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RE - Q2 2014 Everest Re Group Ltd Earnings Call

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OVERVIEW:

RE reported YTD net income of $584m and common diluted EPS of $12.46. 2Q14 net income was $290m and common diluted EPS was $6.26.

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PRESENTATION

Operator

Good day, everyone and welcome to the Second Quarter 2014 Earnings Call for Everest Re Group. Today's conference is being recorded. At this time, for opening remarks and introductions, I would like to turn the conference to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth Farrell - *Everest Re Group, Ltd. - VP of IR*

Thank you, Jessica. Good morning, and welcome to Everest Re Group's second quarter 2014 earnings call. On the call with me today are Dom Addesso, the Company's President and Chief Executive Officer; John Doucette, our Chief Underwriting Officer; and Craig Howie, our Chief Financial Officer.

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

Now let me turn the call over to Dom.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Thanks, Beth, and good morning. We are please to report on favorable second quarter results this morning. Our operating income per share has improved for both the quarter and the year over the comparable prior year period. Net income per share for the quarter was up over the prior year, but the six month number is lower for 2014 due to lower realized gains on investments in 2014.

The improvements in operating results are clearly driven by continuing and growing underwriting gains, offset of course, by declining investment income results. The underwriting results did benefit from lower cats this year, but do reflect $45 million of losses in the second quarter, half of that reported last year. Nevertheless, our underwriting gain in the first half remain strong at $423 million, which was up slightly over the prior year due to growth in premium earned.

The growth in premium was achieved while maintaining margins, which is a reflection of our ability to navigate through this market. Yes, rates are down in many of the cat exposed regions, however, by changing attachment points and reallocating capacity to different product types and new products we have been able to secure additional business at rates that meet or exceed our hurdle rates. In addition, our Mt. Logan and other similar arrangements permit us to present more meaningful capacity to clients, which enable us to secure placements at terms that are acceptable. This trend will continue into the third quarter as we have secured capacity from the Cat Bond placement we sponsored as well as some purchases of ILW capacity.

We are a significant market with over $7 billion of capital, and these strategies allow us to lever that up even further. Combined with our A Plus rating and team of innovative and responsive underwriters we are increasingly becoming a market of choice. Nevertheless, we must continue our disciplined approach. And in some segments you will note that we were forced to retreat due to pricing. John will cover this further in his report, but of particular note is the fact that essentially all of our net premium growth was in our U.S. reinsurance segment.

The insurance operation continues to perform well with an underwriting profit in both the first and second quarters of this year. Growth has been constrained due to the crop book, which has actually declined year-over-year by $75 million due to lower commodity prices. That means, of course, that all of our other targeted growth areas are doing well. Primary pricing is still increasing although at lower rates, and as such, our insurance result excluding crop is running in the mid 90s, which is an improvement over the prior year. The crop portfolio is expected to improve but will lag the other lines this year as we are making significant technology investments there this year.

We were active this quarter on capital management, and Craig will get into the details. Given the financial flexibility gained from our sponsored Cat Bond, the Mt. Logan facility, ILW purchases and our new debt offering we continue to have the ability to maintain share repurchases within our earnings stream while at the same time expanding the franchise. All in all we feel that with an increase in shareholder value per share of over 10% in the first half, we have done an excellent job in a challenging underwriting and investment market. We have the talent, resources, capital and most importantly discipline to continue that through the cycle.

Thank you. And now I will turn it over to Craig for the financial highlights.

Craig Howie - *Everest Re Group, Ltd. - CFO*

Thank you, Dom. And good morning, everyone. We are pleased to report that Everest had another strong quarter of earnings, with net income of $290 million or $6.26 per diluted common share. This compares to net income of $276 million or $5.56 per share for the second quarter of 2013. Net income includes realized capital gains and losses. On a year to date basis, net income was $584 million or $12.46 per share compared to $660 or $13.09 per share in 2013. The 2014 result represents an annualized return on equity of 17%.

Operating income year-to-date was $532 million or $11.35 per share. This represents a 3% increase over operating income of $10.99 per share last year. These overall results were driven by a solid underwriting result offset by lower net investment income compared to the first half of 2013. The results reflect a stable overall current year attritional combined ratio of 80.9% on a year-to-date down from 81.0% at year end 2013. This measure excludes the impact of catastrophes, reinstatement premiums and prior period loss development. All segment reported underwriting gains for the quarter and for the first half of 2014.

Total reinsurance reported an underwriting gain of $181 million for the quarter compared to a $134 million underwriting gain last year. For the first half of 2014, total reinsurance reported an underwriting gain of $396 million compared to a $344 million gain last year.

The insurance segment reported an underwriting gain of $4 million for the quarter compared to a gain of $9 million last year. And on a year-to-date basis the insurance segment reported an underwriting gain of $8 million compared to a gain of $9 million in 2013. Each year reflecting a $2 million underwriting loss for crop insurance during the second quarter, primarily due to the seasonality of crop premiums.

