

Q3 2015 Earnings Call

Company Participants

- George Quinn
- James Quin
- Kristof Terryn
- Martin Senn

Other Participants

- Andrew J. Ritchie
- Andy D. Broadfield
- Andy Hughes
- Daniel Bischof
- Dhruv Gahlaut
- Farooq Hanif
- Mark David Cathcart
- Michael I. Huttner
- Nick Holmes
- Ralph Hebgen
- Sami Taipalus
- Thomas Seidl
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Results for the Nine Months to September 30, 2015 Conference Call. I am Cy, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode, and the conference is being recorded. After the presentation, there will be a Q&A session. The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. James Quin, Head of Investor Relations and Performance Management. Please go ahead, sir.

James Quin {BIO 18345789 <GO>}

Good morning, good afternoon, and welcome to Zurich Insurance Group's Q3 Results Presentation. I'm joined by our CEO, Martin Senn; CFO, George Quinn; and Kristof Terryn,

the CEO of the General Insurance business.

Martin will make a few short comments before handing over to Kristof and then George. We'll then take your questions. As usual, please keep to two questions.

I'll now hand over to Martin.

Martin Senn {BIO 3241585 <GO>}

Thank you very much, James, and welcome to everyone on the call on my behalf as well. Zurich's operating results for the third quarter of 2015 are a disappointing outcome for the group. As we announced on September 21, results for our General Insurance business has been impacted by adverse claims experience in certain portfolios, including a further increase in large losses in comparison to the first half of the year, negative prior development in some portfolios in North America and \$275 million in claims relating to the Tianjin Port explosions. These factors have, in aggregate, led to our GI business reporting a loss of slightly less than \$200 million and a combined ratio of around 109% for the third quarter.

While we are not satisfied with the outcome, this result is in line with our preliminary announcements. In response to the recent performance issue within General Insurance, we commenced an operational review of the business in early September. This review has led to an agreed set of comprehensive actions to improve performance and to get us back on track.

Kristof will give you more information on this review shortly, but I'm very encouraged by the response of the business, and I'm absolutely convinced that we have the actions in place to start rebuilding the credibility of our GI business with investors. Equally, while we need to improve profitability in certain parts of General Insurance, this should not detract from the good progress in other parts of the group or from our continued capital strength and excellent cash generation track records.

For the nine months ended September 30, our life business has reported 18% growth in both business operating profit and in new business sales at constant currency. And at Farmers Exchanges, which we do not own, modest but steady growth in gross premiums is starting to translate into higher revenues for Farmers Management Services.

In terms of our financial position, solvency, as measured by the Zurich Economic Capital Model, was slightly above the top of our target range at the end of June. While this is likely to have dipped slightly due to the weak Q3 results and recent market movements, we continue to be in a very strong position. In addition, while GI's challenges will likely have some impact on cash remittances in 2016, we still expect to generate an excess of \$10 billion of cumulative cash remittances in the three years from 2014 to 2016. This is more than \$1 billion ahead of our target.

These strengths enable us to reiterate our commitment to deploying \$3 billion excess capital by the end of 2016, and this remains a key step in how we want to improve returns

and achieve an ROE within our target range of 12% to 14% next year.

As mentioned in the results commentary, we will set out how the \$3 billion of excess capital will be allocated between organic or inorganic investments and cash returns to investors of both our ordinary dividend with full year results.

And with that, I will hand over to Kristof now who will give you some more details about the outcome of his review of the GI business. Thank you very much.

Kristof Terry {BIO 17664174 <GO>}

Thank you, Martin. Now, as highlighted earlier, the recent performance of our GI business has been disappointing and the review we initiated in Q3 built on some of the actions that were already underway at the half year. Now, this review focused on five elements, from understanding the financial strength of the business all the way to governance. However, the two most important elements that we focus on were the improvement of our underwriting performance and an accelerated drive towards greater efficiency.

Now, while the underwriting review is broad in nature, the immediate focus has been on the 16% of our business that is generating the largest underwriting losses. For these portfolios, we've put in place some very concrete actions for underwriting improvements with detailed weekly tracking, leading up to the January 1 renewal.

Now let me also stress here that this is not just about exiting underperforming portfolios. It is about focusing our efforts and taking tough underwriting actions where it make sense, while considering achievability and our long term customer relationships. That being said, we have made decisions to exit portfolios where we think it is not realistic to turn them around. Some of these we've already mentioned, for example, the U.S. trucking business and the standalone global corporate boiler or machinery line.

Now, within the overall targeted portfolios, we will be focusing on achieving rate and/or lift, recognizing that in some markets and lines of business, rates are still softening. Now, this is where tiering will be a key lever with a particular focus on finding a better balance between risk levels and pricing. And for some of the bottom tiers of our underperforming portfolios, this will mean some very significant rate increases, often at the expense of a significant drop in retention levels.

Now, while the core focus is on restoring profitability, inevitably, we will see an impact on top line, but this is not about shrinking to success. We are taking a targeted and differentiated approach, and we will continue to invest in those areas where we are getting traction and delivering top line at the hurdles we expect. Examples of this are our Swiss business and our North American commercial business.

Now, with regard to efficiency, there were a number of actions already taken, which we expect to start showing through in 2016 and continue beyond. Some of these initiatives addressed a layer of expense about the businesses in both the regions and at the center,

but we are also reviewing our footprint and reassessing some of the investments that we have made or intended to make.

And finally, we'll continue to reduce our expense base beyond 2016 as part of the group's overall ambition to reduce expenses by at least \$1 billion by the end of 2018.

Now with these actions, I believe we can achieve the required short-term profitability improvements while positioning the business for long-term success. And with that, let me hand over to George.

George Quinn {BIO 15159240 <GO>}

Thanks, Kristof. And before we turn to the questions, let me make a couple of quick comments on the results.

