MARKEL CORP
Form 10-Q
November 04, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2008**

or

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______**

Commission File Number: 001-15811

MARKEL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	**54-1959284**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4521 Highwoods Parkway, Glen Allen, Virginia 23060-6148

(Address of principal executive offices)

(Zip Code)

(804) 747-0136

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of shares of the registrant s common stock outstanding at October 31, 2008: 9,811,009

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	September 30, 2008	December 31, 2007
	(dollars in thousands)	
ASSETS		
Investments, available-for-sale, at estimated fair value:		
Fixed maturities (amortized cost of $4,958,869 in 2008 and $5,318,114 in 2007)	$ 4,757,062	$ 5,323,750
Equity securities (cost of $1,039,444 in 2008 and $1,263,266 in 2007)	1,463,772	1,854,062
Short-term investments (estimated fair value approximates cost)	324,468	51,552
Investments in affiliates	92,134	81,181
Total Investments	6,637,436	7,310,545
Cash and cash equivalents	588,459	477,661
Receivables	337,532	296,295
Reinsurance recoverable on unpaid losses	1,157,278	1,072,918
Reinsurance recoverable on paid losses	59,377	78,306
Deferred policy acquisition costs	207,337	202,291
Prepaid reinsurance premiums	104,446	114,711
Goodwill and intangible assets	344,626	344,911
Other assets	494,624	236,781
Total Assets	$ 9,931,115	$ 10,134,419
LIABILITIES AND SHAREHOLDERS EQUITY		
Unpaid losses and loss adjustment expenses	$ 5,789,273	$ 5,525,573
Unearned premiums	937,965	940,309
Payables to insurance companies	58,852	39,790
Senior long-term debt (estimated fair value of $533,000 in 2008 and $706,000 in 2007)	588,386	680,698
Other liabilities	243,958	306,887
Total Liabilities	7,618,434	7,493,257
Shareholders equity:		
Common stock	870,528	866,362
Retained earnings	1,330,974	1,417,269
Accumulated other comprehensive income	111,179	357,531
Total Shareholders Equity	2,312,681	2,641,162
Commitments and contingencies		
Total Liabilities and Shareholders Equity	$ 9,931,115	$ 10,134,419

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Income (Loss)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(dollars in thousands, except per share data)			
OPERATING REVENUES				
Earned premiums	$ 516,063	$ 535,517	$ 1,520,187	$ 1,598,092
Net investment income	68,232	80,938	220,765	235,487
Net realized investment gains (losses)	(168,679)	3,000	(200,247)	64,730
Total Operating Revenues	415,616	619,455	1,540,705	1,898,309
OPERATING EXPENSES				
Losses and loss adjustment expenses	456,172	285,286	1,029,005	839,108
Underwriting, acquisition and insurance expenses	186,206	182,026	552,069	561,094
Amortization of intangible assets	1,141	597	3,239	1,195
Total Operating Expenses	643,519	467,909	1,584,313	1,401,397
Operating Income (Loss)	(227,903)	151,546	(43,608)	496,912
Interest expense	11,024	13,601	35,789	43,385
Income (Loss) Before Income Taxes	(238,927)	137,945	(79,397)	453,527
Income tax expense (benefit)	(96,640)	45,592	(53,340)	141,299
Net Income (Loss)	$ (142,287)	$ 92,353	$ (26,057)	$ 312,228
OTHER COMPREHENSIVE INCOME (LOSS)				
Net unrealized holding gains (losses) on investments arising during the period, net of taxes	$ (122,832)	$ 18,116	$ (374,303)	$ (14,030)
Reclassification adjustments for net gains (losses) on investments included in net income (loss), net of taxes	109,749	(1,950)	130,583	(45,086)
Currency translation adjustments, net of taxes	(3,647)	2,708	(3,380)	4,369
Change in net actuarial pension loss, net of taxes	195	321	748	940
Total Other Comprehensive Income (Loss)	(16,535)	19,195	(246,352)	(53,807)
Comprehensive Income (Loss)	$ (158,822)	$ 111,548	$ (272,409)	$ 258,421
NET INCOME (LOSS) PER SHARE				
Basic	$ (14.46)	$ 9.28	$ (2.63)	$ 31.34
Diluted	$ (14.46)	$ 9.26	$ (2.63)	$ 31.28