Mt. Logan Re's financial position and operating results were consolidated into Everest Re beginning July 1, 2013. These results are shown in a separate segment, and reflected a $9 million underwriting gain for the quarter and a $19 million underwriting gain year-to-date. Everest retained $3 million of this income, and $16 million was attributable to the non controlling interest of this entity.

The overall underwriting gain for the group was $195 million for the quarter, compared to an underwriting gain of $143 million for the same period last year. On a year-to-date basis the underwriting gain was $423 million, compared to a gain of $353 million in 2013. These overall results reflect $45 million of current year catastrophe losses in the first half of 2014 all recorded in the second quarter. Of the total, $30 million related to late reported loss from the snowstorms in Japan, and $15 million related to the earthquake in Chile. This compares with $90 million of catastrophes during the first half of 2013.

Our reported combined ratio was 82.5% for the first half of 2014, compared to 84.2% in 2013. The year-to-date commission ratio of 21.9%, was slightly up from 21.2% in 2013, primarily due to higher contingent commissions. Our low expense ratio of 4.5%, continues to be a competitive advantage.

As for loss reserves, in June we released our fourth annual global loss development triangles for 2013. There were no major changes since the 2012 release. Our overall quarterly internal reserving metrics continue to be favorable.

For investments, pre-tax investment income was $131 million for the quarter and $254 million year-to-date, on our $17.6 billion investment portfolio. Investment income for the first six months declined $40 million from one year ago. This decrease was primarily driven by the decline in limited partnership income for the year, although low reinvestment rates and capital used to redeem stock and debt also contributed.

Limited partnership investments resulted in a gain of $6 million for the quarter, compared to a gain of $20 million last year. On a year-to-date basis, the gain was $4 million, compared to a gain of $37 million in 2013. Our existing limited partnership portfolio is fairly mature, and as result, we have seen a decline in current gains coming from these investments. Despite the declining rates, our investment portfolio continues to perform well. The pre-tax yield on the overall portfolio was 3.1%, with a duration of three years. The first six months reflected $52 million of net after-tax realized capital gains compared to $106 million last year. These gains are mainly attributable to fair value adjustments on the equity portfolio. There were $2 million of derivative gains during the first half of 2014 compared to $27 million of gains last year. This is related to our equity put options and is a function of the change interest rates and indices this year.

Other income and expense included $15 million of foreign exchange losses in the first six months of 2014. This was mostly offset by foreign exchange gains on bonds reflected in other comprehensive income.

On income taxes, the increase in the effective rate is primarily driven by lower than planned catastrophe losses resulting in higher than expected taxable income for the year. The 14.4% effective tax rate on operating income is in line with our expected rate for year given our planned cat losses for the remainder of the year. Strong cash flow continues, with operating cash flows of $590 million for the first half of 2014 compared to $439 million in 2013.

Turning to capital management, we issued $400 million of 4.868%, 30-year senior notes in June to replace our 5.4% senior notes that will mature in October. Shareholders' equity at the end of the quarter was $7.3 billion up $355 million or 5% over year end 2013. This is after taking into account almost $400 million of capital returned through $325 million of share buybacks and $69 million of dividends paid in the first half of 2014. Additionally, we repurchased another $10 million of stock after the quarter closed. These purchases will be reflected in the third quarter financial statements.

Book value per share increased 9% to $160.27 from $146.57 at year end 2013. Our continued strong capital balance positions us well for potential business opportunities as well as continuing stock repurchases.

Thank you. And now John Doucette will provide the operations with you.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Thank you, Craig. Good morning. As Dom highlighted, we continued our strong results in to the second quarter of 2014. Our group gross written premium was $1.42 billion up $155 million from Q2 of last year with growth coming from each of our reinsurance segments. Net written premium was $1.22 billion, which was closer to flat given the various hedges. For our reinsurance segments total reinsurance GWP including Logan was $1.1 billion for the quarter up 16% from Q2 last year. We remain optimistic on our reinsurance operation despite several market headwinds. We are successfully navigating this market and growing profitably by utilizing our many competitive advantages including:

Our leading global market position, franchise and representation;

Our strong ratings and well capitalize balance sheet;

Our expense ratio advantage over our competitors and our culture of bottom line execution;

Our best-in-class analytics, which allows us to make informed and accretive portfolio management decisions;

Our state-of-the-art enterprise risk management framework, which recently got upgraded to strong by S&P;

Our utilization of the capital markets convergence both offensively and defensively across a variety of strategies to maximize efficiencies for our clients and maximize value to our shareholders; and

Our long-term trading relationships with our clients as one of the longest standing and largest reinsures.

These are all advantages that provide Everest with the edge in this competitive space.

