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W. R. Berkley Corp. Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

[Operator Instructions]. And we'll take out first question from Josh Shanker with Citi.

Joshua Shanker - Citigroup

Good morning everyone.

William R. Berkley - Chairman and Chief Executive Officer

Good morning Josh.

Joshua Shanker - Citigroup

Three questions. The first one, as you gave the hypothetical scenario where a... in the specialty line now someone would have price you down by about 50%. I'm wondering these large price cuts, how widespread are these examples have you seen some cases, pricing down that dramatically? Two, given the share repurchase. I was wondering if there is some sort of anecdotal idea about when you come into the market for your own shares? And three, given what was maybe, taking out of context, you said in a previous conference call that you won't be a buyer of your own shares with these levels. I want to know what your own appetite is from that mentality at this point?

William R. Berkley - Chairman and Chief Executive Officer

Well, first, the issue when I said that I wouldn't be a buyer of my own shares was two quarters ago and when we certainly, we were thinking out of context. It really revolved and in part around the same question which was your second question that it isn't in my shareholders best interest for me to tell the world when and what price I'm going to buy my stock at. We'll buy the stock when we think it's appropriate and is recent use of our capital for our shareholders and if the stock doesn't sell at that levels, we'll get other ways to deploy our excess capital through dividends or whatever. But its not that we have a price that we think we should tell the world when the stock gets to \$30.04 or \$28.91 that we are going to buy the stock. We don't really set a price like that and it surely wouldn't be in anyone's interest for us to tell the world that anyway, because we are interested in buying the stock is attractive as we think we can for the Company.

Joshua Shanker - Citigroup

But through the first question regarded how often you are seeing radical cuts in certain contracts and when?

William R. Berkley - Chairman and Chief Executive Officer

No, I understand that question. I think that I was really referring particularly the areas that was... we're going back to the standard market. For example, Nutrition stores that were really clearly specialty risks are now being picked up by standard markets that serve as specialty retailer, and health change where they only have exercise equipment and they don't do any of the other kinds of things. So, they are now being picked up, as long as they don't have pending loans [ph] at the loan side.

So, what I'd call is people are so anxious to get business as is everyone at the moment, that they are rationalizing way the reasons they were in the excess and surplus lines business originally Josh, and

then they are falling back to the standard lines market. And once they get in the standard lines market there, they are being what I call book underwritten. They are looking up on page 93, column 4, class 7 and that tells you the price and that price is often not at all related to what we in the... in as business would assess the risk at and its more of an isle categorized risk.

So, the prices are down substantially and its... I wouldn't say it's a huge amount, but it is... we are seeing that in the past six months for the first half in quite a while.

Joshua Shanker - Citigroup

I appreciate the color. Thank you.

Operator

Thank you and we'll now move on to our next question. We'll now take a question from Charlie Gates with Credit Suisse.

Charlie B. Gates - Credit Suisse First Boston

Hi good morning, a couple of questions. My first question, Bill if you would have looked back in history, what period of time from a competitive standpoint similar to where we are now?

William R. Berkley - Chairman and Chief Executive Officer

How far back do I look?

Charlie B. Gates - Credit Suisse First Boston

I look 30 years.

William R. Berkley - Chairman and Chief Executive Officer

30 years is not very far Charlie. I would guess that we're probably... putting aside... you have to put aside and look which sort of changed the pattern of there are some, I would say we're probably in 89, maybe 90, we are clearly enacting your basis, you are marginally profitable, and heading down, I think business is written now for the best companies has underwriting profits and for the average company, underwriting profits are on actually year basis is probably aren't there.

Charlie B. Gates - Credit Suisse First Boston

Second question, I think by most, any definition seemingly the industry is much over capitalized. What do you see is the out growth or the implication of that?

William R. Berkley - Chairman and Chief Executive Officer

I think a number of companies... firstly I think some thing's have changed. I think that... we have Sarbanes-Oxley which is forcing people to be honest about their numbers. We have a lot more companies, new companies who are trying to find their place. But they can't hide bad results. I think that we have no catastrophes or consequences went through this year. So you had a lot of people who are over capitalized that's still good no return. I think that though... let me correct myself, a lot of people are over capitalized still getting an okay return, I said no return, I apologize, because they had no catastrophes losses. So they are getting an okay return, even in all the way over capitalized with no cap losses.

