S&P Capital IQ

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The Hanover Insurance Group, Inc. NYSE:THG

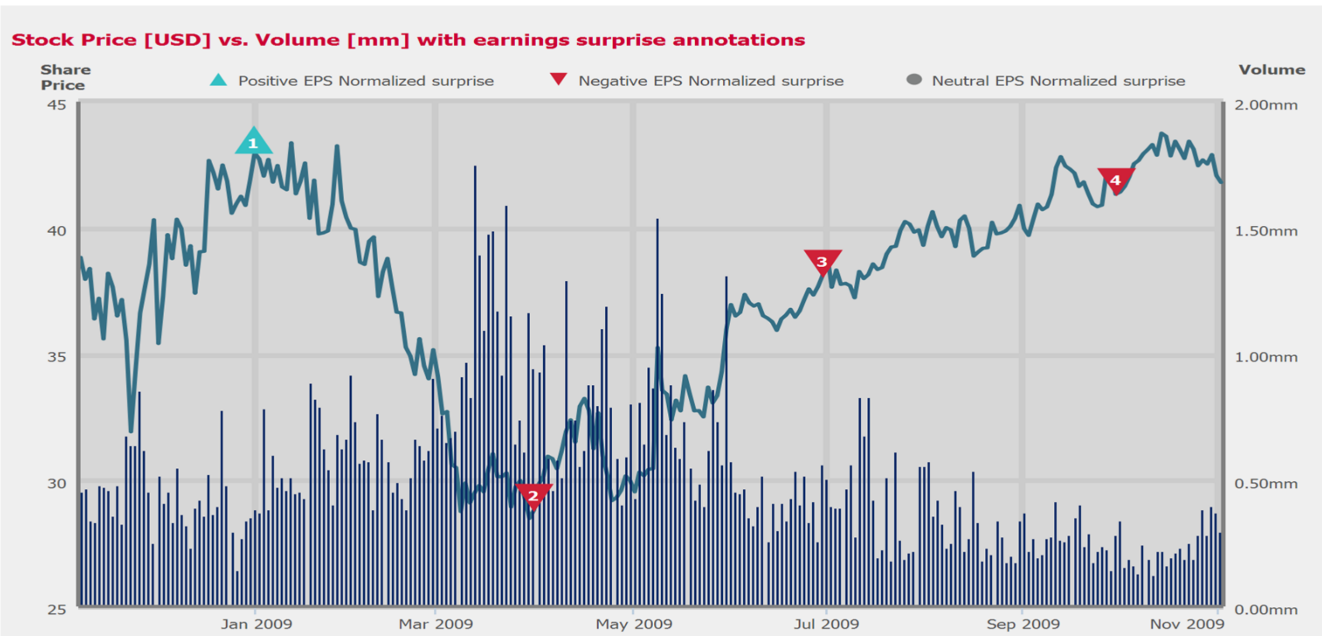
FQ4 2009 Earnings Call Transcripts

Thursday, February 04, 2010 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2009-			-FQ1 2010-	-FY 2009-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.01	0.83	▼(17.82 %)	0.90	3.26	3.08
Revenue (mm)	626.80	626.90	▲0.02	708.65	2608.60	2608.70

Currency: USD
Consensus as of Feb-04-2010 6:16 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2008	1.13	1.16	▲1 2.65 %
FQ1 2009	0.44	0.39	▼2 (11.36 %)
FQ2 2009	1.02	0.86	▼3 (15.69 %)
FQ3 2009	0.98	0.89	▼4 (9.18 %)

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Call Participants

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

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

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Presentation

Operator

Good morning, and welcome to The Hanover Insurance Group Fourth Quarter Earnings Conference Call. [Operator Instructions] I will now like to turn the conference over to Mr. Bob Myron. Please go ahead, sir.

Robert P. Myron
Former Senior Vice President of Finance

Thank you, operator. Good morning, and thank you for joining us for our fourth quarter conference call. Participating in today's call are Fred Eppinger, our President and Chief Executive Officer; Marita Zuraitis, President of our Property and Casualty Companies; and Gene Bullis, our Executive Vice President and CFO.

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 Investor 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 segment earnings, after-tax segment earnings per share, pricing, accident year results, premiums, expenses, development of loss and LAE [Loss Adjustment Expense] reserves, returns on equity and other projections for 2010 and beyond.

There are certain factors that could cause actual results to differ materially from those anticipated by these press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and in this respect, refer you to the forward-looking statement section in our press release, Slide 2 of the presentation deck, and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as total segment income, after-tax earnings per share, 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 thank you for joining us. As we usually do, I will give you some context to our results, as well as share with you our outlook for 2010. Fred and Gene will follow providing additionally insights into our performance and relative trends.

2009, particularly the second half, has been an extremely busy and important time for Hanover, as we continue to position our business, building a stronger franchising, creating significant shareholder value. Obviously, the weather, the pricing cycle and the economy made 2009 challenging, but the resulting market disruption enhanced our ability to position the company to capitalize on the market changes we see in the future periods.

As many of you who know our story will attest, we have made tremendous progress over the last six-plus years, successfully managing through some significant challenges. Over the course of those six years, we've dramatically improved our financial position, assembled one of the best teams in our business, established more and deeper partnerships with winning agents, developed a much stronger product and underwriting capability while creating a more responsive and flexible operating loss.

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While more needs to be done, we have a clear strategic vision. We are in excellent financial condition and our franchise is viewed as one of the most attractive for winning agents.

As we began 2010, we take pride in all we have accomplished and we are prepared to face even more challenges, as our business approaches, what we believe, will be the low point in the cycle, and the economy continues to be challenged. Our operating results for the fourth quarter and the year were below our expectations. Driven largely by prevailing market conditions and the state of the economy, 2009 was also a difficult year, because of non-cat [non-catastrophe] weather-related losses across our footprint.

With that in mind, we think it is prudent to adopt to more cautious point of view, and have increased our 2009 accident year loss picks in some lines of business. And naturally, our expense ratio for the quarter, for the year, reflects the significant investments we have made to launch and build our businesses.

Our combined ratio of 98% was roughly three points higher than it needs to be for us to meet our long-term financial goal, and we are focused on achieving this through the cycle. Notwithstanding the short-term challenges imposed by the current market conditions in our investments, we feel very good about the state of our franchise overall, and our ability to continue to create shareholder value now and in the future.