We are also benefiting from strategic relationships we have been building and the new products we have been rolling out across the entire reinsurance division. All of this has enabled Everest to continue to profitably deploy its capital. This July 1st marks the one year anniversary of Mt. Logan, representing the successful partnering between Everest and third-party investors to opportunistically grow and deploy capacity in the catastrophe risk market. We believe this strategic initiative has been successful for all involved, and our unique Logan structure was validated by new investors again coming into Logan at 7/1, resulting in increased AUM even after paying out profits to our investors. We continue to believe that the Logan structure adds value to both our clients and out shareholders.

Our clients and brokers benefit from Everest being able to deploy more capacity on deals and layers which are attractively priced. Having access to both rated and unrated balance sheets allows us to deploy capacity to our clients in a more efficient manner than either one by itself. And our shareholders benefit from Everest's ability to deepen client relationships, better manage our overall capital and our PMLs, while achieving higher risk adjusted returns and improving our cost of capital.

As we mentioned last quarter, in addition to Logan we have initiated other PML and capital management strategies. We recently obtained fully collateralized reinsurance coverage funded by the Kilimanjaro Re cat bond and we were active buyers in the ILW space. Executing these strategies helped us trim some of our peak PMLs. Currently the price of risk around the world has decreased in many areas. But with our core advantages and deployment of several capital market strategies we can compete, win, grow and build significant shareholder value in any market condition.

Here is some color on June 1 and July 1 reinsurance renewals. For our overall global property reinsurance book at June 1 and July 1, we continue to grow our gross written premium aided by the additional capacity provided by Mt. Logan. While the expected combined ratio was up about 1 to 2 points year-over-year, the gross and the net dollar margin continue to expand in the overall book compared to the same period last year. This demonstrates the significant benefit of our long-standing diversified global portfolio across many clients, products and territories.

Across our book, Florida cat XOL rates were down approximately 10% to 15% compared to last year. Despite that we were pleased with our 6/1 renewal by growing our gross and net premiums as well as our gross dollar margin and our net dollar margin across the Florida book. This was achieved by deploying meaningful capacity on cat XOL deals which we liked with key strategic clients, while reducing shares or declining deals which we did not find attractive, and in some cases moving up attachments on our programs where we found rates were more attractive. In Florida and other USA regions there were some quota share treaties on which we were unable to come to mutually acceptable terms, so we came off. However, we also built new pro rata relationship as well as increased some existing quota share relationships where we liked the clients, the pricing, terms and conditions. We are continuously rebalancing both our cat XOL and pro rata books in Florida and elsewhere around the global as we seek the optimal position on the programs, which we believe provides us with the best risk adjusted returns while maintaining our relationships with long-standing clients. Our overall net, net Florida PMLs are flat from 1/1 as a percentage of GAAP equity against increased dollar margins given our portfolio management and hedging.

Internationally we found renewals a mix bag with some areas under rate pressure particularly China and Australia and correspondingly premiums were down in those areas. But in those and other areas we had better than market results due to our lead market position and the strength our relationships with long-term clients and brokers.

Turning to our overall casualty and longer tail reinsurance book globally primary terms and conditions remain attractive, but reinsurance terms continue to be under pressure for commodity type treaties and seeding commissions on casualty quota share treaties are generally moving up. Therefore we continue to execute new products and new opportunities and we saw some nice growth overall in our long-tail book. These one off highly customized solutions more than offset the GWP on the traditional casualty treaties which we declined due to pricing.

Total reinsurance including Logan bottom line, we continued the strong underwriting results with underwriting profits in the second quarter of $190 million up 42% compared to Q2 last year underwriting profits.

Now with respect to our insurance operations. Our premium was $316 million in Q2 essentially flat from Q2 last year. As mentioned, this is due to a decrease in crop premium at Heartland from lower commodity prices. Stripping out Heartland premium our Q2 insurance GWP is up 12% this year compared to Q2 last year. Rates are generally up in the insurance operation including casualty and workers' comp.

Property insurance rates were mixed depending on the type of risk and the territory. We continue to see profitable growth opportunities in many areas in our insurance book including areas that we have targeted, such as non program workers' comp, casualty, specialty and contingency lines, property E&S and DIC, accident and health and our Canadian insurance operations. However, we remain cautious in the professional lines with more capacity coming into that space.

Bottom line, our insurance results were profitable year-to-date and for the quarter. With the year-to-date results coming in at a 98.1% attritional combined ratio and a 93.9% attritional combined ratio excluding crop, which is better than the same result last year. We continued to be pleased with the underlying trends in our insurance book. We are seeing encouraging results of our insurance growth initiatives over the last several years with noted improvements in both loss ratios and expense ratios as well as premium growth in all areas of our insurance book except for Heartland this year. We expect these trends to continue with both top-line and bottom-line growth in our insurance book.