As you all have seen, the results for GI are in line with the preliminary indications although there are some changes in the mix of the numbers. To be more specific, we've incorporated an expectation of normal nat cat losses for September in the preliminary indication. But in the final event, we've actually had very limited nat cat losses in September. We also took a decision after the end of the quarter to be more prudent in one specific sub portfolio of our construction liability business in the U.S. These two items offset each other. I'm well aware that the second set will further fuel a debate about the overall reserve position of the choices available to us this seemed to me to be the best one.

I want to reiterate a couple of points about the reserve position. First, I mean, there are a number of well-known one-off factors in Q3 but most portfolios are showing expected modest releases. Secondly, we believe we have prudently reserved and our reserves are set above the midpoint in the range.

Third, we believe the reserving process is robust and we have multiple levels of both internal and external reviews in place with a generally consistent view of overall reserve strength. Obviously, we need to demonstrate a more consistent track record in the coming quarters and to actually deliver PYD within the 1% to 2% range that we've guided to. Of course, no one could predict how our reserves will evolve precisely but with the actions taken in Q3, I believe we're in a stronger position and with lower levels of expected volatility.

Together with the underwriting expense actions that Kristof's highlighted, we are confident that we can improve our combined ratio by 2 points to 3 points in 2016 from the adjusted starting point of a 99.5% combined ratio, taking into account expectations for top-line evolution and what we can see today in the external market environment.

With that, we look forward to answering your questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question is from Farooq Hanif from Citigroup. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Thanks very much. I'll just keep it to two. Can you talk about the top line. In your pre-prepared statement you used the word modest top-line decline, and it just seems to me, especially what you're saying now as well as such a large portion of your portfolio is making kind of 140% plus or whatever the combined ratio of that, yet it seems to me that the risk there is quite significant that you see quite - a more major drop in top line. So could you just talk about why you think that might not happen?

And then secondly, how confident can you leave us that you don't need to extend this review of businesses to other areas such as EMEA? I mean, I know the ratios right now are good and therefore the immediate kind of evidence is that they are working well. But given the history of the group, why are you not extending that? Thank you.

A - Kristof Terryn {BIO 17664174 <GO>}

So maybe let me take that question. So first of all, on the top line, I mean as I said, we will have a very differentiated approach, and clearly, some of the areas that are underperforming will see the business shrinking in the single digit percentages, probably. And I don't have an absolute top line number for the business for next year. I mean, the key focus really is on getting the profitability, the underwriting profitability of all the business fixed.

Now, again, even within some of the portfolios that are underperforming, we are very differentiated. I mean, we look at lines of business as part of an overall client relationship from a distributor angle as well, and we'll take very different actions on the bottom tiers of those portfolios than we will on those that are actually performing. So I think, in aggregate, a modest decline is probably still the best view that we have. That being said, clearly, the focus will be on profitability and restoring the business to profitability.

Now, on extending the review, I want to make one thing clear. While we talk about 15 underperforming portfolios, I mean the underwriting review that we did was broad in nature and covered all of our portfolios. Now, the actions are targeted towards those 15 portfolios, but we are comfortable with what we're seeing in some of the other portfolios.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

The next question is from Daniel Bischof of Helvea. Please go ahead.

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Q - Daniel Bischof {BIO 17407166 <GO>}

Yes. Good afternoon. Two questions, please. The first one on the competitive situation in Global Corporate. Some of your peers noted that this remains an intensely competitive area. So in your combined ratio forecast, what sort of range changes are embedded for 2016 especially in Global Corporate and North America Commercial?

And then the second on M&A, I think in one of your earlier comments you mentioned that the most likely development of deploying excess capital is a combination of bolt-on acquisitions and cash returns. So, how do you see the M&A market these days and where do you see opportunities?

A - Kristof Terryn {BIO 17664174 <GO>}

Maybe let me take the first question on the competitive situation in Global Corporate. So it is true that this is a competitive market. There's quite a bit of capital available within this market, and so the pressure on rate is likely to continue.

I mean as I said before, the impact on our portfolio will be differentiated. And given some of the underperformance in some of our Global Corporate business, particularly on the property portfolio and in North America, that is where you are likely to see some significant impact.

The improvement of the portfolio is not dependent – just dependent on rate. A lot of the improvement we are likely to see from lift, which is really a shift in the profitability of the portfolio through the tiering exercise. Because, I think it is unlikely to see a big change in what the market will tolerate in terms of rate increases going into 2016.

A - George Quinn {BIO 15159240 <GO>}

Daniel, on the second point on M&A, let me just reiterate, that the priorities for us for the use of excess capital haven't changed. So, first of all, growth, organic and inorganic; and then second, the return to shareholders, the excess that we can't use in supporting the growth of the business. As you've seen, we've set a clear time horizon for us to reach a conclusion on that, so it has an impact on 2016.

From an overall M&A market perspective, I mean, I think it's very hard to judge. I mean you can see the transactions that I can see taking place. I guess what's most important to us is that I mean if we did commit capital in M&A, we'll apply the discipline that we've talked about before, so the level of returns that we achieve on the invested capital is very important to us, and the benchmarks that we use to establish those returns are also very relevant. And, of course, one of the most important ones is our own share price. So, I mean, more than that in terms of the , we won't know it at this stage.

Q - Daniel Bischof {BIO 17407166 <GO>}

Excellent. Thanks a lot.

Operator

The next question is from Andy Hughes from Macquarie. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Thanks very much, guys. And I guess the first question was on the increased reinsurance you're planning to buy on the kind of Global Corporate business, does that have a benefit to the capital position? And also is there kind of a cost to that? Or is that offset by the falling reinsurance prices?

The second question was on the kind of commercial auto business. I guess peers have seen similar problems in commercial auto, so I was a bit surprised when you sort of talked about a 4% rate increase. And I thought it could be a lot more than that. So, I guess I'm interested in how much the transportation book has caused of the losses you can see on slide 25? And does the business work very different ex the transportation book? Thank you.