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity

	Nine Months Ended September 30, 2008	2007
	(dollars in thousands)	
COMMON STOCK		
Balance at beginning of period	$ 866,362	$ 854,561
Restricted stock units expensed	2,971	2,284
Cumulative effect of adoption of FASB Interpretation No. 48		2,831
Other	1,195	6,158
Balance at end of period	$ 870,528	$ 865,834
RETAINED EARNINGS		
Balance at beginning of period	$ 1,417,269	$ 1,015,679
Net income (loss)	(26,057)	312,228
Repurchases of common stock	(60,238)	(24,210)
Cumulative effect of adoption of FASB Interpretation No. 48		20,131
Balance at end of period	$ 1,330,974	$ 1,323,828
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Net unrealized holding gains on investments, net of taxes:		
Balance at beginning of period	$ 388,521	$ 462,482
Net unrealized losses on investments, net of taxes	(243,720)	(59,116)
Balance at end of period	144,801	403,366
Cumulative translation adjustments, net of taxes:		
Balance at beginning of period	(7,523)	(11,316)
Currency translation adjustments, net of taxes	(3,380)	4,369
Balance at end of period	(10,903)	(6,947)
Net actuarial pension loss, net of taxes:		
Balance at beginning of period	(23,467)	(25,013)
Change in net actuarial pension loss, net of taxes	748	940
Balance at end of period	(22,719)	(24,073)
Balance at end of period	$ 111,179	$ 372,346
SHAREHOLDERS EQUITY AT END OF PERIOD	$ 2,312,681	$ 2,562,008

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2008	2007
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income (loss)	$ (26,057)	$ 312,228
Adjustments to reconcile net income (loss) to net cash provided by operating activities	354,904	71,098
Net Cash Provided By Operating Activities	328,847	383,326
INVESTING ACTIVITIES		
Proceeds from sales of fixed maturities and equity securities	570,166	772,440
Proceeds from maturities, calls and prepayments of fixed maturities	316,474	144,813
Cost of fixed maturities and equity securities purchased	(594,487)	(1,307,396)
Net change in short-term investments	(272,855)	64,007
Cost of investments in affiliates	(11,634)	
Acquisitions, net of cash acquired	(3,050)	(8,103)
Other	(69,375)	(12,322)
Net Cash Used By Investing Activities	(64,761)	(346,561)
FINANCING ACTIVITIES		
Repayment and retirement of senior long-term debt	(93,050)	(73,032)
Retirement of Junior Subordinated Deferrable Interest Debentures		(111,012)
Repurchases of common stock	(60,238)	(24,210)
Net Cash Used By Financing Activities	(153,288)	(208,254)
Increase (decrease) in cash and cash equivalents	110,798	(171,489)
Cash and cash equivalents at beginning of period	477,661	555,115
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 588,459	$ 383,626

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of Consolidation

Markel Corporation (the Company) markets and underwrites specialty insurance products and programs to a variety of niche markets.

The consolidated balance sheet as of September 30, 2008, the related consolidated statements of operations and comprehensive income (loss) for the quarters and nine months ended September 30, 2008 and 2007, the consolidated statements of changes in shareholders equity and the consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007 are unaudited. In the opinion of management, all adjustments necessary for fair presentation of such consolidated financial statements have been included. Such adjustments consist only of normal, recurring items. Interim results are not necessarily indicative of results of operations for the entire year. The consolidated balance sheet as of December 31, 2007 was derived from the Company s audited annual consolidated financial statements.

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

The consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company s annual consolidated financial statements and notes. Readers are urged to review the Company s 2007 Annual Report on Form 10-K for a more complete description of the Company s business and accounting policies.

Certain prior year amounts have been reclassified to conform to the current presentation.

2. Net Income (Loss) per Share

Net income (loss) per share was determined by dividing net income (loss) by the applicable weighted average shares outstanding.

	Quarter Ended September 30,		**Nine Months Ended September 30,**	
(in thousands, except per share amounts)	**2008**	**2007**	**2008**	**2007**
Net income (loss) as reported	$ (142,287)	$ 92,353	$ (26,057)	$ 312,228
Basic common shares outstanding	9,842	9,957	9,897	9,962
Dilutive potential common shares		18		19
Diluted shares outstanding	9,842	9,975	9,897	9,981
Basic net income (loss) per share	$ (14.46)	$ 9.28	$ (2.63)	$ 31.34
Diluted net income (loss) per share	$ (14.46)	$ 9.26	$ (2.63)	$ 31.28

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3. Reinsurance

The following tables summarize the effect of reinsurance on premiums written and earned.