In summary the world of insurance and reinsurance is a rapidly changing world, and while there may ultimately be a structural shift in the market, we are as well positioned as anyone to benefit from these changes. We remain confident in our ability to achieve profitable growth for our shareholders, and we remain bullish on our future. Thank you, and now back to Beth for Q&A.

Elizabeth Farrell - *Everest Re Group, Ltd. - VP of IR*

Jessica, we are open for questions now.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). We will go first to Amit Kumar with Macquarie.

Amit Kumar - *Macquarie Research Equities - Analyst*

Thanks, and good morning. Just two quick questions. The first question relates to your underlying loss ratio ex-cat for reinsurance. I am looking at the numbers, and I am wondering, you are talking about pricing declines, why wouldn't that number go up? Is that more a business mix shift issue or is there more to it?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Amit, this is Dom. There are a number of factors. One is mix of business, another would be some of it is pro rata and to the extent that primary pricing is increasing that impacts it. And I think your question was just related to the reinsurance book.

Amit Kumar - *Macquarie Research Equities - Analyst*

Yes.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

And then new products in particular is what would be driving that and different lines of business that we are getting into.

Amit Kumar - *Macquarie Research Equities - Analyst*

So that is nearly offsetting the double digit declines in pricing?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Correct.

Amit Kumar - *Macquarie Research Equities - Analyst*

Got it. The other question I had is just going back to your discussion on the crop, how should we think about the future with the prices being down but the yields being up? How do you feel, how does this play out? I know it is a bit early, but would just love to get your thoughts for the future on the crop.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

You have already given part of my answer, which is it is a bit early. For now weather is looking favorable, so we are anticipating decent yields. Certainly commodity prices are down for now but there is still a lot of room to go on where that market settles out. And then you've got the issue of retentions by the -- or deductibles that the clients have retaining portion of the risk, so we are not anticipating at this point that the downward turn in commodity prices would be a factor. But there is still plenty of room to go here.

Amit Kumar - *Macquarie Research Equities - Analyst*

What percent of your --

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

(Inaudible).

Amit Kumar - *Macquarie Research Equities - Analyst*

I'm sorry?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Did you have a follow up?

Amit Kumar - *Macquarie Research Equities - Analyst*

Yes, what percent of your book is revenue based?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Amit, this is John. Most of it. A vast majority of it is revenue based.

Amit Kumar - *Macquarie Research Equities - Analyst*

Got it. I'll stop here and re-queue. Thanks for all the answers.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Amit, I want to go back also to your first question which is the declining property cat pricing, you also have to remember that property cat premium only represents about 25% of our total premium. So you can have a decline in pricing there but other new products and other things can -- it's highly levered, the impact of that is highly levered.

Amit Kumar - *Macquarie Research Equities - Analyst*

Got it. Fair enough.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Okay.

Operator

We will go next to Josh Shanker with Deutsche Bank.

Josh Shanker - *Deutsche Bank - Analyst*

Hi, good morning, everyone.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Good morning, Josh.

Josh Shanker - *Deutsche Bank - Analyst*

I wanted to talk a little about the premium cede in the international segment as it relates to pricing and as it relates to Mt. Logan's participation.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, some of the premium in the international is a result of some strategic relationships that we have with some large global clients, so that is dominating that. It is heavily reinsured as well. So that is dominating the cession there. And then, of course, you do have the Mt. Logan impact as well.

Josh Shanker - *Deutsche Bank - Analyst*

So the Mt. Logan portion of that would be the minority of the cede?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

That is correct.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Correct, yes.

Josh Shanker - *Deutsche Bank - Analyst*

And these relationships I guess you did not have them one year ago?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

That is correct.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Excuse me. Let me just clarify that. These were clients we had one year ago, but these particular transactions were not in place one year ago.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Yes.

Josh Shanker - *Deutsche Bank - Analyst*

And just what lines of business is this, and in order to get it you have to have a -- it is a fairly high cede, so I am just sort of interested in like what lines or I don't know what you are willing to say about it.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

It is across the whole lines of business. It's multi line quota share.

Josh Shanker - *Deutsche Bank - Analyst*

Okay. And you're willing to say as much as you want to say about it I guess. That was my only question.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, it is essentially the ability for these clients that need Everest in that marketplace with our rating and our capital and enables them to increase their participation in the markets that they operate in by partnering up with Everest on these particular transactions.

Josh Shanker - *Deutsche Bank - Analyst*

Okay. So these are reinsurance companies who probably couldn't get the business on their own?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

No, no, no, no. They are primary companies. They are primary companies.

Josh Shanker - *Deutsche Bank - Analyst*

So I guess you are retro ceding back to the client? I don't understand why there is a high cede I guess.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

That is correct.