So I think at the moment everything looks okay. I think that as time evolves new capital is going to come in the business in a different way and I think it's going to come in the business in a matter of that it's temporary capital. It will come in as side cars and other vehicles where investors can put their money and then get it out because in spite of lots of promises many of these people put their money in vehicles but they expect it to be liquidated or merged out and they get their money out and that hasn't happened.

So at the moment I think that we are stuck with a lot of more embedded capital than the industry needs. There will be some mergers, mergers are hard it means people giving up positions, it means a whole lot of different things happening, but I think mergers are inevitable. There will be more consolidation to business and I think that's going to continue. So, I think that my forecast is, next

round of capital raising will come in on a short-term basis, side car type vehicles, that a number of the newer entrants will have to consolidate, and a lot of people who have big amounts of capital but don't have any distribution relationships are going to have to have merger partners or find other ways of returning their capital.

Charlie B. Gates - Credit Suisse First Boston

Was there, an insurance aspect of the acquisition of the aviation company?

William R. Berkley - Chairman and Chief Executive Officer

No, it was really... it was really just part of our investment portfolio. It was part of our private equity investment portfolio. It's just a small investment and we're just buying some of these things with the view that it will go public or we'll spend it out to our shareholders, do something else. It's just a good return business that I coincidentally knew something about nothing particular.

Charlie B. Gates - Credit Suisse First Boston

My final question. I think Gene made reference to two investment managers, some issue with regard to those in the quarter and I didn't understand that.

William R. Berkley - Chairman and Chief Executive Officer

The answer is we have a few outside investments in both the real estate and merger arbitrage business they are outside and two of them did give us very low returns in the quarter just compared to what they had been giving us. So, that was the reason our investment income was not up as much as one might have expected.

Charlie B. Gates - Credit Suisse First Boston

Thank you.

Operator

Thank you. And now moving on our next question from Michael Phillips. with Stifel Nicolaus.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Thanks. Good morning, a couple of questions here. First to try get my hands around how you think about the margins put under your current business. The answer to your product question that you just gave to Charlie on the industries on an x year [ph] basis, the industry is still marginally profitable but of course heading down. How in fact that your prior year business has been developing pretty well have changed the way you think about your current year when you set up your initial reserves?

William R. Berkley - Chairman and Chief Executive Officer

I think that when we look at our current year, each successive year loss picks are based on prior year loss picks and the development of those prior year loss picks. Looking at combination of Case and IBNR, it's not that we get smarter, we get older, and older that you look, more accurately what was happening before. So, for instance, in our California comp, it wasn't that suddenly we had much better results; it was that we started to see the real results that changed and won the development and we felt confident in making changes.

So, we effectively are just constantly looking back and trying to evaluate, what should our current loss pick be? How did the prior years develop? And while we may not take down everything that was there in the prior years we are constantly using that data to make the best pick we can in the current year given inflation and price changes.

So, it's really a continuum of adjustments and you try to get it as right as you can in a longer... you have the better you are going to estimate. So, if I know 2004 with a lot more accuracy, I am going to have a much better pick on 2007 because I built 2007 from 2004. So, it's just a continuing process.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Okay. But it wouldn't be incorrect to say that, if we looked at margins in your current business, they prior deteriorated from last year just given what's happening with rates, I mean, I think your loss

trends in the carriage business they are going to be pretty favorable but with rates coming down, it's fair to say that the margins are not quite what they were last year?

William R. Berkley - Chairman and Chief Executive Officer

I think that our current year loss picks reflect that our expectation of that deterioration I think our loss picks, probably three or four points worse.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Okay, good. And just real quickly on the break out that you put in the income statement, the margins on that business... is that pretty stable?

William R. Berkley - Chairman and Chief Executive Officer

I'm sorry what are you talking about?

