

STANDARD & POOR'S	ClassicDirect
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Overview**Houston Casualty Co.****FSR: AA/Stable/--**

FSR Last Reviewed: 11-Mar-08

United States

CCR: AA/Stable/--

CCR Last Reviewed: 11-Mar-08

Sector: Property/Casualty Insurance



Currency: United States Dollar

Scaling: Thousands

Regulatory

Key Financials	2006	2005	2004	2003	2002
Gross Premium Written	738,596	833,566	927,909	909,775	490,159
Net Premium Written	485,571	499,452	471,045	422,279	228,819
Adjusted Shareholders Funds	952,083	812,520	604,394	409,466	400,647
Technical Reserves	1,411,285	1,211,569	839,025	568,228	280,911
Total Assets	2,520,418	2,235,101	1,663,676	1,261,854	851,590
Earnings	2006	2005	2004	2003	2002
Underwriting Profit	90,950	(33,067)	(833)	(16,314)	5,432
Net Investment Income	85,123	40,312	34,373	41,519	26,258
Net Realised Gains	31,236	10,453	4,254	5,618	2,775
Other Income	31,118	10,539	4,634	5,176	3,811
Pretax Profit	207,191	17,784	38,174	30,381	35,501

Company Details

Last Financial Year End:	Dec 2006 (Regulatory)
Ultimate Parent:	HCC Insurance Holdings Inc.
Auditors:	
Chief Exec:	
Tel:	713-462-1000
Fax:	
Website:	
Email:	
Address:	13403 Northwest Fwy Houston, TX 77040-6006

ClassicDirect ID:	124748
S&P ID:	SP-1114070
FEIN:	74-2195939
NAIC:	42374
Primary SIC:	PROPCASUC
Ticker:	11521Z
LORS:	B03286
CUSIP:	
CINS:	

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Company FSR Ratings Houston Casualty Co.

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■ Ratings History

Date	Local FSR
11-Mar-08	AA/Stable/--
26-Feb-07	AA/Stable/--
20-Dec-06	AA/Stable/--
20-Nov-06	AA/Stable/--
10-Feb-06	AA/Stable/--
14-Apr-05	AA/Stable/--
10-Aug-04	AA/Stable/--
21-Apr-04	AA/Stable/--
21-Nov-03	AA/Stable/--
25-Jul-03	AA/Stable/--
06-Nov-02	AA/--/--
21-Aug-01	AA/--/--
18-Jul-01	AA/--/--
31-Oct-00	AA/--/--
02-Nov-99	AA/--/--
12-Aug-99	AA/Watch Neg/--
25-Feb-99	AA/--/--
08-Jan-99	NR/--/--
19-Aug-97	Aq/--/--
13-Aug-96	Aq/--/--
04-Oct-95	Aq/--/--
03-Oct-94	BBBq/--/--
20-Sep-93	BBq/--/--
24-Aug-92	BBq/--/--
04-Oct-91	Bq/--/--

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Summary: Houston Casualty Insurance Group

United States

Summary

Publication date: 17-Jun-2008
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Local Currency

Credit Rating: AA/Stable/--

■ Rationale

The insurer financial strength ratings on the members of the Houston Casualty Insurance Group (HCC) are based on the group's very strong competitive position, very strong operating performance, very strong capitalization, and strong financial flexibility. Partially offsetting these positive factors are increased balance sheet risk as the group expands its business into longer-tail lines and increases its retentions, as well as the integration risk associated with frequent smaller acquisitions.

HCC enjoys strong positions in its key market segments. It is well established in the short-tail specialty lines of medical stop-loss, aviation, surety, and property/marine/energy, both in the U.S. and abroad. In recent years, HCC has expanded into longer-tail, more ratings-sensitive lines, including directors' and officers' liability (D&O) and professional liability, primarily errors and omissions.

HCC's growth strategy has generally focused on acquiring specialty underwriting agencies. Then, as HCC becomes comfortable with the book controlled by the agency, it gradually transfers the business to its own insurance companies. This strategy provides HCC with significant benefits, including control over much of its product distribution and less reliance on dividends from the insurance companies to cover holding company cash requirements.