Josh Shanker - *Deutsche Bank - Analyst*

Okay. Okay, very good. Thank you.

Operator

We will go next to Jay Gelb with Barclays.

Jay Gelb - *Barclays Capital - Analyst*

Thank you. On the international reinsurance segment with the retention the net to gross going down to 70%, do you feel that is something we should just see this quarter or will that affect the cessions going forward which is typically much closer to a -- where the net to gross is typically much closer to 100% in international reinsurance.

Craig Howie - *Everest Re Group, Ltd. - CFO*

Jay, this is Craig. I think this is something that we would expect to see going forward as well.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

This is John. We would also as Logan as we continue to cede business from all the segments we would see an impact to that at least somewhat within the international segment as well.

Jay Gelb - *Barclays Capital - Analyst*

Okay. Have you said before what portion of Everest Re's business is ceded to Logan?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

You can see that in the segment report in terms of what the gross written premiums that are seeded to Logan in the Logan segment at the back of the analyst report.

Jay Gelb - *Barclays Capital - Analyst*

So that is just direct from the Everest Re book.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Correct.

Jay Gelb - *Barclays Capital - Analyst*

Okay. And then on share buybacks the pace slowed in 2Q relative to 1Q, why was that?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Basically the price of the stock kept going up and exceeding our target in terms of what we gave -- instructions that we gave to our broker and we just couldn't keep pace with it.

Jay Gelb - *Barclays Capital - Analyst*

All right. I guess that is a good problem to have. Thank you very much.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Thank you.

Operator

We will go next to Kai Pan with Morgan Stanley.

Kai Pan - *Morgan Stanley - Analyst*

Good morning. Thank you for taking my call. The first question is just follow-up on Josh question on the retro buying. If you step back and think about strategically do you think it is a defensive move that you want to retain, maintain and grow the relationship or it could be a arbitrage that actually can enhance your margin offensively.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

This is John. Good morning. Lots of times around the world we have opportunities to partner and build strategic relationships with clients and there is a variety of reasons why they do that. And sometimes it is to get access to their business or our business or as Dom said earlier, to give them an opportunity to enhance their writings. As we have been saying for many quarters now, we have been building strategic relationships with this, which has -- gives us access to what we believe is profitable business and helps strengthen relationships with some of our long-standing clients around the global.

Kai Pan - *Morgan Stanley - Analyst*

Okay. And then you mentioned on sort of your global reinsurance book raise of pricing decline at (Inaudible) renewals expected combined ratio to deteriorate about 1 to 2 point, but that seems -- could you give more color on that? Seems more comparable with some of your pricing commentary you had said about the pricing decline especially in Florida pretty big, but it looks like the combined ratio deterioration relatively moderate so anything behind that?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, in part it is what I mentioned before ,and I will ask John to comment as well, but again recollect that the cat premium particularly the cat XOL premium, are total cat premium is 25% of our total premium volume. So if that pricing is down 10% to 15%, it is not going to be dollar-for-dollar impact to the combined ratio across the entire book, so there is that leverage impact.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Right. And the 10% to 15% was a comment on Florida rates. We also talked about how we move up in programs where the rates weren't -- we move within programs so that the impact to us may not be 10% to 15%. But then the comment on the one to two combined ratio points that was on our global property book. And I think that just highlights the strength of a diversified portfolio trading in 80 countries around the world where we write property reinsurance with clients that we have been trading with for a very long time, and it helps insulate our portfolio, and we look to grow areas around the global where we think we are getting paid to take the risks and that helps to insulate our portfolio for varied rate decreases that are happening in different areas.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

And remember in the first quarter, you might remember in the first quarter that we referenced some areas of the world rates were going up in particular Canada. So that is something that helps offset declines that we see in other territories.

Kai Pan - *Morgan Stanley - Analyst*

Great. Last question maybe for Craig. I saw that you mentioned the tax rate is going to be 14% or run rate or am I miss that?

Craig Howie - *Everest Re Group, Ltd. - CFO*

That is correct, Kai. So let me just explain a little bit. Taxes --operating tax specifically, operating tax are based on the geographic region where the income is earned, right. And then it is also based on the tax rate in that country. What we had is an annualized rate of 14.4%. That is higher than where we were after the first quarter at 13.8%. It is primarily due to the fact that we had lower than planned cat loss. So with a full cat load for the year, we would expect our tax rate to be somewhere between 13% and 14%. And with the remaining cat load for the rest of this year we expect it to be up at about 14.5%. If we look at this with no more cats for the rest of the year, I would expect that rate to even rise further to about a 15% to 16% rate. So it is really based on -- currently it is primarily based on the amount of catastrophes we have or don't have during the year.

Kai Pan - *Morgan Stanley - Analyst*

Great. Thank you so much for all the answers.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Thank you.

Operator

We will go next to Michael Nannizzi with Goldman Sachs.