Michael W. Phillips - Stifel Nicolaus & Company Inc.

On the wholly owned stuff that you broke out in... on the income statement is the margin there pretty stable?

William R. Berkley - Chairman and Chief Executive Officer

Yes.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Okay, great. That's all I have. Thank you.

Operator

Thank you. We'll now take a question from Jay Cohen with Merrill Lynch.

Jay Cohen - Merrill Lynch

Yes, two questions. The first is with the reinsurance business, shrinking the most among your segments. I guess my assumption is that that's one of the more capital intensive businesses and if that's the case, does that essentially free up capital a little bit quicker?

William R. Berkley - Chairman and Chief Executive Officer

Capital as it primarily today related as much to loss reserves as the volume of premium, and it also has a longer tail, so just because you are writing less business, your reserves aren't going down and in fact, even though we are writing less business, we're putting out more reserves. So we are... I wouldn't expect that, that's going to happen.

I think we are very comfortably capitalized and we have no problem. Basically we're looking at our earnings and saying what do we want to do with the earnings, I don't think we need to build up any of new capital. So to suggest that we're going to look at these new capital we generate and see what do we want to do with it, what do we need, we don't think we need it to run our business per se unless opportunities change. So... but I don't think we think we should just sort of pull out capital that's embedded in the business at the moment.

Jay Cohen - Merrill Lynch

Okay. Next question, the higher commissions, was that simply a change in business mix or did it relate to any strategic change that you made as far as commissions you are paying out?

William R. Berkley - Chairman and Chief Executive Officer

I think the commissions are partly, we have contingencies for our standard market businesses. Then, there is slight changes in business mix, but the commissions were 3% of the base of commissions. So, it wasn't three percentage points higher. Gene's statement was a little confusing if you just listened to it as it was a 3% of our standard commissions, one up so it was sort of probably a four-tenths of a percent increase in commissions. Most of that was contingencies because underwriting profits have been so good and we expect that this probably pretty good embedded underwriting profits.

Jay Cohen - Merrill Lynch

And, I guess lastly, what's the rationale for growing the IBNR as much as you have when in fact, your premiums are shrinking. I assume unit count is not growing?

William R. Berkley - Chairman and Chief Executive Officer

No. Well. I ask the guys and the claims people and presidents of each of our units and I ask all the Senior Vice Presidents, many of whom I am looking at around this table now and why are they low bowling me, Jay? And, I asked them that same question and then I asked the actuaries that and, you know, they tell me that these are their best estimates of the numbers and no one would want me to arbitrarily lower our reserves. So, I just simply tell them that I don't like it. I think our reserves are probably erring more on the conservative side. But it is in fact the blended view of all of the people involved and it's not so conservative that I feel I can't live with it. It's on the conservative end of what I believe is reality but we have a big amount of reserves and we've had positive developments of the past few quarters and my expectation is that will continue. But the fact is that the worst thing for an insurance company if its decentralized too is to go out and direct the people in the field to change their reserves. So, unless we can't live with it that's just not where we're going to. There are occasions where that maybe the case but it's surely not how we want to run the business.

Jay Cohen - Merrill Lynch

Right. Thank you.

Operator

We'll take our next question from Scott Heleniak with Ferris, Baker Watts.

Scott Heleniak - Ferris, Baker Watts

Hi. Good morning. Just a couple of quick questions. First of all the California workers' comps have the latest reforms. Does that really change your mindset on doing business out there? It was just passing this a couple of weeks ago in one way or the other.

William R. Berkley - Chairman and Chief Executive Officer

We've restrained ourselves in California. We've kept business to at least something less than 5% of our overall total. We recognize that things change in California, its political environment that's constantly changing some times good and some times bad. We think we have a terrific team of people there, who understand the business and therefore this is a business that provides us good opportunity and, no, we are not going to... just as we didn't rush in to write all the business we could and make it a huge part of our company, we are not going to run away with... we are in there, we are pretty happy with our people. We think we understand how to make money there and no we are not going to change the review in California.