A - George Quinn {BIO 15159240 <GO>}

So, on the first one, I guess, just to avoid that I give the signal to our insurance partners that we're willing to buy reinsurance at any price. We are evaluating the risks in sort of buying more reinsurance. But again, given the accumulation of large losses and some of the things that Kristof has talked about is actually focused on the incoming business to try and reduce the exposure that we have to some of those. And then beyond that, we would like to try and reduce the volatility generally. And I think in that way, reinsurance can play a role.

I mean, I guess the challenge is that doesn't come free of cost. I mean, I think obviously I mean the market is softer than it's been for some time, to make anyone say give it away - that we would expect to have some benefit in the capital position but again it depends on the lines of business that it attaches to. But it would come at some marginal cost to the sum overall, would be our best expectation at this time.

On commercial auto, I mean obviously, commercial auto is one of the triggering points of the preliminary release of the Q3 that we made in September. It was a large part, both the current year and the prior year of the \$300 million charge that we identified there net in the GI business. And in fact, about \$140 million of it was driven by commercial auto.

If you go back to some of the comments that Kristof made about particular lines of business, I mean, obviously you'd expect that there are some sub-segments of the commercial auto market where we see the most significant negative loss cost trends are going to be very high on the list of priority for us to target. I mean, we have a particular exposure on some of the larger trucking end of the market and that's an area that we're going to tackle with vigor before we go into next year.

So, I mean, again, I think through a combination of that and pushing across the board on commercial auto, we expect to see a significant improvement. On the rate that you're seeing, remember, I mean the rate picture is obviously backward looking. I mean the

exact extent of the issue that we face in commercial auto, I think, became clearer to us during the quarter. You're going to see more radical action from this point onwards.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you.

Operator

The next question is from Andrew Ritchie, Autonomous. Please go ahead.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi, there. I wonder if you could just give us a bit more detail. One of the points of the normalized review was on organization and governance. And I wonder, what was the weakness identified in organization and governance? And how do you think you've solved it, because I guess, there's not a lot of detail on that, I'm just curious to know what was the problem identified.

And then, in terms of the speed of any improvement, on the portfolio, you've identified the 15 portfolios. I mean, I think commercial auto is about 40% of the loss within those portfolios. And I guess, first of all, what is the kind of tail and the speed of getting likely improvement in commercial auto? I'm assuming, there's not that short tail of the auto liability.

And of the other 60% of loss is being generated in this portfolio. Is it property? Is it liability business? What is the tail and the speed of improvement on that we should think about for those books? Thanks.

A - Kristof Terryn {BIO 17664174 <GO>}

Hi, Andrew. Maybe let me start with the organization and governance part of the work stream. I mean, really, two pieces within that. I mean, one is we looked at the overall set up. And as part of that, we actually are driving a reduction of the number of people that we have sitting in the global layer. And we announced a number there, I mean a reduction of 200 positions. I mean, the basic principle is that we want to put accountability back in the frontline, put it within the market. And I actually don't believe that the size of the organization that we had at the top was commensurate with what needed to be done. And that does not mean that we're not, at the same time, strengthening the control environment.

I think what actually - if you go back to the governance on what has happened, I think it is more around the right focus and the right strategic tiering. And I think in some areas, we have just pushed growth over profitability, and that's an area where we need to intervene. I think, actually making things simpler at the top and with a smaller team, I think that actually we'd be much more focused on a holistic picture of what needs to be done and understanding the trade-offs that need to be made between growth and profitability.

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I mean, I don't think this is a fundamental issue when it comes to technical excellence. The information is there. The KPIs are there. I mean, we are doing a full review on what some of the leading indicators are that we can better assess some of the portfolios that are trending away from us but, by and large, I mean we didn't find any major gaps in the control framework. It's much more around having the right accountability in the right place and having the right focus in terms of what we're trying to accomplish in making the trade offs.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

So the information was there. It just wasn't linking strongly enough to the front line. Is that a good summary?

A - Kristof Terryn {BIO 17664174 <GO>}

So, I think there's a little bit of that. And then I think on the large losses, we have probably been somewhat slow in recognizing what was a trend and not a one-off. So that's an area and that is an area where we've done a deeper dive and we've made some of the points around reducing our exposure, being careful where we actually allocate capital. We're having to looking at what retentions are we willing to take on standalone risks, but also through relationship. So these are all things that we're looking at. But I would say, by and large, this is not an issue of not having the right information.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

And this governance review has happened across all the units of GI?

A - Kristof Terryn {BIO 17664174 <GO>}

That is correct. Yeah.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. And on the tail of the business you need to improve?

A - George Quinn {BIO 15159240 <GO>}

Andrew, why don't I take that? I mean, if you look at GI overall, there are expectations of the improvement we expect to see for the plan. The largest single theme is actually large loss. I mean, I think it's over one-third of the improvement that we expect to achieve. Some of that will come from commercial auto, but the vast bulk of it comes from property.

So the points that Kristof made at the beginning around how we approach underwriting, risk acceptance accumulation, I mean, these are actually expected to have a much larger, and obviously a much more immediate impact on performance.

I mean, beyond - I mean, just the issues that we have in the U.S. and Canada, which is obviously where the main focus is, the team are working hard to be set up for January 1 renewals in a number of European markets on some of the retail lines. So we also expect to have a significant impact. I mean even though commercial auto stands out as one of

the major challenges, it does have a longer tail line which means it takes longer to effect the change but it isn't going to be the key source of the overall underwriting improvement.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Great. Thank you.

Operator

The next question is from Vinit Malhotra from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi there. Good afternoon. So actually, my question has sort of been answered, so I will still put it just out there. The link between reserve issues and expenses, we have seen expense cuts - and Kristof, you just mentioned the fact that control was not a problem. But is it - this is the same problem that happened or similar problem happened in the German Meine Allianz lines where the people who were watching the claims were not there because of cost cuts. So if you could just reassure, I mean, once again, I apologize for repeating the question but this has been a problem, and even in the reserve - reserves are not part of this review, but we still do feel it surprise us. So if you could just clarify and repeat, reiterate that the people who watch these reserves are being carefully - or that process is complete. That's my first question.

