catastrophes that we've put into our assumptions come to fruition. If they don't, then that tax rate will go up. But, operating income will go up at a faster rate.

Operator

[Operator Instructions] Our next question comes from Brian Meredith with UBS. Please go ahead.

Brian Meredith
UBS

Couple of just quick questions here. One, book on the investment portfolio looks like. It is up a little bit sequentially, is that just because of deployment of assets?

Ralph Jones

Yes Brian and you'll note that our cash in short-term positions have been coming down over time, so we've been trying to remain more diligent around moving out of assets yielding less than 1%, and trying to put that money to work. As well as increased cash flow.

Brian Meredith
UBS

Also did any FX impact on top line?

Ralph Jones

Yes, about 1%.

Brian Meredith
UBS

1% impact, okay. Positive I assume, right?

Ralph Jones

It was 4% it would have been 5%, FX foreign currency.

Brian Meredith
UBS

And then last question, on the Chile loss. Where do stand with respect to your excessive loss limits, so you are pretty much maxed out there? And then any kind of color you can give us as far as aggregate caps in your quota shares, and kind of where we stand close to those?

Ralph Jones

Well on the XOL contracts we are very near the top. Now that can move a little bit because of currency movements, but nevertheless it's still in the last 10%. We are up in the 90% range in terms of maxing that out. On the production-ratas our aggregate limits there are in the low $500 million range.

Operator

[Operator Instructions] We'll take our next question from Mr. Ron Bobman with Capital Returns Management. Please go ahead sir.

Ron Bobman
Capital Returns Management

I had a quick question with the California work comp book, and curious to know what loss that are taking with current accident year? And then also, how it changed year-over-year, '10 versus '09?

Ralph Jones

Well on a combined basis the accident year picks in the mid 90s and that's about the same as last year. Even though we're getting rate increases.

Dominic James Addesso
President, CEO & Non-Independent Director

That's a combined ratio.

Ralph Jones

Combined ratio.

Ron Bobman
Capital Returns Management

And then would you just give us a little bit of description as to the nature of the risks, sort of the profile of the risks and account types that's represented by the book? If it has any sort of dent one way or the other? Thanks

Ralph Jones

Its two pieces to the book. One is, we write directly through our operations and underwriting operations in Orange County and Oakland. And the other we have through a good program manager in San Diego called Arrowhead. And principally, it is construction and agriculture.

Operator

And with no other questions in queue I would like to turn call back over to Ms. Beth Farrell for any closing remarks.

Elizabeth B. Farrell
Vice President, Investor Relations

Thank you for joining us today. And certainly, as always if you have any questions please feel free to call myself or Dom Addesso. Thank you.

Operator
Ladies and gentlemen that concludes today's presentation. Thanks for your participation.