The group produced very favorable operating results again in 2007. The generally accepted accounting principles (GAAP) combined ratio was an exceptional 83.4%, a slight improvement from 84.2% in 2006. The improvement in 2007 was the result of a modest level of reserve releases. Both years benefited from strong product margins and an insignificant level of natural catastrophe losses. Return on revenue (ROR) has surged in the past two years to more than 24%. The company's strong performance continued into the first quarter of 2008. HCC reported a combined ratio of 83.7% versus 84.0% during the same period in 2007.

Operating company capitalization supports the rating. Based on Standard & Poor's Ratings Services' model, HCC's consolidated (including HCC Life Insurance Co. [HCC Life] and international subsidiaries) capital adequacy ratio (CAR) improved to more than 175% as of year-end 2007 versus 143% as of year-end 2006. This measure dipped from 152% at the end of 2005 because of the acquisition of the Health Products Division of Allianz Life Insurance Co. of North America (the Health Products Division). Other positive factors are HCC's track

record of strong reserve adequacy, lack of exposure to asbestos and environmental claims, and very conservative investment strategy.

The amount of underwriting risk that HCC assumes has increased substantially in recent years. Until 2007, the group had steadily increased its premium retention rate in response to stronger pricing, management's favorable view of the quality of business written, and the group's rapidly growing surplus base. As a result, net premiums written have increased rapidly, rising to \$2 billion in 2007 from \$865 million in 2003. Net loss reserves jumped to about \$2.3 billion as of year-end 2007 from \$705 million at the end of 2003. Although the rapid growth has increased the group's risk profile, this concern is mitigated by HCC's impressive surplus growth, to \$1.7 billion from \$592 million during the same periods, and its conservative reserving practices. In addition, much of the growth is attributable to increased retention of business the company has underwritten for several years under improved rates and policy terms and conditions.

We do not expect the departure of HCC's founder and longtime CEO, Stephen Way, in November 2006 following the board of directors' investigation into the group's stock option granting practices, to result in any material changes in the group's corporate strategy. His successor, Frank Bramanti, was part of HCC's senior management team for many years until taking early retirement, and he remained on the board before his return as CEO.

HCC's exposure to reinsurance recoverables, historically a concern for Standard & Poor's, is no longer an issue because HCC has scaled back its traditional reliance on reinsurance. Net retention of premiums written rose to 81% in 2006 and 2007, from 56% in 2004 and 29% in 2000. This shift in business strategy, combined with rapid surplus growth, has reduced recoverables as a percentage of surplus to a relatively low 55% as of year-end 2007, down from 155% at the end of 2003.

Although HCC has a history of successful acquisitions, the fast pace of acquisitions in recent years heightens integration risks. HCC has concentrated mostly on multiple small acquisitions, thereby decreasing its exposure to problems with any one acquisition.

■ Factors Specific To Holding Company

HCC Insurance Holdings Inc. (HCC Holdings) has a strong ability to service its debt obligations and meet its other cash requirements, principally dividends to shareholders (\$46.2 million in 2007). GAAP interest coverage is extremely strong at 42x in 2007. Statutory interest coverage, which is the ratio of holding company interest expense to the dividend capacity of its insurance subsidiaries, was very strong at 18.1x in 2007, as dividend capacity increased to \$172.1 million from \$90.3 million in 2006 and holding company operating expenses rose because of costs associated with the stock option investigation. This ratio understates the amount of cash available to HCC Holdings because it does not include dividends available from noninsurance company affiliates.

As of Dec. 31, 2007, the company had notes payable outstanding of \$324.7 million, including \$200 million borrowed in 2007 under a \$575 million bank credit facility primarily to redeem \$172.2 million of 2.0% convertible exchange notes. There are no scheduled maturities in 2008, but the holders of about \$124.7 million of convertible notes currently may have the right to convert these notes depending on the stock price during the preceding calendar quarter. The company must settle any conversions by paying cash for the principal amount of the notes and issuing its common stock for the value of the conversion premium. Standard & Poor's believes HCC Holdings has ample liquidity to repay these notes, even in the unlikely event that all noteholders were to convert these securities.

Cash and securities held by the holding company totaled \$37 million at the end of 2007. The large holdings of short-term investments and the high quality of the fixed-income portfolios at the operating company level further enhance balance sheet liquidity.