Scott Heleniak - Ferris, Baker Watts

You don't think it will be that much more competitive then it is right now just...

William R. Berkley - Chairman and Chief Executive Officer

It may be more competitive, but we think the best people can still make money there.

Scott Heleniak - Ferris, Baker Watts

Okay. And then the regional, I was just curious, what areas kind of your seeing the growth there and you also talked about the sticky pricing is this pricing off is it sort of flat or is off a few percentage points or wonder if you might make a comment on that.

William R. Berkley - Chairman and Chief Executive Officer

I think that our overall pricing is down around 5% for the year. That is low in 12 months and in the regional business pricing is down about 4% specialty business pricing is down a little over 7% and I think that more you can get across the idea to your customers, that they are buying service and that one out of five, one out of ten is going to have a claim and they want to be sure they get the company that gives them the service, when they are without one; you can sell that issue.

On price differentials get to be more than 10% or 12%, you are going to likely lose the business. So I think that at this point we are still able to handle large percentage of our business. Our retention rates are you know sort of 80% to 90% in general, little lower than that in the specialty areas.

Scott Heleniak - Ferris, Baker Watts

Okay. And then the start-ups in 2006, could you give an overview what the premium volume is, what they did for the quarter, third quarter?

William R. Berkley - Chairman and Chief Executive Officer

That \$35 million, I would still say, behind where I thought they have not really got an attraction. A couple of them have gotten great traction and couple of them have not. We have invested a lot of time and effort, we have a couple of people here who have actually gotten grey hair because of it and I think that we are working on getting that. What I think we are seeing is some real cost developments and the two start-ups we have this year actually, we had the middle of this year actually already in the quarter contributed about \$4 million of business. So and that will be more significant in the fourth quarter. So, still behind slower start for the '06 ventures to... or to an okay to a sort of not up to where we thought and we think that we now are on track with last year.

Scott Heleniak - Ferris, Baker Watts

And do you think, we are at the point of cycle where there is enough opportunity and prices come down and of the few, do you want to get in to somewhat new category expand or is it easier to just tie someone or do you still prefer kind of starting up, I know you made the acquisition this quarter but what's kind of your thoughts on that?

William R. Berkley - Chairman and Chief Executive Officer

Well, I think we'd always be happy to buy some of them. If we are able to but that's determined by price, risk in reserves and the quality of the people. I think there is almost always a risk in reserves. We were very confident and the management and the reserve levels and the people at American mining and we thought it was a first-class opportunity for what we think is a long-term industrial opportunity for us, which is why we bought American mining. So, there we didn't see any of the normal risks we normally expect. On the other hand, most things that we see have substantial reserve exposures, lots of uncertainty and even want a price far in excess of what would give us the kinds of return targets we have. It's a more immediate positive if you buy something but on real economic terms it's better to start if you are able.

Scott Heleniak - Ferris, Baker Watts

Yes. That's all my questions. Thanks.

Operator

Thanks. We'll now move on our next question with Mike Grasher from Piper Jaffray.

Unidentified Analyst

Hi. This is actually Joe Dimario [ph]. You may have already said this but did you purchase any shares during the quarter?

Eugene G. Ballard - Senior Vice President, Chief Financial Officer and Treasurer

Yes, we did so. During the third quarter we purchased 9.7 million shares.

Unidentified Analyst

10 million.

William R. Berkley - Chairman and Chief Executive Officer

9.7 million.

Eugene G. Ballard - Senior Vice President, Chief Financial Officer and Treasurer

12 million for the full year, for full 9 months.

Unidentified Analyst

Thank you. And my other question is you said on average you are seeing 5% price declines on retained business. But that... it could be, it was substantially lower on loss business. Can you give any more color on?

William R. Berkley - Chairman and Chief Executive Officer

We just, we kind of can't give you any statistics. We don't know but on the business we enquire about that we lose. We lose it for certainly more than 10% price differential.

Unidentified Analyst

Okay, thank you.

Operator

Thank you. [Operator Instructions]. We go to Sam Hopkin with Adar [ph].