We have every confidence that the investments we have made in our business over the course of the year, and that we will continue to make, will enable us to compete, grow profitably and win over the long term. We are equally confident that the thoughtful capital management actions we have taken, and that we will to continue consider, will enable us to continue to deliver value for our shareholders.

In the fourth quarter, we announced that we would significantly expand our commercialized footprint effective January 1, 2010, with seven state launches in the West. This initiative has been met with great deal of excitement in the region.

This expansion into the western part of the country will enable us to capitalize on the increasing interest in our products and services from the agents in the region, an opportunity to partner with some of the best agents in the business. This expansion is a key component of our very disciplined and strategic approach to growth.

We began this expansion targeting winning agents with our suite of Specialty, Niche and Segmented businesses. Our renewal rights arrangement with OneBeacon announced just days after we announced our Western expansion plan, further strengthens our efforts to build our presence in the West, with roughly $100 million of mature, profitable premium available in our expansion state.

In addition, this arrangement will significantly accelerate our product segmentation efforts and development in the small and middle market, adding many well-established programs to our portfolio. It is also creating more opportunities for us to partner with select winning agents, and has enabled us to add many talented experienced professionals to our company and to build on the momentum we've already established.

In Small Commercial, this transaction will enable us to make product enhancements across more than a dozen programs, including apartments, manufacturers restaurants and retail, and increases our scale to more effectively compete with the best competitors in that business.

In the Middle Market, we have acquired product capabilities in several sectors including brewers, cultural institutions, food industries, printers and more.

Unrelated to this transaction, we've also made numerous significant product improvements and introductions, greatly enhancing our product portfolio, helping our agent partners create new and stronger revenue streams and growing the businesses. In particular, we substantially enhanced our portfolio of professional and management liability capability.

Last month, we added professional liability coverage for architects and engineers through the acquisition of Benchmark Professional Services [Benchmark Professional Insurance Services], a leading provider of insurance solutions for the design professionals industry.

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In addition, we launched a suite of stand-alone miscellaneous professional liability coverages that offers small and midsize businesses comfortable, flexible solutions that can be tailored to their needs. At the same time, we unveiled a team of experienced professionals in a suite of management liability products, including new capabilities to protect private companies against the growing number of financial exposures, as well as coverages for nonprofit entities, employment practices liability and fidelity and crime protection.

And in January, we reached an agreement to acquire Companion Group, which specializes in insurance solutions for the healthcare industry. The Companion Group offers professional and general liability solutions for a range of healthcare providers, including durable medical equipment suppliers, behavioral health specialists, elder care providers and pediatrists. This transaction reflects our commitment to offer a range of products for the healthcare industry, which we think represents tremendous growth opportunities for many of our agents and partners.

We have made significant investments in our Personal Lines business as well late last year, repositioning our company as an unrivaled total account writer, to a marketing and business development initiative we call Think Hanover. We've made approximately two dozen significant product automation and service enhancements.

This initiative is intended to help our partners to avoid unproductive price competition, while meeting more of their customers' needs. It leverages the innovative total account product suite for front-line excellence and distinctive tools and programs designed to help our partner agents attract, ground and retain more accounts. Of course, it is also intended to generate more profitable growth for us in personalized markets as well.

The investments we've made across our business to obtain dividends, as we continue to generate profitable growth, with total net written premiums of 5% for the quarter and 4% for the year. And more importantly, we continue to improve our mix towards the commercial, specialty and controlled businesses. At the same time, we've been able to take rates, with average increases in the quarter of 5.2% in Personal Lines and 2.3% in our core Commercial Lines.

While we continue to strengthen our business, we also continue to be thoughtful about capital management and the optimization of our capital structure. Through our capital, our stock buyback program, we repurchased nearly 50 million in stock in open market transactions during the course of 2009, and executed $100 million Accelerated Share Repurchase Transaction in December, all at prices below book value. We have also continued to buy back stocks in the current calendar year.

Our debt refinancing was completed early in the year and resulted in a $34 million pre-tax gain and a $3 million per annum interest expense savings. The board also demonstrated its confidence in our financial position and its commitment to deliver value to shareholders by voting to increase the company's annual dividend by 67% to $0.75 per share, and by voting to move to a quarterly dividend schedule this year.

As shown on Slide 4 of the presentation, as a result of the improvements we've made across our business, our operating results, and with the effective use of our capital, our book value per share grew 34% in 2009, as almost $50 a share, its highest level ever. And even with the operating results impacted by weather, market and economic conditions, in significant business investments, we generated an enterprise return on equity of 9% in 2009.

As we begin 2010, we are better-positioned than ever to achieve our goal. Our mix of business is good and improving. And we have several levers that can drive improved operating results. In particular, we are moving toward critical mass in many of our Specialty Commercial Lines business segment, with the key component of this being many of the new capabilities we acquired or built during 2009. We expect this will have a bigger impact in the second half of 2010 and into 2011.

In general, our core Operating and Commercial Lines is now distinctive, and at this point, we have what we need to execute our strategy. The investments we made in our Personal Lines platform substantially improved our competitive position. We expect to begin to realize the benefits of these enhancements we made this year, and the end of last year, while investment begins to taper off.

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We are optimistic that the upper trajectory of our pricing in both our Commercial Lines, and most notably in our Personal Lines, will continue in 2010. And we will continue to be thoughtful about capital management.

With the rating upgrades we have achieved over the last two years and our very strong balance sheet, we now have the increased flexibility with respect to share repurchases, dividends and the optimization of our capital structure.

In consideration of all of these, our outlook for 2010 is going after-tax segment income EPS in the range of $3.85 a share to $4.20 a share, which assumes normal cat of 3.6 of earned premium. We expect net premium growth in the low double-digit.

In achieving these results, we intend to take full advantage of all the leverage that I have described, to create an increased efficiency in our operating model, as the year develops.

Despite this momentum, the first quarter of this year could be very challenging. It is typically our worst-weather quarter. We haven't realized the full impact of our recent price increases in Personal Lines, and we had not yet reached the economies of scale in several of our new business initiative.

Our outlook for 2010 produces the segment ROE in a high single digit. I assure you however, that achieving our goal of an 11% to 13% ROE continues to be our focus. We are confident we can achieve that goal as we employ all leverages I discussed.