And second question is just on the - back on this NAC, could you just also reassure us that the NAC also does a lot of the car dealers in America. And could you just reassure us that the portfolio there is sort of okay and doesn't need any further reserving action? Thank you.

A - George Quinn {BIO 15159240 <GO>}

I'll start on the first one and Kristof will take the second one. So on the reserving side of things, I mean, if you look at the way the group's allocated resources, reserving is actually one of the areas where we invested fairly significantly last couple of years. We have an ongoing program to improve the consistency of the reserving process globally. And while it wasn't completely untouched by some of the efficiency efforts, we've had last year and this year, I mean the impact of that has been very modest on reserving.

I mean, I mentioned in the introduction to the call that, I mean, I think - I mean, we feel comfortable that we have a good reserving process. I think some of the steps that we've announced around, I mean trying to focus a bit more on the large loss side of things. So I think if we're not so deep in the tail and not looking to accept quite so much volatility, it make some of the - I mean, some of the decisions that you have to make about whether something is bad luck, good luck is much more easy to deal with. So from a expense cut perspective and a efficiency perspective, I don't see that that's had any impact on the reserving process. And if anything, we're looking to obviously further strengthen the reserving process.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you, George. Thank you.

A - Kristof Terryn {BIO 17664174 <GO>}

So just to reiterate on the first question on governance, I don't think this has anything to do with lack of transparency. Again, I think it is around having the right focus, the right strategic focus, making the right trade-offs between growth and profitability and intervening more quickly. I think on the large loss side, I mean there, I think it is a trend we're well aware of and we're taking the actions to address it.

And then on your second question around the impact on direct markets, I think some of the strengthening in the U.S. order book was direct markets, but that is a much smaller part of the overall strengthening that we did in Q3.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you, Kristof.

Operator

The next question is from Thomas Seidl from C. Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Two questions. The first is on the P&C target. I think you acknowledge now that the baseline is 1 percentage point higher, but you're still confident that you can improve 2 percentage point to 3 percentage point. You also say that rate changes are 1 percentage to 2 percentages sort of claims inflation level plus you say because of lower volumes expense ratio is not improving. And expense ratio, if I remember correctly, after H1, was the main driver of the 2-percentage-point to 3-percentage-point improvement in the past. So, those two factors fall away.

So, how do you want to achieve the 2% to 3% if you want to do this with 16% of the portfolio? That would mean roughly a 15% improvement of underlying margin with this business, how realistic is this? It's my first question.

Second question is capital. I wonder a little bit about the considerations you had on the \$3 billion excess capital in September. The stock price was at a very low level compared to recent history. So what kept you from buying back then? Is it that you mainly expect to deploy into organic and inorganic growth or what other thoughts have driven this decision?

A - Kristof Terryn {BIO 17664174 <GO>}

Yeah, let me take the first question. So, on the efficiency side, as you know, initially we targeted \$200 million of savings in 2016. That number will be higher and is likely to exceed \$300 million in 2016. The reason that it won't have the impact as anticipated on the efficiency, on the expense ratio is because, as we stated before, we're likely to see a

modest top line decrease. And the targets we set for local business units are very much on an absolute expense basis, because I want to make sure that the focus, really, is on profitability and not volume.

On the second part of your first question, we're not just tackling the 16% of premiums that are in those 15 underperforming portfolios. I mean, we are taking actions across the board. And while rate may be difficult in this environment, a lot of the combined ratio improvement, loss ratio improvement will actually come from lift, which is the improvement on a loss ratio because of growing disproportionately the better tiers and taking some very significant and tough actions on the bottom tiers of the portfolio. So, even with a low-rate increase assumption, I think that 2 points to 3 points improvement in combined ratio is still an achievable target for 2016.

Q - Thomas Seidl {BIO 17755912 <GO>}

But this is now, if I – to be absolutely sure here, this is now exclusively coming from the loss ratio improvement. The expense ratio you should expect to stay flat.

A - Kristof Terryn {BIO 17664174 <GO>}

I think the majority will come from the loss ratio, I mean, the expense ratio will probably be roughly flat or marginally improving.

A - George Quinn {BIO 15159240 <GO>}

Thomas, on your second question on the capital side of it. Obviously, we're in a fortunate position from a balance sheet perspective that we have a very strong capital position, and we still estimate that we will have \$3 billion available to us to deploy through the end of 2016. What you've heard from us today is that we'll resolve how that will be done with the full year results in February and we'll give clarity to investors as to how we'll do it.

I mean, I guess if you look back, as we entered September, I mean, I guess, our intentions were clearer at that point that we had intended to apply it inorganically. I guess today, it's less clear exactly how that would be done. And I mean, we'll look at it as we go through the year-end. The most important thing for us is value. So, given the choices that would be available to us where do we the highest possible return for the benefit of the shareholders and that would drive the allocations in the end.

Q - Thomas Seidl {BIO 17755912 <GO>}

But wouldn't have the Zurich stock in September provided a lot of value?

A - George Quinn {BIO 15159240 <GO>}

Zurich stock provides a lot of value today.

Q - Thomas Seidl {BIO 17755912 <GO>}

No, as a buyback.

A - George Quinn {BIO 15159240 <GO>}

Again, I mean, we'll make a decision on capital and the allocation of capital between the different choices that we have in front of us, and the key driver will be value.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks George.

Operator

The next question is from Nick Holmes, Société Générale. Please go ahead.

Q - Nick Holmes {BIO 21515144 <GO>}

Hi there. Thank you very much. Two questions. The first is coming back, sorry, yet again on the expense ratio. I just wondered, I'm curious that you are not increasing the \$1 billion cost reduction target. I mean, I think you said you'd take the \$200 million next year up to \$300 million. Why not take the \$1 billion up because clearly top line is going to be under pressure?

And then second question is coming back on the \$3 billion of capital and M&A activity, would you be able - do you feel that you can make a bold statement like you would rule out a major M&A transaction or is that like RSA was or is that something that you don't want to say at this stage? And could you elaborate more on the sort of bolt-ons that you might be contemplating? Thank you very much.