(dollars in thousands)	Quarter Ended September 30, 2008 Written	2008 Earned	2007 Written	2007 Earned
Direct	$ 511,424	$ 534,958	$ 559,931	$ 564,865
Assumed	52,472	54,846	40,654	47,688
Ceded	(65,793)	(73,741)	(87,021)	(77,036)
Net premiums	$ 498,103	$ 516,063	$ 513,564	$ 535,517

(dollars in thousands)	Nine Months Ended September 30, 2008 Written	2008 Earned	2007 Written	2007 Earned
Direct	$ 1,562,272	$ 1,584,990	$ 1,689,205	$ 1,696,960
Assumed	185,289	149,014	168,314	133,794
Ceded	(205,273)	(213,817)	(243,819)	(232,662)
Net premiums	$ 1,542,288	$ 1,520,187	$ 1,613,700	$ 1,598,092

Incurred losses and loss adjustment expenses were net of reinsurance recoverables (ceded incurred losses and loss adjustment expenses) of $126.5 million and $16.4 million, respectively, for the quarters ended September 30, 2008 and 2007 and $245.8 million and $78.8 million, respectively, for the nine months ended September 30, 2008 and 2007. Both periods of 2008 include $87.7 million of estimated reinsurance recoverables related to Hurricanes Gustav and Ike.

4. Investments

a) The following table summarizes the Company s available-for-sale investments.

(dollars in thousands)	September 30, 2008 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	$ 853,265	$ 9,503	$ (3,716)	$ 859,052
Obligations of states, municipalities and political subdivisions	1,921,336	3,615	(100,220)	1,824,731
Foreign governments	296,201	6,078	(1,548)	300,731
Public utilities	93,593	264	(1,915)	91,942
All other corporate bonds	1,794,474	8,598	(122,466)	1,680,606
Total fixed maturities	4,958,869	28,058	(229,865)	4,757,062
Equity securities:				
Insurance companies, banks and trusts	436,866	329,236	(8,912)	757,190
Industrial, miscellaneous and all other	602,578	133,224	(29,220)	706,582
Total equity securities	1,039,444	462,460	(38,132)	1,463,772
Short-term investments	324,461	8	(1)	324,468

Investments, available-for-sale	$ 6,322,774	$ 490,526	$ (267,998)	$ 6,545,302

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b) The following table summarizes gross unrealized investment losses by the length of time that securities have continuously been in an unrealized loss position.

	September 30, 2008					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$ 278,204	$ (3,176)	$ 20,464	$ (540)	$ 298,668	$ (3,716)
Obligations of states, municipalities and political subdivisions	1,119,417	(54,286)	472,315	(45,934)	1,591,732	(100,220)
Foreign governments	90,326	(1,230)	16,478	(318)	106,804	(1,548)
Public utilities	62,216	(1,894)	4,635	(21)	66,851	(1,915)
All other corporate bonds	620,793	(33,964)	661,278	(88,502)	1,282,071	(122,466)
Total fixed maturities	2,170,956	(94,550)	1,175,170	(135,315)	3,346,126	(229,865)
Equity securities:						
Insurance companies, banks and trusts	89,416	(8,704)	809	(208)	90,225	(8,912)
Industrial, miscellaneous and all other	153,269	(25,729)	31,881	(3,491)	185,150	(29,220)
Total equity securities	242,685	(34,433)	32,690	(3,699)	275,375	(38,132)
Short-term investments	4,989	(1)			4,989	(1)
Total	$ 2,418,630	$ (128,984)	$ 1,207,860	$ (139,014)	$ 3,626,490	$ (267,998)

At September 30, 2008, the Company held 800 securities with a total estimated fair value of $3.6 billion and gross unrealized losses of $268.0 million. Of these 800 securities, 282 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $1.2 billon and gross unrealized losses of $139.0 million. Of these securities, 277 securities were fixed maturities where the Company expects to receive all interest and principal payments and five were equity securities. At September 30, 2008, none of these five equity securities had a fair value of 80% or less of their cost basis for a continuous period of six months or more. The Company believes all five equity securities have low market valuations due to market sentiment, as opposed to the operating fundamentals and financial conditions of the companies. The Company has the intent and ability to hold the fixed maturities and equity securities that were in an unrealized loss position at September 30, 2008 until they recover in value.

The Company completes a detailed analysis each quarter to assess whether the decline in the value of any investment below its cost basis is deemed other-than-temporary. All securities in an unrealized loss position are reviewed. Unless other factors cause the Company to reach a contrary conclusion, investments with a fair value of less than 80% of cost for more than 180 days are deemed to have a decline in value that is other-than-temporary. A decline in fair value that is considered to be other-than-temporary is charged to earnings based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security.

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c) The following table presents realized investment gains (losses) and the change in net unrealized holding gains.