While we don't have visibility to when exactly the market will begin to harden, we will continue to be disciplined in our underwriting approach. And at the same time, we will continue to build our franchise, so that we can improve our relative position and capitalize on a market turn [ph] on many funds, when it does occur.

I would like to welcome Steve Bensinger to our team. Steve is in the room with us today, and having started to working with us over the last month. Steve is already proving to be an extremely valuable member to our senior management team. And we are pleased to have him on board, as we gain the benefit of his years of experience in the insurance business, and as we transition him to the CFO role.

And at the same time, I would like to thank Gene Bullis for all his hard work and guidance over his two and a half years of service with us. This will be Gene's last conference call, and we wish him the best in his retirement, once he finishes up with us in May. 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

As Fred said, our 2009 results are as much about the reported earnings and revenues, as they are about the long-term capabilities and the competitive advantages that we built during the course of the year. So I'll first walk you through the major drivers of our fourth quarter and full-year 2009 underwriting profitability and growth, and then I'll discuss how our results and new capabilities will impact 2010 and beyond.

Moving to Slide 8 for an overview of our P&C operations. In the fourth quarter, our P&C operations generated $70 million in pretax income, that's down from $98 million in the prior year quarter. For the full year of 2009, we generated a pretax segment income of $270 million compared to $302 million in 2008.

While 2009 was a relatively benign catastrophe year, we did experience a significant increase in non-cat weather. We estimate the non-cat weather impact on 2009 pretax earnings to be approximately $40 million higher than in 2008. Investments in our franchise, the current state of the insurance market environment and the economic slowdown also put some additional pressure on our earnings for the year.

As you see on Slide 9, excluding the pretax net impact of catastrophes, Personal Lines segment income was $26 million in the current quarter, compared to $50 million the prior-year quarter. The year-over-year decline in ex-cat earnings resulted primarily from an increase in the 2009 expected losses in both homeowners and auto liability lines.

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In homeowners, higher losses were primarily a consequence of continuing development of non-cat weather losses from the first three quarters of 2009. However, it should be noted that our accident year loss ratio in the fourth quarter of 2008 for homeowners, was lower than our run rate for this line, making for a more difficult year-over-year comparison. Going forward, we expect our homeowners results to be solid, driven by significant rate increases and improvement in the elevated level of non-cat weather we experienced in 2008 and in 2009.

In auto liability, we reacted to higher BI severity and partially attribute this phenomenon to a change in insured behavior due to the state of the economy. As has been our historical practice, when we see deterioration in the line of business, we react prudently, with a view towards ensuring that the deterioration is adequately captured in a period in which it is observed.

Lower favorable development of prior year loss reserves in personal auto also impacted Personal Lines earnings in the quarter. As you can see on Slide 10, the same trends drove the full-year Personal Lines results.

In addition, non-catastrophe weather was also a driver of increased loss activities for 2009, exceeding the 2008 impact by approximately $25 million, split between current and prior accident years. We expect improved accident year profitability in 2010, as our past and recent rate actions impact earned premiums and as our non-rate actions take hold.

As we've said in prior calls, as 2009 progressed, we took increased levels of rate in both auto and home. In the fourth quarter alone, written premium reflected applied rate increases of 5% in auto and 5.4% in home. We have also planned and filed additional rate increases in both lines for the first and second quarters of 2010 that are higher than we achieved in the fourth quarter of 2009.

Our Personal Lines net written premiums for the fourth quarter and the full year both decreased by approximately 1%, as demonstrated on Slide 11.

In the fourth quarter, net written premium in our core states shrunk by approximately 2%. As we've said before, given our significant position in these states and the state of the economy in Michigan and Massachusetts, we seek to manage these states very carefully with a greater focus on margin and on growth. However, because of our strong account product offering, and our strong shelf space, we continue to grow with our best partners.

Accordingly in 2010, we anticipate flat to low single-digit net written premium growth from our core states, which will be principally driven by rate increases opposed to an increase in exposures. We continue to see strong momentum in our growth states, as net written premium increased 7% in the quarter. This growth was the product of both the growing strength of our Personal Lines product offering and our growing ability to leverage our total franchise value to get preferred shelf space with our winning agents.

As you know, many of these states were reasonably new for the Hanover, and we are now seeing our increased franchise value bringing Personal Lines, Commercial Lines and Specialty lines together, to help us get more attractive account-oriented books of Personal Lines business.

Notably as of the end of the year, 70% of our new Personal Lines business was coming from accounts. This is up from approximately 50% three years ago.

In addition, Think Hanover is a significant improvement in our product for agents that want to efficiently sell a tailored account offering. Also, our retentions continue to improve indicating that the market is supporting our recent rate filings, and validating our premise that accounts improve retention. This gives us confidence that we'll be able to continue to grow our newer states in 2010.

So overall, between rate actions, product improvements and increased franchise value, we see a moderately growing Personal Lines business with improved margins in 2010.

Moving on to Commercial Lines starting on Slide 12. As you can see on Slide 12 and 13, Commercial Lines ex-cat pretax segment income was $53 million in the fourth quarter of 2009, down from $60 million in the

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prior-year quarter. For the full year, ex-cat segment income was $219 million compared to $254 million in 2008.

Drivers of lower profitability were essentially the same for both periods, higher underwriting expenses and higher ex-cat accident year losses partially offset by higher favorable prior year loss development. The higher expenses in the quarter and the full year of 2009 results were driven by continued investment in our product capabilities and geographic expansion, as well as higher pension costs.

As Fred mentioned, 2009 was an unprecedented year for us in terms of expansion of our capabilities in new products and in new geographies. While these accelerated investments in talent, product capabilities and acquisitions impacted our bottom line in the quarter and the year, we're confident that this money is well spent.

We are also excited about the opportunities now open for us in the West, as well as in new areas of commercial businesses like allied health and expanded professional and management liability. These new capabilities, along with our geographic expansion, were planned with and designed around our partner agents. We're confident that these actions position as well for the future, in particular when the market cycle turns.

While our expense ratio in Commercial Lines was higher than 2008, it was driven by the accelerated investments that we continue to make during 2009. We expect that in 2010, in particular, in the latter half of the year, we will begin to reach critical mass with respect to our newer businesses and products that we've acquired and developed over the last two or three years.