Michael Nannizzi - *Goldman Sachs - Analyst*

Thanks. Dom, I just have a question on I think it was to an answer to a mix question about mix change. What lines of business are you growing in or are you mixing towards where margins are kind of similar or better than the cat business?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Most of it would be in the credit space. John?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

It definitely -- we are seeing some. We have talked about that the last several quarters. We also are doing one off highly customized products that we think have better pricing. It is not commodity. They are not just a plain vanilla product that everybody can do. Again some of these are very complicated products, that we have the underwriting talent, the actuary, the contract wording, tax, et cetera to bring to bear. And we are seeing a lot of traction in that.

Michael Nannizzi - *Goldman Sachs - Analyst*

Got it. And from a capital intensive perspective how do those products sort of compare to the cat business?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Well, the way we think of capital is capital where we are full -- areas where we were full attract -- either fullness or volatility attract more capital. So in a lot of cases we are not that full and a lot of these products have more structure to them, so they don't have the volatility that cat books have, so in general they attract less capital.

Michael Nannizzi - *Goldman Sachs - Analyst*

Got it. So this is an area, it sounds like, that you will continue to move towards. Good margins, you are getting paid for technical expertise that others can't replicate, so that seems like an area that you will look to continue to grow?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

That is our job, to find areas like that and others.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

And it is not just technical expertise it is also size, capital base, rating these are all things that give us a unique advantage.

Michael Nannizzi - *Goldman Sachs - Analyst*

Got it. Okay. Can you give an example, is this like in the mortgage guarantee space or is this something different?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

There is a whole array of deals. But as Dom said, we have done a lot of different things in the credit space, some in the mortgage space too.

Michael Nannizzi - *Goldman Sachs - Analyst*

Got it. Okay. And then one question about Mt. Logan, so the cat load there was higher than the legacy business. So is that what you would expect that Mt. Logan will run at higher cat load than the sort of on balance sheet business or was that somewhat anomalistic as we are trying to figure out how the relationship between that and your on balance sheet business moves.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

This is John. If I understand your question correctly, it is what is the embedded cat load as percentage of premium. Mt. Logan is taking all and only property catastrophe excess of loss business, where Everest on the reinsurance book and the cat load as a percentage of premium is applied to all lines of business. So you would see --

Michael Nannizzi - *Goldman Sachs - Analyst*

A more concentrated. Okay, that makes sense.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Yes.

Michael Nannizzi - *Goldman Sachs - Analyst*

Okay. And then just last question, Dom, I think a number of questions you mentioned 25% cat as percentage. Do you have any -- what is that in terms of as a percentage of underlying or underwriting profitability? Just trying to right size those two.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Our expected underwriting profit on a cat book would be running to a 50% to 60% combined ratio, that would be kind of what we would expect, somewhere in there. It depends on territory, it depends on attachment point, a lot of variable there. But that would be kind of the expected outcome of the outcome from the catastrophe book. Does that answer your question?

Michael Nannizzi - *Goldman Sachs - Analyst*

Maybe I didn't phrase it right. But I guess if cat premiums are 25% of total premiums is there an equivalent percentage or can we know what the equivalent percentage is of just profitability of total Everest profitability represented by your cat business?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, it is a significant portion no question. But you got the cats that earn the premium. And you have commission and brokerage that gets charged against that, so it is a significant percentage of profits, no question.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Given the volatility we would certainly expect it to run to a higher percentage of underwriting profits for us to assume the volatility tied to the capital. And we would -- likewise we would assume it to run to lower combined ratio.

Michael Nannizzi - *Goldman Sachs - Analyst*

Right, got it. Okay. Thank you.

Operator

We will go next to Meyer Shields of KBW.

Meyer Shields - *KBW - Analyst*

Thanks, good morning, everyone. John, one quick question. I guess I was a little surprised that you said you are moving up in attachment points in Florida because my understanding was that the higher the attachment points the more competitive things were. Am I misreading the situation?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

I think the situation is dynamic and I was trying to give a couple of examples and there's other examples that would be counter to that. But one thing I think we saw was some of the Florida companies moved up partially because of not having had cats over the last couple of years had moved up their retention. And again our view of risk may be different than other people's view of risk, but there were definitely cases where we thought the pressure on rates was less higher up in people's programs than otherwise.

Meyer Shields - *KBW - Analyst*

Okay. That is helpful. Two quick numbers questions if I can, I guess for Craig. One, the tax rate specifically on net investment income also went up in the quarter is that likely to persist?

Craig Howie - *Everest Re Group, Ltd. - CFO*

That is really based on where that investment income is, and so when you say likely to persist, if it is in the U.S. it is taxed at a 35% rate, that is really what it comes down to.

Meyer Shields - *KBW - Analyst*

Right. Is the mix shifting away or towards the U.S.?