Unidentified Analyst

Good morning, can you comment on the prospects for tax reform in Bermuda in terms of the facility of reinsurance, corporate inversions and any other options that are under consideration?

William R. Berkley - Chairman and Chief Executive Officer

Our only comment as to what's already public and that is we are working with a coalition of other companies, which consists of Liberty Heart for Travelers, Safe Go, AMPAC [ph], MBIA, Hartford, Chub, Berkshire Hathaway, Scottstel division of Nation wide, a number of others I probably have forgotten to get legislation to address the current status of facility of foreign, domiciled insurers who set up U.S. subsidiaries and then reinsure this business to low or no tax environments and we are working diligently with the people in Washington and we are optimistic that we will succeed in getting legislation.

Unidentified Analyst

What do you feel is the timing?

William R. Berkley - Chairman and Chief Executive Officer

If the President can't forecast timing for legislation that he wants, how should I be able to do that?

Unidentified Analyst

Okay, thank you.

Operator

[Operator instructions]. And now, we'll go back to Mr. Michael Phillips with Stifel Nicolaus.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Hey thanks. Just one quick follow-up on numbers item. I think you said last quarter that the reinsurance contract that you lost, that was running off this quarter. This quarter, the impact was around \$40 million, is that correct?

Eugene G. Ballard - Senior Vice President, Chief Financial Officer and Treasurer

For the third quarter, it's about \$30 million.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

\$30 million this quarter?

Eugene G. Ballard - Senior Vice President, Chief Financial Officer and Treasurer

Yes, third quarter, right.

Michael W. Phillips - Stifel Nicolaus & Company Inc.

Okay. Thank you.

Operator

Yes, thank you and now we will move on to the next question. We do now have a question from Charlie Gates with Credit Suisse.

Charlie B. Gates - Credit Suisse First Boston

Can one of you speak to the approximate size of the investment in sub-prime mortgages?

William R. Berkley - Chairman and Chief Executive Officer

It's virtually none. I think we have \$20 million in Alt A and I think that's it. I think one of our companies... one of our investor companies had roughly \$20 million of which we have sort of 10% piece, so to complement but Charlie, the answer is its pro-intensive purposes, it is none.

Charlie B. Gates - Credit Suisse First Boston

Do you have a... second question, do you have guesstimate as to what the off balance sheet asset specific to the grants property might be?

William R. Berkley - Chairman and Chief Executive Officer

You mean, how much our building is worth, Charlie?

Charlie B. Gates - Credit Suisse First Boston

Yes sir. relative to what you have paid for?

William R. Berkley - Chairman and Chief Executive Officer

It's probably worth more than a \$100 million above our quota [ph].

Charlie B. Gates - Credit Suisse First Boston

My final question.

William R. Berkley - Chairman and Chief Executive Officer

Is that a promise.

Charlie B. Gates - Credit Suisse First Boston

Yes sir, at this time. Do you see any implications for Company of the horrible fires in California.

William R. Berkley - Chairman and Chief Executive Officer

For us. None, it shouldn't be much. If there is exposure, it's going to be... it should be de minimus exposure. I really can't imagine that they'll be any... there'll be none that we go out there and write other than that we know of... by that I mean could we have \$5 million or \$10 million or \$20 million or \$30 million. Yes, its surely is possible, but its nothing that would have any consequential financial impact on the Company and it would be because I don't want to... I don't want to give you a more precise number because we think know we might miss one building that's on some schedule of some something but as far as we know it's virtually nothing.

Charlie B. Gates - Credit Suisse First Boston

Thank you.

Operator

[Operator Instructions]. And Mr. Berkley, there are no further questions at this time.

William R. Berkley - Chairman and Chief Executive Officer

Okay. Thank you all very much. We continue to be optimistic about being able to generate the kinds of returns we have seen. While it's always a challenging environment, we continue to believe that next year will offer us great opportunities to continue to do well, which in substantially see our target returns. So, thank you all very much. Have a great day.

Operator

Thank you. That does conclude today's conference call. We thank you very much for your participation. Have a great day.

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