Our operating model is also scalable, which will allow us to achieve economies of scale once the growth from these new initiatives begin to earn through our portfolio.

As shown on Slide 14, Commercial Lines accident year losses were higher in the current quarter by 3.2 points and for the full year by 1.4 points. Performance in our auto and CMP lines are consistent with prior-year trends.

However, CMP is prone to occasional large property losses and thus, its performance can be lumpy, and this is what we experienced in the fourth quarter of 2009. However, the 2009 CMP accident year loss ratio is consistent with the full year of 2008, which under these market conditions, is a tribute to strong underwriting and disciplined pricing.

The quarters deterioration in worker's compensation results was driven by two main components: First, audit premiums, driven by smaller payrolls, had an adverse impact on the loss ratio; and additionally, the high unemployment rate also lead to longer return-to-work times, thus increasing severity in a small number of larger indemnity claims.

In general, we're very satisfied with our current worker's compensation book. It's a relatively small book of business and is predominantly in smaller accounts and lower-risk industry classes. We have and will continue to take a conservative approach to underwriting this line.

Accident year results in our Other Commercial Lines reflects an increase in our accident year picks, due to some loss activity, and our Surety Line, which was clearly driven by the state of the economy. As we mentioned last quarter, we're watching the performance of this book carefully and believe that it's prudent to increase our loss .

Additionally, we have established a more cautious approach to loss estimates in some other lines, which we know are usually affected by the economic slowdown and have modestly increased our loss picks. This resulted in an increased accident year loss and adverse development in our Other Commercial Lines in the current quarter.

In general, our intention with respect to our reserves in our Other Commercial Lines, is to set the middle level that mitigates the risk of adverse development in future periods. At the same time, we have, and we'll continue to implement, rate increases in surety in response to the state of the construction market.

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We are also adjusting pricing on other lines to appropriately reflect higher risk of loss where the economy may be a factor.

Moving on to Slide 15 to discuss Commercial Lines growth. Our 15% net written premium increased in Commercial Lines for the quarter and 10% for the full year, reflect to the AIX acquisition, as well as growth in our Niche, Professional Lines, Marine and segmented middle-market businesses. AIX continue to gain traction, reaping the benefits of Hanover's agency partners, as well as our A rating.

Our Marine segment grew 15% during the quarter and 11% year-to-date. Our Marine book is a highly-diversified and profitable portfolio, and we continue to be very pleased with its level of growth.

Our middle-market niches and segments grew 14% in the quarter. These industry-specific bundled products that have unique endorsements and specialized services, are seen as having great value to our partner agents and give them something distinctive to sell in their markets. They are attractive for us to offer, as they have historically had higher margins than more traditional products, which we view as critical in these tough market conditions.

We expect an upward trend in these businesses in 2010, as we enter attractive new segments and geographies through to the OneBeacon renewal rights deal. The transaction with OneBeacon expands our capabilities into new niches and segments. It also helps us further strengthen our distribution by selectively adding new agents, while increasing our business and deepening our relationships with many existing partner agents.

Notably in some states, where we already have a strong presence, the number of new agency appointments we have to make with respect to the OneBeacon premium is in the low single digits. We performed extensive due diligence on this book in advance of entering into the transaction. We are convinced that the business we are targeting will ultimately be highly-profitable, once the associated startup expenses are behind us.

On an overall basis, the OneBeacon transaction should allow us to reach critical mass in terms of business volume and fixed cost leverage in our small and middle market segments. Lastly, the transaction provides us with an installed base of premiums to offset start-up expenses for our go-west initiative, which will allow us to be profitable in these seven western states, faster than we otherwise would've done.

We are expanding into the West only in Commercial Lines, specifically leading with our Niche, Segmented and Specialty Products, whether acquired through the OneBeacon transaction or a part of our existing product suite. We have chosen this approach due to the margin characteristics of this business, as well as the fact that it requires lower levels of start-up expenses in the geographies that he had chosen to focus on.

We also continue to tighten our underwriting on all flow businesses and hold firm on pricing. Our rates for the quarter were up 4% in Small Commercial and 1% in Middle Market. We believe our pricing actions have been ahead of the general market.

This reduced our new business flow, into a lesser extent, our retention rates. In 2010, we will continue to be selective around the business that we choose to underwrite, as well as price that we obtain, and we will not sacrifice the underwriting quality for growth.

An increasing level of our written premium in Commercial Lines is coming from our partner agents. For the first time last year, the amount of premium written through our best partners exceeded 50%. This is an important threshold in our journey, as it validates the viability and the relevance of our strategy, and reflects the momentum we have established our business.

So in summary, results for the fourth quarter of 2009 contained a significant amount of noise, and we're below our expectations. However, 2009 was notable for how much we developed our franchise, as we ramped up our capabilities and continued to invest in our future, as well as continuing to grow in targeted geographies and product lines. Through this growth, we continue to improve the overall mix of our portfolio towards higher-margin Commercial Specialty and Segmented Businesses.

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At the same time, we are improving our Personal Lines mix, focusing on growth states and more attractive full account business for our best agents. We're very pretty pleased with this continuing shift in our book of business.

We're excited as we look forward to 2010 and 2011, and we will reach another level in terms of product capabilities and agency penetration, as well as achieve greater scale with respect to many of our newer geographies, products and transactions. With more than 30 new products and product enhancement launches this year, including recent acquisitions, our renewal rights deal and a high level of agency penetration we are achieving with most of our partners, we believe we will significantly enhance our franchise, while producing attractive margins.

We believe that pricing and economic conditions will continue to be difficult during 2010, particularly in Commercial Lines. However, we're confident that we will continue our product innovation and segmentation, reach in transactions and partner agent support, and we'll be able to continue to manage our business well and deliver solid returns through this part of the market cycle. Looking forward to 2010, we are confident that we will absorb the product capabilities we built and leverage partner agent relationships that we've developed.

Before I turn the call over to Gene, I want to provide you with some visibility on our leadership structure, as well as give you just a quick update on our January reinsurance renewals.

Mark Desrochers was recently named head of our Personal Lines segment. Mark has been with the company since 2006, and has been in effect, acting in this capacity for the last year. In Commercial Lines, we've structured our leadership in order to align the strength of our management team with the various challenges and opportunities of our expanding businesses.