A - Martin Senn {BIO 3241585 <GO>}

Hi, Nick. Let me comment first with the issue on our efficiency program. The plan remains to drive efficiency and cost savings through the organization of \$1 billion-plus. That's got to be more than \$1 billion by the end of 2018.

With the review we have taken in GI, we have also stated that we look to accelerate and reprioritize some of those investments or as well, let's say the initiatives. I think we have shown with the comments from Kristof that this is happening, particularly as well with regards to some of the head count reductions.

The other initiatives are ongoing with regards to continuous streamlining of the organization. And with that, we want to deliver first on these targets before we add traditional cost savings program on top of it. I think that's the key priority. With regards to the M&A, I hand over for that to George.

A - George Quinn {BIO 15159240 <GO>}

Hi, Nick. It's George. So I think we've actually made that bold statement already. I mean I think that's really what happened in September. I mean, given the challenges we faced in GI, we made it clear that that's the number one priority for us. So, for me, next time round when they open up the possibility, we would execute a major acquisition. I mean, that

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would be really odd. So I mean, I think this September was a statement of intent from us around what the number one priority would be.

I mean as regards how we may deploy it between bolt-ons and capital return, I mean, again - I won't go into that in depth today, but other than to say, I mean, value is the key driver for us. If I look at the transactions that take place in the market today, you've seen some recently, it strikes me they take place at levels that are above that, which would give us the indicated return that we believe we would need for deployment of the capital. It doesn't mean it's impossible but we're certainly very well aware of what the current clearing prices are. It's difficult to make things work at those levels. We continue to look for opportunities to deploy capital for the benefit of shareholders but value is the number one driver.

A - Martin Senn {BIO 3241585 <GO>}

Just to add to that, Nick, obviously, given what we just have said with regards to the initiatives in General Insurance, it is somewhat unlikely that we will deploy significant capital in organic investment, and given as well the outcome on the discussion we had on RSA. Inorganic opportunities are going to be likely to be bolt-on in nature as you're striving, and we will not deviate from that in the past, but got to understand that we were not sort of in a position to talk more in to that than where we stand at this point.

Q - Nick Holmes {BIO 21515144 <GO>}

Thank you very much for that. Can I just follow up? Just with another angle on this, which is that, with the bolt-ons, I think with the RSA acquisition, you said that the timing was not right. The GI business was not in the right condition. Now, with bolt-ons, is the GI review making it more or less likely that you might make bolt-ons? But bolt-ons like this could actually help you in some ways and I just wondered if you had any thoughts on that.

A - George Quinn {BIO 15159240 <GO>}

Maybe the one first comment I'd make, Nick. I think when we spend five minutes discussing bolt-on acquisitions, we leave people with the impression we have a giant list of bolt-on acquisitions that were just waiting to use the \$3 billion on. I don't want to leave people with the impression that that would be the case.

I think when we consider adding to the portfolio that we have, I mean, it has to follow the strategic direction we set in the past. So we'd have to strengthen distinctive positions that the company has. It has to meet the financial hurdles. There's a number of significant challenges that we would apply to the use of capital in any inorganic form.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. Thank you very much.

Operator

The next question is from Michael Huttner, JPMorgan. Please go ahead.

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Q - Michael I. Huttner {BIO 21417183 <GO>}

Fantastic. I'm going to ask the same questions. Sorry. I really apologize for that. But good for you for having - saying you're going to cut premium volume. There's one inconsistency which is that you're saying the \$3 billion gross, then deals, then return money even though your language at the moment is more value, which I take to mean return money.

And then on the non-life side, you're saying the problem was we didn't focus enough on profit and we focused too much on growth. So I detect there an inconsistency. And I want to be really, really sure that the message internally is indeed profit, not growth. There's a mix to that which I'm wondering about.

And then the other thing which is really for George Quinn because you're much better at this than I'll ever be. But you said or somebody said that the cost of capital for the decision to allocate capital is partly dependent on the share price. So, let's assume that as you pay your lovely [17%] dividend the share price slides as it normally does after December. Let's assume the share price now is \$300. At \$300, would you imply the same discipline which you're talking about at the moment which is really to kind of really brush aside deals is the feeling I am getting and focus more on value which I take to mean capital return? Or is \$300 the level at where you think, oh, things look better now, cost of capital is down, investors love us, we can go out and spend a bit of money. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you for your question. On the first one, I guess, maybe we separate a bit. I mean, what's happening operationally and the imperative we have that Kristof has talked about rates to improve, what's taking place at the front line. There's no one there where we said to them we've got some money we like you to spend. And they're all under a clear instruction from Kristof and the GI leadership that the priority is profit.

On the second topic, I mean, I guess, and you would understand this even better than I would, I mean, that - I mean, basing the hurdle rates on the opportunity posed by your own stock means that that's always a dynamic process. I mean, I think I wouldn't react and we tried not to react to short-term changes in the share price. So if it goes significantly up, I don't think we'd automatically assume that the cost of capital has significantly fallen.

And in fact I think if you go back to the, I mean, the last two investor presentations we've given, I mean, we could debate what the cost of capital was when we gave those presentations, but we set a threshold of 10%. And I think that, I mean, generally, in most cases, I mean, even if the cost of capital appeared lower, I mean, you'd have to be very, very careful about deciding you wanted to deploy capital at levels lower than that. But having said all of that, I mean, obviously, it's our aim to try and drive value overall for shareholders. I mean, if we see the share price rise to the kind of levels that we've discussed and hopefully it follows the improvements that we've made, I mean, then that decision would be a luxury problem for us, to be frank.

Q - Michael I. Huttner {BIO 21417183 <GO>}

That's well, I hope to discuss it with you in February. Thank you.