Craig Howie - *Everest Re Group, Ltd. - CFO*

For the gains that happened this period yes.

Meyer Shields - *KBW - Analyst*

Okay. And we talked about higher commission expense on contingent commissions. Is that both U.S. reinsurance and the insurance segment?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

It is mostly the reinsurance segment. On the insurance side most of our contingent arrangements would have been with MGAs, and, of course, as you know, we have been shrinking our participation in that segment of the market. So while we still have some reserves out there for profit sharing, contingent payouts, the impact of that is much smaller. It is mostly the reinsurance book.

Meyer Shields - *KBW - Analyst*

Okay, fantastic. Thanks very much.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Meredith - *UBS - Analyst*

Good morning. A couple of just quick questions here for you. First one with respect to some of the quota share (Inaudible) business you got off in the quarter, did that impact the second quarter results or are we going to see that hit the third quarter because I know in the past you have had some ups and downs in your North American business because of some big quota shares you have gotten off of.

Craig Howie - *Everest Re Group, Ltd. - CFO*

There was an impact to the book this period. Again it is based on the amount of premium that was leaving and being returned, but small impact to the book this period.

Brian Meredith - *UBS - Analyst*

So it wasn't (Inaudible) going out, okay.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

But over time our mix between pro rata and XOL really have not changed that dramatically. And in fact the reference quota share that we are now off of in particular in Florida we have replaced with some other Florida quota shares, as well as some quota shares in the Northeast. So again the book is constantly -- it is fluid.

Brian Meredith - *UBS - Analyst*

Got you.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

We would not expect any significant impact when the complete year unfolds the year-over-year numbers will not be that dramatically different.

Brian Meredith - *UBS - Analyst*

Great, thanks. And then second question I am just curious, Dom and John, can you chat a little bit about what you are seeing with respect to demand for casualty reinsurance out there right now? Has it increased at all?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

If you are willing to pay a high cede, yes the demand is going up. And in our particular case we are not playing in many of those high ceding commission transactions. John, if you have anything further to add?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

There certainly have been some cases of people coming into the market that haven't been in the past. But I think there has been a long-term trend of kind of tepid demand on casualty business, and again that's more -- it varies a lot around the globe.

Brian Meredith - *UBS - Analyst*

Okay. So you haven't really seen a change necessarily this quarter where primaries are trying to buy more casualty?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Not in any strong trend that we could identify at this point, Brian.

Brian Meredith - *UBS - Analyst*

Great. Thank you.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Thank you.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Thank you.

Operator

And we will go next to Vinay Misquith with Evercore.

Vinay Misquith - *Evercore Partners - Analyst*

Hi, good morning. Just to follow-up on the international retro that was purchased, I believe you said that that should continue in the future. But this quarter we saw about a 30% increase in gross written premiums, so should that continue into the future so higher gross written premiums and higher retro in the future?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Let's maybe clarify something, it is retrocessional absolutely in the way it is booked or what it is called, but it is not really retro in the way you are implying. These are transactions where we are participating with some global clients on deals where we are taking a premium in the front end and they are participating to a significant degree as a reinsurer of that in coming portfolio. So don't think of it in the terms of we are out there buying retro in the retro market. It is not that. We do -- we have increased our quarter on quarter retro buying just from the mere fact we have the Mt. Logan facility and various ILWs that we are buying, but it is dwarfed by the strategic transactions that we have been talking about earlier. So that percentage that you see, that you saw in terms of cessions is likely to persist but it is not necessarily going to grow dramatically from here unless we find other strategic relationships and transactions to enter into with clients. So that is the best I can do about telling you what is out there in the future with respect to that number.

Vinay Misquith - *Evercore Partners - Analyst*

Sure. But it says on the gross written premium line says you are also taking more on the front end and then giving it out sort of on the back, correct? I mean that is the way to look at it.

THOMSON REUTERS

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Right, right. But it is part of a complete transaction that -- of a few clients.

Vinay Misquith - *Evercore Partners - Analyst*

Sure. That is helpful. The second is with respect to the primary insurance I see the expense ratios are going up. Was this a one time (Inaudible) in that?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

That was really more of a function of the fact that our Heartland the crop premium was down dramatically this year as I mentioned because of commodity prices and the commission ratio in the crop book is less than our standard the other primary lines of business

Vinay Misquith - *Evercore Partners - Analyst*

Sure fair enough. And then the last one the share repurchases I think you answered that question. But if I heard you correctly, you said you can give back all the capital from earnings despite growing your business. I just wanted to understand that correctly. Can you buyback --

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

I don't know that I quite said it that way. I basically said that we certainly look -- our share repurchase program looks to be contained within earnings, that does not necessarily mean that we are saying or predicting that we would buy in up to our actual earnings. It all depends on the price of the stock. It depends on what opportunities we see out in front of us and what our needs for capital are, but certainly we got a little bit behind our targets in the second quarter again due to price movement in the stock.