Notably, Jack Roche, who has been with us since 2006, is leading our Small and Middle Market businesses; Tony de Padua, joined the company in December, and is leading our Marine and umbrella businesses, as well as our core Commercial products and underwriting functions; Dave Firstenberg, who has been with us since 2001, is leading our Surety and Hanover Specialty Property businesses, as well as product and underwriting functions for certain of our Specialty businesses; and Andrew Robinson, who has been with us also since 2006, is leading our AIX and Hanover Professionals businesses. We clearly have a strong leadership team and this structure allows us to leverage that strength.

With respect to our reinsurance renewals, we renewed our largest treaties at essentially the same structure as the expiring programs. We achieved a rate decrease in our catastrophe treaty in the low single digits, on a program that was already very competitively priced. For our casualty treaty, our renewal cost was basically flat. 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'd like to touch on a couple of non-segment earnings items in our income statement on Slide 17, before I move on to discussing our balance sheet.

For the full year 2009, net income was $197 million or $3.86 per share, compared to $21 million or $0.40 per share in 2008. A favorable year-over-year net income comparison reflects 2008 net realized investment losses of $97 million and 2008 losses of $85 million related to the sale of FAFLIC. Net income in the fourth quarter 2009 was $57 million or $1.14 per share, compared to $34 million or $0.66 per share in the prior year quarter.

Fourth quarter of 2009 benefited from realized investment gains of $11 million resulting from some portfolio repositioning. Net income for the fourth quarter 2009 also included a benefit of $6 million, related to a release of a deferred tax valuation allowance related to capital loss carry-forwards, as a result of the implementation of certain tax planning strategies. In addition, there was a further benefit from this strategy of $27 million reflected in AOCI, which I'll touch upon when I discuss our book value for the quarter.

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Now I'd like to move on to a discussion of our balance sheet, starting with a quick overview of the company's investment portfolio. I'm now on Slide 18. At the end of December we held by $5.2 billion in cash and investment assets. Cash and fixed maturities represent 98% of our total invested assets. Nearly all or roughly 93% of our fixed income securities are investment-grade.

In the fourth quarter of 2009 we sold $59 million of our equity holdings and reinvested the proceeds into fixed maturities, which we believe represent better long-term value. Aside from this modest change, the composition of our portfolio remains largely the same as in the prior period. The average duration of the portfolio is 4.2 years.

Net investment income from continuing operations in the fourth quarter was $64 million compared to $65 million in the prior-year quarter. For the full year 2009, net investment income from continuing operations decreased $7 million to $252 million compared to $259 million in 2008. This decrease is due to lower new money yields, as well as the utilization of fixed maturities to fund the 2009 repurchase of corporate debt. Year end yield on our fixed income portfolio remain relatively flat at 5 53 for the full year 2009 compared to 5 65 in 2008. New money yields were 4.88 in the fourth quarter 2009 and 4.68 for the full year.

Skipping to Slide 21 for a discussion of our unrealized gain position. Our net unrealized gain position decreased by $13 million in the fourth quarter. A spike in interest rates late in the quarter drove the modest decrease in market values of our portfolio with longer duration assets being affected more substantially, as in the case with our taxable municipal bond portfolio, which has an average duration of almost seven years. Per labor reminder, our municipal portfolio is predominantly taxable munis [municipal] due to a rather large alternative minimum tax carry-forward position. We are very comfortable with the credit quality of our entire portfolio, including our municipal bond holdings and CMBS. These portfolios are highly-rated and well-diversified.

Turning to Page 22 for a discussion of recent capital management actions. We continue to open-market repurchases of our common stock in October and November, for a total cost of approximately $12 million. In December 2009, our board approved the third increase in our stock repurchase program and authorized an accelerated stock repurchase transaction, under which we have repurchased 2.4 million shares.

Additionally, since the end of December we bought back another 100,000 shares of common stock for $4.3 million through our 10b5-1 plan. This plan expires today, leaving us with approximately $87.5 million remaining under the current share repurchase authorization of $300 million. Looking ahead, it is our intention to be opportunistic about future share repurchases as well as other capital management actions.

After a successful restructuring of our corporate debt and drawing the $125 million of Federal Home Loan Bank loan, our consolidated corporate debt stands at $434 million. This equates to a debt to total capital ratio of 15 1/2%, which is below our long term targeted ratio of low to mid-20s, providing us with flexibility going forward particularly in light of the current rate environment.

As Fred mentioned, capital management is an important part of our overall operating strategy, and we will use this lever overtime, along with earnings growth to achieve our targeted returns. We expect to generate an additional capital in 2010 and we will take a balanced approach in returning this capital to shareholders, as well as utilize it to support growth, including the capital required to support premium growth arising from the renewal rights transaction with OneBeacon.

On Slide 23, we've displayed changes in our book value per share, which improved by 3 1/2% in the fourth quarter of 2009 to $49.72, a 34% increase for all of 2009. Let me go through the changes in AOCI. First, as a result of the annual actuarial review of pension related items, our AOCI pension debit balance decreased by $21 million in the fourth quarter. Additionally in January, Hanover Insurance Company made $100 million contribution to the company's qualified pension plan. And as a result, the plan was fully-funded as of that date. The liquidity for this funding occurred within the Hanover Insurance Company, do not affect holding company liquidity and will not immediately impact book value. The decision was driven by asset liability management considerations. Also, as I mentioned earlier, an additional $27 million release of the deferred tax valuation allowance also ran through accumulated other comprehensive income in the quarter.

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Turning to Slide 24, our balance sheet remains very strong. Our GAAP equity decreased $48 million during the quarter, reflecting the open market repurchases in ASR for a total of $112 million, as well as dividends of $38 million. On a per-share basis, book value increased 3 1/2% as I mentioned earlier.

In the fourth quarter, we paid an ordinary annual dividend from the insurance company to the holding company in the amount of $154 million. After this dividend, statutory surplus ended the year at $1.74 billion and a 1.5 to 1, our premium to surplus ratio remains more than acceptable for our current ratings and mix of business. Holding company cash and investment securities were $293 million at December 31.

This concludes the prepared marks for my last earnings call with Hanover Investors. I will retire shortly at age 65. And I really enjoyed working with all of you over the course of my two plus years at the Hanover. The recent financial crisis definitely made my experience even more interesting. Thanks for your confidence, trust and support during this difficult period. With that, I'll turn the call back to Bob.