Operator

The next question is from Andrew Broadfield from Barclays. Please go ahead.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Yeah. Hi. Good afternoon. Two questions, please. I think you've said that you are setting sort of absolute cost levels of targets for the divisions within the GI. Could you just explain what the basis for those targets is, whether it's sort of arbitrary x percent cuts or whether it's more fundamental in terms of what's the competitive cost base for that line of business?

The second question is just on the slide six, which shows the underperforming portfolios. My question is, this is as at year-to-date. I'm always a little anxious for companies where there's been a radical management change that there is - or within a business unit that there is a sort of overreaction on near-term problems which perhaps look slightly different over longer term, and you end up just sort of chasing the last trade, if you like.

What do those charts look like? Are they similar? Have you looked at them on a 3-year, 5-year, 10-year view? And if so, and as a sort of follow-up to that, you mentioned that you'd identified that Zurich had been slow to recognize some of the large loss trends. I just wondered whether you could just articulate what those trends were or whether they were simply within certain business units?

A - Kristof Terryn {BIO 17664174 <GO>}

Okay. So, let me take those two questions, Andrew. So, on how we set the cost targets - and let me make a distinction between 2016 and then the longer-term objective that we're trying to accomplish.

I mean, so for 2016, we have set some absolute cost targets. I mean, these were a combination of some of the initiatives that are already underway. Yeah. I mean, whether that is lean, some of the centralization of the functions. And a combination then as well on the assumptions we made on volume and the required resources for that.

So where in smaller part of the portfolio, we exited lines. I mean, that clearly has an impact on the resources that are required and some of those actions we have taken immediately. So, that's how I would categorize 2016. So it was a detailed assessment of what is required, what are the initiatives that are already underway to make this business more efficient.

Now, on your point around the longer term on efficiency, I mean, it is clear that for us to be competitive in this industry in the longer term, we need to continue to focus on efficiency. We do look at where we stack up competitively. And that is also how we set the strategic long-term target of achieving at least \$1 billion of cost savings by the end of

2018. As you know, GI is the largest part of that. I mean, that should get us to a competitive cost position.

So that's on the first question. On your second question on page six, on the portfolios in the short term versus the longer term, if you would actually look at previous years, I mean some of the portfolios that are in the red buckets would've been underperforming, not to the same extent, and depending on the year, I mean, 2014 was actually in hindsight for some of these portfolios a relatively benign year in terms of large losses. So it is important to take a long term view.

What we have seen, though, is a significant deterioration in 2016 that has accelerated in the first half, and then going into Q3. When we talk about some of the things that we were late to spot, I think in particular that those are the large loss piece. I mean that is one where I think we have been too slow to react. That is a key focus area. I think with the actions again that we're taking, some of the volatility, some of the exposure to large losses should absolutely come down. And I think that is the right thing, short term, but also longer term.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Just on that last point, Kristof, I guess I don't feel, you said that 2014 perhaps some of these had been benign for these and said that it accelerated in 2015 and got worse. That feels like a very short time period to me making a decision and it doesn't sound like a trend to me for a business that has a multi-year pattern.

So I guess, and also on the large loss points you're making, I mean, are you able to articulate more fundamentally what those trends were, whether it's from lines of, very specifically trends within the line of business that you just don't you can overcome or trends in terms of your lack of your capabilities or scale or technological capabilities or digital capabilities? It's just not clear to me that, you say they're trends but I'm not sure I totally understand what those trends are given that they're not coming from long-term trends in the business.

A - Kristof Terryn {BIO 17664174 <GO>}

First of all in the views that we said that we took, I mean, we've taken a 3-year, 5-year and 10-year view on some of these portfolios. And when we look at the volatility and the returns that they were generating, I think it is the right strategy going forward to reduce the exposure and reduce the volatility.

When you look at the trend in large losses, I think there are a number of factors that are playing here. I mean, there is the interconnectivity of risks. There is the aggregation across different lines of business that plays a role here and that is where some of the fundamental analyses we are doing in terms of the large losses, some of the events that we've seen should give us the right tools going forward to reduce that volatility.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay, that's helpful. Thank you.

Operator

The next question is from Sami Taipalus, Berenberg Bank. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi, guys. Just to keep you on slide six to begin with. Obviously that 143% is not a great number, but to be honest I don't think that 94% is a great number either, I mean, 94% is a decent combined ratio for a lot of your peers in a normal year. But this is for the portfolio excluding all the bad stuff in what is actually quite a nice favorable weather year. So I'm wondering what makes you think that you don't actually need to improve the rest of the portfolio by quite a bit as well because it seems like quite a lot of the actions are focused on the kind of orange bits that you've highlighted there. That's the first question. And then the second question is on reserves, could you just tell us a little bit more about this reserve increase in construction liability, what it relates to, whether it's an industry issue and maybe what underwriting years it comes from as well? Thank you.

A - Kristof Terryn {BIO 17664174 <GO>}

And so, Sami, let me take the first question. I'll let George comment on the reserves. So, just to make it very clear, the underwriting review that we did was very broad. I mean, it's covered all portfolios and we have specific actions across all of our portfolios, because you're absolutely right. Yeah. We're not going to get to the required combined ratio by just addressing the 15 portfolios. The reason we've highlighted the 15 portfolios is that some of the tougher actions we're taking where we're exiting lines of business, where we're willing to see very significant drops in retention, I mean, will clearly be focused on those 15 underperforming portfolios.

But for the other US\$17.7 billion NEP with the 94% combined, you're absolutely right, that combined does need to improve. And that will again be a combination of looking where do we need some rates. Tiering is something that we apply across the entire portfolio and the extent of the actions that we take will probably be a little bit more moderate there than on the underperforming portfolios. But by and large the underwriting review covered the entire book, because clearly our combined ratio is not where it needs to be.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay, is the philosophy the same in the other portfolios as well of kind of prioritizing margins over volume there?