(dollars in thousands)	**Quarter Ended September 30, 2008**	**2007**
Realized gains:		
Sales of fixed maturities	$ 723	$ 771
Sales of equity securities	8,690	4,333
Other	166	
	9,579	5,104
Realized losses:		
Sales of fixed maturities	(83,637)	(2,010)
Sales of equity securities	(14)	(94)
Other-than-temporary impairments	(94,607)	
	(178,258)	(2,104)
Net realized investment gains (losses)	$ (168,679)	$ 3,000
Change in net unrealized holding gains:		
Fixed maturities	$ (98,711)	$ 52,139
Equity securities	79,400	(27,408)
Short-term investments	7	
Net increase (decrease)	$ (19,304)	$ 24,731

(dollars in thousands)	**Nine Months Ended September 30, 2008**	**2007**
Realized gains:		
Sales of fixed maturities	$ 9,425	$ 5,228
Sales of equity securities	65,948	73,529
Other	1,267	273
	76,640	79,030
Realized losses:		
Sales of fixed maturities	(85,495)	(6,084)
Sales of equity securities	(3,657)	(94)
Other-than-temporary impairments	(187,145)	(3,489)
Other	(590)	(4,633)
	(276,887)	(14,300)
Net realized investment gains (losses)	$ (200,247)	$ 64,730
Change in net unrealized holding gains:		
Fixed maturities	$ (207,443)	$ (38,142)
Equity securities	(166,468)	(53,427)
Short-term investments	7	

Net decrease	$ (373,904)	$ (91,569)

Net realized investment gains (losses) included $94.6 million of write downs for other-than-temporary declines in the estimated fair value of investments for the quarter ended September 30, 2008. The write downs were made with respect to seven equity securities, two nonredeemable preferred stocks and five fixed maturities. The two largest write downs of equity securities related to the Company s investments in General Electric Company and International Game Technology, for which the Company had write downs of $32.7 million and $16.1 million, respectively.

Given the magnitude of the unrealized losses associated with these securities and management s belief that these securities were unlikely to recover in the near term, the decline in value was

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deemed other-than-temporary and was charged to earnings. The two nonredeemable preferred stock write downs related to the Company s holdings in Fannie Mae and Freddie Mac and totaled $9.0 million. The two largest write downs of fixed maturities related to the Company s investments in Morgan Stanley and Kaupthing Bank, an Icelandic financial institution, for which the Company had write downs of $18.4 million and $10.5 million, respectively. During the third quarter of 2008, the Company sold a portion of its holdings in Morgan Stanley and, as a result, determined that it no longer had the intent to hold this investment until it fully recovered its value. The write down on Kaupthing Bank was made because the Company believes it may not receive all interest and principal payments when due. The six investments discussed above represent 92% of the total other-than-temporary write down recorded in the third quarter of 2008. There were no write downs for other-than-temporary declines in the estimated fair value of investments for the quarter ended September 30, 2007.

Net realized investment gains (losses) included $187.1 million and $3.5 million of write downs for other-than-temporary declines in the estimated fair value of investments for the nine months ended September 30, 2008 and 2007, respectively. Net realized investment losses for the nine months ended September 30, 2008 included write downs for 15 equity securities, two nonredeemable preferred stocks and five fixed maturities. Approximately 40% of the write downs for the nine months ended September 30, 2008 were due to the determination that the Company no longer had the intent to hold these securities until they fully recovered in value as it began selling a portion of the securities in order to allocate capital to other securities with greater potential for long-term investment returns. The remainder of the write downs related to securities that had other indications of other-than-temporary impairment, including having fair values of less than 80% of cost for more than 180 days. The most significant write downs during the first six months of 2008 were related to the Company s investment in Citigroup Inc., a security that it began selling in March 2008, and to its investment in Bank of America Corporation, a security with significant declines in fair value that management believed would not recover in the near term. Write downs for Citigroup Inc. and Bank of America Corporation were $37.6 million and $17.0 million, respectively, for the nine months ended September 30, 2008. These two investments and the six investments discussed above for the third quarter of 2008 represent 76% of the total other-than-temporary write down recorded during the nine months ended September 30, 2008.

5. Hurricane Losses

The Company s results for the quarter and nine months ended September 30, 2008 include $115.1 million of underwriting loss related to Hurricanes Gustav and Ike (2008 Hurricanes). The underwriting loss on the 2008 Hurricanes was comprised of $109.1 million of estimated net losses and loss adjustment expenses and $6.0 million of additional reinsurance costs.

The estimated net losses on the 2008 Hurricanes were net of estimated reinsurance recoverables of $87.7 million. Both the gross and net loss estimates on the 2008 Hurricanes represent the Company s best estimate of losses based upon information currently available. The Company has used various loss estimation techniques to develop these estimates, including claims received to date and detailed policy level reviews. The Company s estimate is dependent on broad assumptions about coverage, liability and reinsurance. While the Company believes that its reserves for the 2008 Hurricanes as of September 30, 2008 are adequate, the Company continues to closely monitor reported claims and will adjust the estimates of gross and net losses as new information becomes available. Accordingly, the Company s actual ultimate net loss from these two events may differ materially from this estimate.