Robert Myron
Thank you, Gene. Operator, that concludes our prepared remarks. Could you please open the line for questions?

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Question and Answer

Operator

[Operator Instructions] Our first question is from Jay Gelb of Barclays Capital.

Jay H. Gelb
Barclays PLC, Research Division

If I could hone in on the guidance range of 3 85 to 4 20, you're saying the first quarter is going to be challenging, so I guess that means you're going to earn less or something less than the dollar a share in 1Q. That would mean well over a dollar a share for the remainder of the year. What's your level of confidence there and to what extent does that include expectations of reserve releases?

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

I think we feel very confident within that range. And I think what we're going to see during the year is a ramp-up. And the ramp-up is really a combination of three things. One is obviously, the growth that we're going to earn in from the renewal rights, and frankly the little acquisitions we've done and the growth we are seeing in the Specialty business earns it's way in, which has an impact both on obviously the premium growth, but it also has the leverage of all the expense because we have a tremendous amount of, if you can imagine, start-up and conversion expenses to get the products up and running for the conversion we'll going to do to our paper, which will occur mid-year on the OneBeacon deal. Second, the premium increases, we're seeing on Personal Lines are real and actually accelerating. And so you're going to see that earn in through the period. And it's, we're at five now and those are going to go up a little bit as we look forward. So you got that going through the period as well. And then the third piece is this weather. We typically have, because you thought as days that where Michigan and Maine and Massachusetts, and we tend to have a little bit of drag on our results in the first and a little bit in the fourth because of that weather. So I would say that, that's what the ramp-up looks. Now again, because so much of this is business as being presented to us, we have confidence that it will improve throughout the year. And again, if you can see it in the numbers based on the earned rate we're getting. So I feel pretty good about those range we've gave you.

Jay H. Gelb
Barclays PLC, Research Division

And how much will reserve releases contribute to that?

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

What we said before is that the reserve releases will probably moderate. They'll come down slightly through time, and our accident years will improve. And I think that's what will happen, this next year. And as we've said before and that's what will happen.

Jay H. Gelb
Barclays PLC, Research Division

And then for first quarter, how much startup expenses should we expect to be reflected in the quarterly results?

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

What you have seen in the ramp-up in the fourth quarter, I think you're going to see continue into the first quarter of next year. I mean, we have essentially this level of expenses going into next year that as a percentage of premium, et cetera is roughly what it is today. There's a little bit of spike, obviously because things like contingent commissions and variable cost like bonuses, et cetera that were lower last year

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because of our results. But I think you're going to see continuation of the expense levels we saw in the fourth quarter.

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

And obviously, with the large renewal rights deal, a lot of those expenses are front loaded, and it takes a little longer for that premium to earn its way through to offset those.

Operator

Our next question is from Michael Phillips with Stifel, Nicolaus.

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

I just want to make sure I confirm, on your guidance, that sounds like that 12% goal at the end of this year, you've got goal from in terms of timeframe a little bit?

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

Yes, obviously when they talked about that before three acquisitions and three new launches pf businesses. But I'm very confident in the trends. So what I have said before that the run rate in the fourth quarter was going to get closed before we did all these acquisitions and investments. And so I think it gets pushed back two or three quarters, but the trend is good. Again when I looked at it, all the businesses we brought in have been successful. I mean if you will look at the Hanover Special Property, we're getting nice traction there with our agents. The percentage of our Marine business is now with our partners is terrific. The LPL [Lawyers Professional Liability] stock has gone very well and we've gotten to a pretty sizable LPL books has got nice margins. So I am pretty confident that a lot of those businesses were over the hump because you can just imagine last year, like in LPL we put all the money in the front end and all the IP systems that we're going to use for the architects and engineers and the CPAs and the miscellaneous that we're ramping up. So I feel very good about the improvement that you are going to see in so many of those levers as we look forward. So again, I have reasonable confidence. The issue I got is that, as Marita said, this OneBeacon thing, we brought in 150 or so employees, January 1. Well you don't earn all that premium to match that in. And you can obviously some of that gets advertised but most of it, you just hits your bottom line. But the IRRs of all these transactions are terrific. So I feel actually terrific about the shareholder value and how it ramps up through the year. But it does push things back a little bit, given the amount of capital that I'm deploying to all these things and expenses.

Jay H. Gelb
Barclays PLC, Research Division

Questions, I guess surrounding Marita's comments on Personal Auto and kind of Health, the economy's impacted, the BI [Business Intelligence] trends there. I guess the place that I was most surprised was that line, Personal Auto and the current accident in the year and the uptick there. But if I look at how that line has performed for you guys in the past couple of years, you've seen an uptick in the accident margins, accident loss ratios pretty steadily, one or two points and almost three points here this quarter. That's so much surprising to me, given your changing focus to the accounts, given your rate change history that you guys like to stick to. So I'm a little surprised for that. So maybe you can comment on that and a little more detail on what you really meant by how the economy's affected? Is that just a change in attitude towards willingness to assume or what else are you talking about there?

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

Yes, I mean the first thing I would say is we have the rate increases we need to offset a lot of this. And perhaps we were a little late and a little slow in putting those rate increases through, but you saw the numbers that we put through in the fourth quarter. The first quarter and second quarter rate increases are just as strong, if not stronger in some of the places where we needed it. And in auto, this will earn its

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way through the book and it's pretty easy to do the math and see the results that these rate increases will have. As far as the economy, obviously, the unemployment rate, obviously the fact that there is some economic pressure there. Just speaks to the fact that the line needs more rate to offset that. And I think we've put the rate needed in place and you're going to see that on it's way through.