A - Kristof Terryn {BIO 17664174 <GO>}

Yes. In general - I mean, you can absolutely make that statement. I mean, across the book margin is the top priority over volume and that does not mean that some parts of our book will not continue to grow, because we see continued good profitability in parts of our book. But as part of the rest of GI that US\$17.7 billion, there will be parts of that book as well that will see some shrinkage and will require some rate as well.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

Sami, on the second part of your question on this sub-portfolio of construction liability, it's not a particularly large product line for us; it's less than \$200 million of earned premium. But it's been significantly impacted particularly in the 2012 and 2013 years for claims from those two periods.

The preliminary announcement that we made in September had already contemplated an increase. Again, as I mentioned earlier, I mean, given the outcome that we had for the quarter, we also felt that we should take a more prudent view in this part of the overall portfolio. We are market leader in this relatively small segment. The claims are quite lumpy so they tend to be quite large in nature, so it does pose some reserving challenges. But given what we've done, we feel we're in an appropriate position for reserves for this line of business.

Q - Sami Taipalus {BIO 17452234 <GO>}

Do you think it's fair to say that your kind of confidence level on those reserves is quite a bit higher than what it is on average across the whole book?

A - George Quinn {BIO 15159240 <GO>}

I mean, it varies from area to area. In fact if I looked across the book, the areas that would typically cause you more concern typically are like APH, A&E, workers comp, those types of things. But these have all performed within our expectations. With the things we've dealt with, obviously the steps we've taken here improves the confidence we have in this particular line, and in fact that's also true for what we've done in commercial auto in the third quarter.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Thank you.

Operator

The next question is from Ralph Hebgen, KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Hi, guys. Ralph Hebgen from KBW. I've got three things. One is back to the reserve increase in the construction line I'm afraid. I would just like to understand perhaps better your thinking of why you needed to increase these reserves following a profit warning in September where you knew you had to strengthen reserves but in other lines of business. So in other words, I'd just like to explore what is behind your reserving philosophy now?

Is that particular reserve increase which we have known about now a sign of increased prudence or is it a sign of heightened understanding of what your claims experience is like and therefore was made necessary by developments which you became aware of

only after September 21? That was the first question. The second question relates to cash targets. You confirmed again today that you stick by your target of more than \$3.5 billion of remitted cash in 2015. That number of course is now after sort of \$800 million profit warning. I am guessing there's an underlying operating remittance of about \$2 billion. So I'm just wondering where does all this cash come from?

Well, that's really the question. What specific items are there that you are confident must emerge before the year is out which support this level of cash to this order of magnitude? And finally, just a numbers question. Would you be able to give us more insight into the split between prior years and current years on the various reserve increases which you have conducted? Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Thank you, Ralph So if you don't mind, I'm going to direct your number three to the IR team. I'm sure they can give you some assistance and...

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. That's cool. Perfect.

A - George Quinn {BIO 15159240 <GO>}

... break down the numbers. So on the other two. So, on reserving, I guess I've tried to say, I mean as carefully but as clearly as I can today that - I mean, essentially the way the process has worked for us, I mean, we've reviewed the reserving position, I think we mentioned already that we had the benefit of the reserving process, actually running in the few days prior to the September 21st announcement.

We reviewed all of the areas that we felt were relevant and we came to various conclusions. And arriving at the number that we publicized in September, we allowed for what would be a normal month of September for nat cat. As we've now closed the quarter, we don't have a normal month, for the month of September, it's much lower. In fact, I think it's - I think from what we had assumed, it's close to zero impact.

At the same time, we've looked again across the portfolio and we've decided to increase the prudence that we have around this particular topic. I mean, it was one of the things that was - actually in the estimate that we had in September but we have increased it. Overall, as I mentioned earlier, the two items offset and we end up back - almost exactly the same position that we had led investors to expect.

Now, again I think I said in the intro to the call that I think I was well aware when we made that decision that would trigger additional questions. But of the choices that were in front of us, the one that we opted for seemed like the best one for me then. And to be honest, it still seems like the best one to me today.

On the cash, the cash, well, I was going to say it's not very complicated; it's always a bit complicated. So for 2015 I guess the good news is that the drivers of what drives cash for

this year are largely in the bag already. So it's cash remittance that we've had from subsidiaries during the year. And the challenge of what's happened at the end of the year is more likely going to affect dividend flows in 2016.

But the reason that you see the confidence, I mean, not only around cash for this year but also confidence that we can continue to achieve the \$10 billion that we talked about at Q2, which of course exceeds the target level by about \$1 billion. I mean that's driven by a number of things. I mean the very basic thing it's driven by is when we gave the \$10 billion number we had an expectation that we'd be well above the \$10 billion number. And even if I knock off the after-tax profit warning, it brings me down to a level where we're still confident we can deliver the more than \$10 billion.

I mean, practically what drove that higher number? One of the things that would certainly drive it is Farmers. I think as everyone is well aware, we've had a program led by Jeff and the team to discuss with the key stakeholders a reduction in the capitalization of Farmers Re. I'd say that the team have executed that extremely well and over the course of the next 12 months to 18 months, as we've said previously, we expect to extract the vast majority of the capital in Farmers Re.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Can I just follow up on that, on the cash, I mean, it's still the case that you have about operating cash flow of \$2 billion now for 2015, which means that we have \$1.5 billion at least in specific items topping that up. But where does this come from? Is this already some of the Farmers extraction not only from Farmers Re but also from the floating rate note included in the solvency of the exchanges? Are you making more progress in the extraction of that not quite \$1 billion?

A - George Quinn {BIO 15159240 <GO>}

So we're making exactly the progress that we have planned for. So, again, we said, I think in the early part of this year, that we expected to extract all or almost all of that over the next 18 months. And I guess I'm trying to signal as much as I can that our confidence is very high given the stage of completion that we're at with the various key stakeholders.

On top, I mean, it's not just Farmers. We also have, I mean, the GL team have been doing good work. You see what we've done earlier this year around the annuity transaction, of course, that helped. It's a one-off. We sold an asset manager in the UK, that again, helped. And in fact, I mean, GL also has a target to reduce utilization of capital in some areas over the course of the next 18 months. So, a combination of all of these things, I mean, more than offset the short-term weakness in the operating performance because of the profit warning this year.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. And just one follow-up on the heightened prudence relating to your reserving decision. Can we expect that this heightened prudence in reserving philosophy will also affect other areas of the business as you go forward, and as you conduct your regular reserve reviews?