Vinay Misquith - *Evercore Partners - Analyst*

Okay, that is helpful. Thank you.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Thank you.

Operator

And our last question comes from Ian Gutterman with Balyasny.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Hi, good morning, guys.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Good morning, Ian.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

I guess my first question is sort of big picture. I guess, Dom, I am sort of puzzled why we are not shrinking the reinsurance book? And what I mean by that is if we had this conversation a year ago or even in January frankly, it seemed like the pressure was mostly on cat. When you talk to people, you made the reference and others have to casualty ceding commissions it seems like the [Lloyd's guy] is trying to cause trouble in the other non cat property lines. Why aren't we shrinking the book instead of growing the book?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Because our margins are expanding and in many cases the premium or the transactions that we are exceed and I don't mean by a slight margin, exceed our hurdle rates for business. So if we are able to put additional business on the books and still generate double digit returns on equity to our shareholders we are going to continue to do that. Also remember that we have increased as we mentioned we have had our sponsored cat bond, we have had ILW purchases. Our net return on capital on transactions is higher than the gross cost. So in other words, we are improving our ROE by bringing on business and then using -- taking advantage of the capital markets to lay off significant portion of that risk if not in some cases all of it. So that is the reason why.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

So when there -- I guess the reason I ask is there are other reinsurance executives saying we are starting to have behavior that is starting to I guess maybe no be the late '90s, maybe rhymes with the late '90s. You don't agree with that statement then?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, because we have other forms of capital we can hedge the exposure.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Okay.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

So if -- that we didn't have in the late '90s. So if we are able to utilize the capital markets and improve our ROEs while at the same time maintaining, and John mentioned this but it is worth reemphasizes, our net PMLs from the beginning of the year have not really changed materially as a percentage of capital. So we are expanding margins with basically the same PML exposure.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

I'd like to add a different dimension response to your question. We also are seeing opportunities. There has been a lot of talk about the haves and the havenots in the reinsurance world. And so I can't respond specifically to you say, other reinsurance executors are saying these things. But our opportunity set is not the same as the opportunity set in front of a lot of other reinsurance companies. We see deals around the globe that are shown to three or four reinsurance companies. We are creating new distribution sources through these new products we have been talking about now for several quarters. So we have significant clients, we have global clients that want to do more business with companies like Everest and less business with other people. So there is a lot of other dimensions to the landscape and we think we are navigating it pretty well.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

That is a very, very good point. Just to follow-up, I normally wouldn't ask about a specific contract but I think it is in the public domain who Citizens reinsures with. You guys took a very large line I believe on that new Citizens program. I don't think you were on it much or at all the year before. Can you just maybe talk a little bit about why that was a good place to put capacity?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

Yes, we did take a larger line this year. We liked it. We liked where it attached, and frankly there were some improvements in the contract wording is one of the reasons we didn't put up a bigger line last year. So we were happy with that, and it met our returns and so therefore as we look and headed into our June renewals we thought it was accretive to the portfolio that we are trying to build and it made sense particularly -- it fit well, and given the way we managed our net PMLs we thought it was the right thing to do.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Got it. So if looked -- obviously you had a big up there, a big down on universal. Outside of those two would you say your cat book grew the quarter or was it really just those were the two big swings and the rest was maybe flat to down?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

It grew in the quarter.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Gross. Remember what I was saying earlier.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Right. But I am saying ex-citizen growth. What I'm trying to get is was citizen all of the growth or was there other growth even if you didn't (Inaudible)?

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

There was lots -- one way I would describe this renewal was very volatile.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Got it.

John Doucette - *Everest Re Group, Ltd. - Chief Underwriting Officer*

There were lots of new structures, we played at different levels of attachments, our line sizes moved up and down more than it had in the past.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Got it, got it. And then just lastly a number questions, in the U.S. reinsurance segment the acquisition expense ratio historically it has been around maybe a 22 and went up to 25 this quarter. Was that mix, was that higher ceding commissions, any color on that.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

That is a the higher contingent commissions in the commission ratio.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Okay. But it is more contingents than the base ceding commission going up?

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

That is correct.

Ian Gutterman - *Balyasny Asset Management LP - Analyst*

Got it, perfect. Thank you.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

You got it.

Operator

And at this time I would like to turn the conference back to Dom Addesso for closing remarks.

Dominic Addesso - *Everest Re Group, Ltd. - President, CEO*

Well, thanks for all your questions this morning. In summary, I would like to reemphasize that despite the many challenges that are out there in the market place that we have discussed this morning, we remain optimistic about continuing to deliver double digit ROEs due to our size and ability to navigate through this market. So again thank you for participating on the call this morning.

Operator

This does conclude today's conference. Thank you for your participation.