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

In hind sake, in corporate time sake, we're relatively conservative about the way we put up our reserves and then we mechanically will release in some of these lines because we try to be thoughtful, because we are getting into some new businesses. In perfect time set, I would say that in the last two quarters and the first two quarters, last quarters of 2008 and maybe the first quarter of this, we are probably a little light on auto rate, particularly on BI. And just to comment on the economy, to me, one of the things reason will be a little cautious, is this whole notion kind of the uninsured motorist issues, the PIP issues. And the uninsured motorist are interesting. People have talked about it, right? People are buying down coverages. Now, what's interesting is our customers aren't. When accidents occur, the people they are hitting have less insurance, where are more of them are uninsured. So there's a little bit of trend there. Again, all of these things are a little here and a little there. But we thought it was appropriate to be a little bit more cautious about our pick. I'm not excited about is that was the wrong word, but what has happened in the last 12 months, very clearly, maybe the last 18, is that many of the regional companies we compete against have gotten hammered. I mean if you looked at the regional companies in the Midwest and to some extent the North East, the accident years and their combines, all of them are in the 115 to the 120s. So the ability for us to achieve rate now and hold retention is very good. And so we're trying to be a little bit more cautious and aggressive about taking rate because we think it's both appropriate that we think we can. Because we see the retention of our business holds, and we see the actions that some of our competitors are having to take. You've seen just in Michigan alone in the last three or four weeks, a couple of downgrades. It is a tough environment,some of these States. And so, it allows us, as you say, we tend to take rate every year so we don't have a 14 point or a 15 point rate increase that we're going to have to take. So we believe that we will see very little disruption as we take that rate level, and I think it's prudent to do. And I think it sets us up nicely for the tail in the next year and '11.

Operator

Our next question comes from Dan Farrell of Macquarie.

Daniel D. Farrell
Macquarie Research

Just a question on Personal Lines. When you think about the accident year picks for next year obviously, maybe some upward pressure related to the non-cap weather and the higher severity in auto. But you're also getting a fair amount of price increase coming through, and I want to try and get your sense of how much of an offset you think that pricing increase will have to sort of balance that out, and the flow-through of when that starts to hit a balance and to when if it canned [ph]?

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

I think we're going to see some improvements in our acts. One of the interesting things about it, a lot of other folks are saying they going to have decay in their accidents. And I actually believe we have a shot, as you said, to improve our accidents, net accidents...

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

Yes, I would agree. What I would say is because of the size of our personal auto books, the actuarial science around this is pretty robust. So you can look at the sells, the States, the individual coverages, the rate that you're putting through it and pretty well predict where you think that's going to land. And we're really comfortable that we are going to see marginal growth with slightly increased performance

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in 2010. I think we've made the right rate actions. And as you know about the line, when you've got that actuarial science and that data, it's pretty easy to run it through and predict where it's going to land, especially when we're seeing the increase in our business coming from accounts. It's worked with preferred distribution sources, and we feel good about the next.

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

We said this in the last call, because of the weather in the first couple of quarters, and frankly the previous two quarters of the year before, in this non-cap we didn't assume that it was just because it was above average, we were going to say it was going to go away. We assumed that the vast majority of it was going to be permanent and we've priced accordingly and we've been putting in rates to achieve that, and some underwriting actions as well. And so if we get it close to -- if that improves at all, we feel very good about our ability to improve. And even if it doesn't, we believe we will. I don't think anybody sees the inflation levels of the rate levels were putting through with the book. So I do believe we have a very good shot to improve our accidents section.

Daniel D. Farrell
Macquarie Research

On the per share guidance next year versus your '11 to '13 ROE target, that would still be even pretty far from the low end of the 11% range. And I'm trying to understand, as we go in the longer term year, year and a half, can you talk a little bit more about the levers that can get you to that low end? What's your expectation, either premium to surplus changing from further capital management? If you can expand on what you think ultimately takes you there, even though it might take a little longer to get there?

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

Yes, say it was nice 98, right? So think about us at 95 is when you can get to the kind of returns I'm talking about for our book of business, right? This particularly sense you see our growth is kind of, in some of the casualty lines, we're a little bit, but more tails. So you're talking about three points through the cycle. Well, quite half of that, and maybe up to two in many cases is an expense issue, right? It's essentially we've overinvested to try to build these businesses. Well you can imagine our commercial growth that you can see because of the OneBeacon and what we've done, on the leverage that we're going to get on the expenses. Now again, it's tough in the first half of the year. But I'll tell you, you can see that in every line of business, we should see improvement next year as we go through the year. Expenses are a little odd, right? Because where mix is going so much to commercial. Our total expense ratio might go up because of the mix changes so much the commercial for personal. But in each individual line of business, you can imagine, by the end of the year, we're going to get wonderful leverage. And I can tell you, our operating model's working. I feel very good about it. I'm willing to ramp this up and the ability to take this stuff on is real. And I see that we're going to have a greater leverage and all of that. So that is going to happen, right? And even with the market doesn't turn, we believe that there's enough quality business in this OneBeacon book. And there's enough book roles, books thins that we're getting from our partners, enough growth momentum from our Specialty business, that we're seeing very good business, and we're going to see growth in many of these Specialty businesses that will allow that leverage to occur. Second lever, we have thought we have probably somewhere between $200 million and $300 million of excess capital still. I've tried to be thoughtful about how we use it. We've started to give it back to our shareholders in a number of ways. If we see additional growth opportunities that get up the kind of returns, go get it and we use the capital that way, but if we don't, we'll continue to be thoughtful to think about the best way to get it back to our shareholders. And we've been fortunate to be able to give it back to them at under book value, which again is a wonderful depreciation of value. We're not giving up on that, that we still have a significant portion of that, that there's some opportunity there. And then on third, on top of those two, the question of accident that we've been talking about, we have not been bashful. If you look at our competitors, I would argue that our small commercial and middle market rate increases is as good as anybody in the business, and that our mix has improved every single day. We write a lot less flow than we've ever written, a lot more segmented, a lot more niches, most of that stuff is coming in that better than expiring rate. So our mix of business is improving every day and