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A - George Quinn {BIO 15159240 <GO>}

I guess all I could really do is repeat what I said at the introduction to the call. And I guess as everyone knows by now, there are no absolute guarantees in reserving. I mean, these are based on judgments of individuals looking at the facts before them. In this particular quarter, we've taken the position to be more prudent around this particular line. We do not anticipate that we'll make further changes in what's been a very consistent reserving process.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Fantastic. Thank you very much, indeed.

Operator

The next question is from Mark Cathcart, Jefferies. Please go ahead.

Q - Mark David Cathcart {BIO 19783252 <GO>}

Yeah. Hello. Back in 2003, I think under Jim Schiro we had a presentation which introduced The Zurich Way and one of the notions was driven by losses of the World Trade Center where you had I think 12 contiguous buildings, in other words concentration of risks. And we were assured in that presentation that under The Zurich Way, there'd be no such concentration of risks ever again.

So I just wondered if you could talk about Tianjin? Surely that was a huge concentration of risk. You've talked about volatility of risk but that seemed to be high concentration. You've had losses way larger than any other insurer or reinsurer in that region. So what has actually happened? You talk about governance issues. Did The Zurich Way book gradually get torn up page by page? I mean what has actually happened?

A - Kristof Terryn {BIO 17664174 <GO>}

Let me take that question, Mark. So, no, The Zurich Way book is still very much there, and it's still what our underwriters use and The Zurich Way of underwriting is still very much how we drive underwriting excellence.

When we look at concentration of risks, I think where we have been particularly strong is when it comes to managing the aggregations of our property portfolio. I think the interplay between business interruption and property risks, cargo, etcetera, I think that is where I want to do a deeper dive and understand whether we have the right accumulation management across all the different lines of business in place. Now that being said, we are one of the biggest players in the OEM space and you would have expected that we would have had a disproportionate share of the Tianjin loss.

Q - Mark David Cathcart {BIO 19783252 <GO>}

But it was still - wouldn't you argue too large a risk to take given the resultant loss?

A - Kristof Terryn {BIO 17664174 <GO>}

Well, this goes back to my comment on our large losses and the increase of large loss frequency across the portfolio. When I look at the profitability and, again, going back to all the different historical views, I mean, I don't think we're getting the right returns on some of the large loss exposures that we're having.

So I would say more in aggregate across the portfolios, and this is particularly a global corporate issue. We're not seeing the right returns on the large loss exposures that we're writing. So the strategic review of looking at retentions, accumulation of retentions, reductions of lines and use of reinsurance, I think, is the right answer to that issue.

Q - Mark David Cathcart {BIO 19783252 <GO>}

So, you weren't unduly concerned by the concentration of risk in Tianjin?

A - Kristof Terryn {BIO 17664174 <GO>}

Look, I mean, I think the fact that we had a disproportionate share was to be expected. I mean, I do want to understand whether we can further improve our accumulation management across different lines of business. I think that is a fair point.

Q - Mark David Cathcart {BIO 19783252 <GO>}

But you can say that since The Zurich Way was in store, there's been no lowering of underwriting standards within the Zurich Group that's been adhered to?

A - Kristof Terryn {BIO 17664174 <GO>}

That, I can absolutely say yes.

Q - Mark David Cathcart {BIO 19783252 <GO>}

Yeah. So, what's the governance issue then?

A - Kristof Terryn {BIO 17664174 <GO>}

I think it goes back to more how we strategically looked at the portfolio and how we were pushing growth, not always at the right levels of profitability. So, for me, this is much more around how we steer the business, how we set priorities and being realistic about what we can achieve in what is a softening market environment.

Q - Mark David Cathcart {BIO 19783252 <GO>}

Okay. Thank you. Thank you.

Operator

The last question is from Dhruv Gahlaut, HSBC. Please go ahead.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon, guys. Just a couple of questions. Firstly, just going back to slide six, could you give some flavor in terms of how the 15 underperforming portfolios are split between the different regions in terms of international markets, Europe, et cetera or U.S.?

Secondly, also the other operating business line this year is running lower than expected. How should we think of this in 2016? And also could you give the growth exposure to Tianjin for you guys as well? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Hey, Dhruv it's George. So on the first one, can I ask you to again go back to IR and they can help you with.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Sure.

A - George Quinn {BIO 15159240 <GO>}

On the OOB side of things, I mean, if you look at the traditional pattern that we exhibit, the costs in OOB tend to be weighted to the second half of the year. I think from what I've seen of the analyst estimates, certainly in prior periods, people understand that and estimate it I think pretty well. I mean, OOB, we said earlier in the year that I mean I think we were expecting something in excess of \$900 million. I mean we're going to be lower than that this year and that's partly driven by what we'd started to do in response to the efficiency program that we announced back in May. But we've also had a number of benefits that I guess we couldn't claim complete ownership of, so we have lower financing costs in there and our hedging program has also generated in the year to-date about a \$75 million gain. So you need to back that out from OOB's performance. But I mean that's clearly an area where we're going to target to drive further efficiency into 2016.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

So what do you think the running would be if I could just follow up on that? What do you think the running run rate would be going forward?

A - George Quinn {BIO 15159240 <GO>}

The only reason I am hesitant is - in fact, I have a meeting with all of my corporate center colleagues on Monday when we are going to discuss that particular number for next year. So I expect us to bring it down but I don't have a precise figure I could guide you to yet. That discussion is about to take place.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Okay.

A - James Quin {BIO 18345789 <GO>}

Thank you, everybody. We are aware there's a few more questions out there. Unfortunately, we don't have any time to take them right now. The IR team will definitely give you a call. Thanks very much for dialing in and good-bye.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call and thank you for participating in the conference. You may now disconnect your lines. Good-bye.

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