The company's ability to access the capital markets is strong. Its stock currently trades above its book value, which facilitates capital raising and acquisitions. The company quickly raised \$100 million and \$150 million of new equity capital in 2004 and 2005, respectively, demonstrating its access to the capital markets. Financial leverage is conservative for the rating at 11.8% as of Dec. 31, 2007, down from 13.1% as of year-end 2006. We expect the company to maintain leverage at or less than 25% in the medium term, so debt issuance is another capital-raising option.

■ Outlook

We expect gross premium growth to slow significantly in 2008. Absent another acquisition, premium volume should be flat or down somewhat in 2008 in response to softer market conditions. Net premium growth is expected to track gross premiums as the company has finished increasing net retentions. We expect HCC's operating performance to remain very strong, with a consolidated GAAP combined ratio of 90% or less. Standard & Poor's believes HCC's underwriting cycle management strategy will continue to yield superior relative results during periods of evolving market conditions. The company should maintain its very strong capital adequacy in 2008 as net premium volume and reserve levels stabilize.

■ Members Of The Houston Casualty Insurance Group

HCC Insurance Holdings Inc., Houston Casualty Co., American Contractors Indemnity Co., Avemco Insurance Co., HCC International Insurance Co. PLC, HCC Life Insurance Co., HCC Reinsurance Co. Ltd., HCC Specialty Insurance Co., Houston Casualty Co. Europe Seguros & Reaseguros S.A., United States Surety Co., and U.S. Specialty Insurance Co.

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STANDARD & POOR'S	ClassicDirect
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Company Narrative

Houston Casualty Co.

FSR: AA/Stable/--

FSR Last Reviewed: 11-Mar-08

United States

CCR: AA/Stable/--

CCR Last Reviewed: 11-Mar-08

Sector: Property/Casualty Insurance



Publication date:

31-Dec-2001

■ Incorporated

1981

■ Ownership

HCC Group

■ Lines of Business

Group A&H, 44.5; Aircraft, 29.7; Ocean Marine, 17.2; Fire, 5.1; Earthquake, 2.6.

■ Geographical Spread

Business is geographically distributed as follows: OT, 38.7; AK, 11.6; TX, 9.2; CA, 5.0; FL, 4.7.

The company is licensed in the following states: TX.

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STANDARD & POOR'S	ClassicDirect
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Company Ownership Houston Casualty Co.

FSR: AA/Stable/--

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Ownership

HCC Group

Related Entities	Country	Current Rating
American Contractors Indemnity Co.	United States	AA
Avemco Insurance Co.	United States	AA
De Montfort Group Ltd.	United Kingdom	-
HCC Capital Trust I	United States	-
HCC Capital Trust II	United States	-
HCC Insurance Holdings Inc.	United States	-
HCC International Insurance Co. PLC	United Kingdom	AA
HCC Life Insurance Co.	United States	AA
HCC Reinsurance Co. Ltd.	Bermuda	AA
HCC Specialty Insurance Co.	United States	AA
Houston Casualty Company Europe Seguros & Reaseguros S.A.	Spain	AA
National Insurance Underwriters	United States	NR
U.S. Specialty Insurance Co.	United States	AA
United States Surety Co.	United States	AA
USF Insurance Co.	United States	NR

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Company CCR Ratings
Houston Casualty Co.

FSR: AA/Stable/-- FSR Last Reviewed: 11-Mar-08 United States
CCR: AA/Stable/-- CCR Last Reviewed: 11-Mar-08 Sector: Property/Casualty Insurance



Current Counterparty Credit Rating

Type	Date	Ratings
Credit rating	18-Jul-2001	AA/Stable/--

Counterparty Credit Rating History

Date	Description	To	From
02-Nov-1999	Local Currency	AA/Negative/--	AA/Watch Neg/--
12-Aug-1999		AA/Watch Neg/--	AA/Stable/--
25-Feb-1999		AA/Stable/--	New

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STANDARD & POOR'S	ClassicDirect

Company Debt Ratings Houston Casualty Co.

FSR: AA/Stable/--

FSR Last Reviewed: 11-Mar-08

United States

CCR: AA/Stable/--

CCR Last Reviewed: 11-Mar-08

Sector: Property/Casualty Insurance



No Debt Rating information exists for this company.

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