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in Personal Lines, we know we had an issue particularly with weather this year. And we believe we've achieved great rate and the retention, who is not so encouraged about retention because, I'll tell you, accounts business when you haven't grown at home and auto, your abilities are retained and you put in a 5% or 6% or 7% or 8% rate goes way up. And so our ability to do that. And remember, we also have limited partners. So we don't have this 10,000 partners with five policies with us. We know everybody that holds our business, is going to work to retain that business. Our confidence in our margin improving in all our lines of business, I will argue, will go up. So again, I look at this and I say it is and it isn't far away. I mean, again, you look at the run rate, I talked about the run rate and how the back half of next year happens and as you go forward, we are getting much improvement. And obviously, our cost of capital, and everybody in the industry has changed and going down a little bit, which is also an added benefit to our shareholders, given the rate environment. But I do think all three of those levers are very visible to us. I mean, We have obviously taken advantage of the disruption in the current market and made the adjustments. But we haven't made investments and lost a lot of money doing it. I simply have been thoughtful about it. Have we taken some margin away by doing it through expenses? Absolutely. But everything we've done is accretive. Everything we've done, I look at it and I say, its built with the value of the operation in the enterprise. And I feel really good about where we are. Frankly, I wouldn't trade our spot with anybody else in the industry because we have a real upside I think, and it's starting to really work. And I really feel that our position with agents gets better every day because it puts them in such [ph] strain on the organization's shore. Is it operationally difficult? Absolutely. But I'd rather do it this way because remember what we're doing, we're doing small face value business with the right 700,000 winning agents in this country in particular, very sticky. It's hard to get, and it's hard to lose. That is so much better than going to the brokers and the wholesaler for large accounts to try to cover overhead with worker's comp and large casualty. So while it's harder to do, what we are building is a very, very high-value position with agents that's very sustainable. So again, I feel very good about our book value growth and our shareholder growth in the next two or three years.

Operator

Our next question comes from Larry Greenberg of Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

So you guys do appear to clearly be pushing price a little bit more aggressively than we hear from others. Can you just talk about how your retention rate is doing? And then secondly, just wondering, Gene mentioned a little bit of portfolio repositioning. I'm wondering if you could elaborate on that? And talk perhaps about the tax rate for 2010 and whether that repositioning has anything to do with your tax position?

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

First on retention, obviously you saw in the material that our retention ratio in Commercial Lines is down slightly. And as we've said in our scripted comments, that we'll take that trade off all day long as we push rates in these core businesses. Our retention on our Specialty Niche segmented business actually is a little bit higher, so we feel good about that. And like we said in Personal Lines, on the retentions holding, as we push these rate increases. So that we're going to continue to push that line and find that balance. but in the Core Commercial business, I think its right, right now for us to make that trade-off continue to push prudent rate and if the retention slips slightly, that's probably better for us moving forward. Fred's comment about more of our business being with partner agents, more of our business being tied up in total account, whether it's Personal Lines or Commercial Lines, I think is helping that retention pretty significantly.

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

On the portfolio repositioning, actually if you follow the cash, we've sold some equities in the fourth quarter and it found its way into the pension. So that really doesn't affect portfolio repositioning too much.

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It certainly doesn't affect the tax rate. It helps cash because you get an immediate reduction. So the pension contribution, we're not ready yet to shift our asset allocation to exempt municipals because we still have a alternative minimum tax carryforward that we'll probably still be feeding off for the next 18 to 24 months.

Operator

Our last question will be from Cliff Gallant of KBW.

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

In the past, are recently looking at your core book of business, your partner agents strategy has been very successful, not just growth but I think just the comfort with the quality that those agents produce. When you go into new States and you start to have traffic growth, how do you manage the quality and how do you apply that partner agent strategy to this new States?

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

What ends up happening is we are very -- we appoint very limited guys, and part of the dialogue is how do we get to a critical mass of controlled business relatively quickly. SO we actually get pre commitments to most of the folks we go to in these States. And so what you've seen us do in the last, is this handful of folks, we actually start with this OneBeacon book with many of them, it's not most of them. But what we have done is we go with the portfolio of segment and then niche, and Specialty businesses, which are our higher-margin business and we get commitment from folks and get more and more of the controlled business upfront. So we've done that and pretty much everything. And if you look at what's happening now in the growth States for the Personal Lines books, which is really important to us, is that as the commercial franchise gets stronger on the specialty and the niche, we can go to those partner agents and ask for more what I call ballast [ph], which is mature books of Personal Lines to thin out their books, so we get the critical mass. And that's the thing to me that's interesting, when people talk about us from growth. If you look at our growth, it almost all experience mature books in the form of book rolls or book thin. Like this LPL, we didn't just go get a lot of LPL one at a time. A lot of our partners took their small LPL that maybe they'll go into wholesalers where they were to another market and they gave us books of it or portions of it. And that's what's most exciting about this, this tends to be controlled business. And even if it's new, new like in some of the Hanover Specialty Property, it is books of business that have had a long track record of profitability, that the agent is selling through that because of the specialty nature of the business or because of the features that we have. So I actually feel pretty good about the agency strategy. And again, if we reasonably didn't do California previously, as I didn't feel that our product portfolio was distinctive enough to make that kind of ask. I mean, before we were just a pure Personal Lines and more of a full Commercial to go to a significant agent and say I want some unfair advantage, when you didn't have enough distinctiveness was not in the cards. But the combination of the OneBeacon transaction and the portfolio we now have of niche and segment of businesses, it has actually worked out quite well. I mean, I'm actually feeling very good about it and that's why we picked the timing we did. The other point that's going on obviously, is that you can't underestimate this disruption. We all say because some of the big guys didn't get blown off, that there is a disruption. The stress of so many companies that haven't have not is starting to separate. And so many of these agents are being very aggressive, trying to get to know us and get to a level where we can have a real partnership. I mean the dialogue is not one-way. It's not just us asking. It is two-way, and it's been received really quite well. I mean, I'm actually as pleased as I could be of the best agents in this country really talking to us about significant change in share for them towards us. So I am encouraged. I really don't know what else to say...

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

Yes, I mean the only thing I would add to it, and Fred said it is, whether we were filling out our existing geography and entering a new state East of the Mississippi, like Maryland or Minnesota or going West with the OneBeacon transactions, they are not new places. They may be new places for the Hanover

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but they're not new places for the leadership and they're not new places for the underwriters who have worked on these books of business as many of them for 20 or 25 years. We've been lucky enough, fortunate enough to hire the veterans of this business and have great global leaders, and we always put the leaders and the underwriters ahead of the premium, which is part of the investment thing that we were talking about before having the leadership on the ground, having the underwriters embedded before you take on the premium, certainly helps your long-term profitability of the books. They may be new, but they're certainly not new to the people who are making the transactional decisions.

Operator

We have no further questions. You have your closing remarks, sir?

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

We just want to say thanks to everyone for participating, and we look forward to speaking with you next quarter.

Operator
Thank you for joining. This conference has now concluded. You may now disconnect.

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