Q2 2014 Earnings Call

Company Participants

- Adrian Peter Cox
- David Andrew Horton
- Martin Lindsay Bride

Other Participants

- Ben Cohen
- Chris D. Hitchings
- Eamonn M. Flanagan
- Joanna T. Parsons
- Nick H. Johnson

MANAGEMENT DISCUSSION SECTION

David Andrew Horton {BIO 5697110 <GO>}

So, I'd like to welcome you all to the six months results, the six months ended the 30th of June, 2014. I wanted to make a particular welcome to Chris. As I understand, it's going to be his last Beazley analyst presentation. And as always, Chris, we look forward to your questions at the end with excitement and some trepidation, and we all at Beazley would like to wish you all the good luck in the future. So, thank you for all the things you have covered on us, Chris, over the many years including your last home, which was excellent I thought.

So, if I dive into the agenda, I'm going to give you an overview of what's actually going on and then I'm going to hand over to Martin and he's going to take us through the financials, investments, reserves, as normal. And then I'm going to hand over to our 2014 special guest star, back by popular demand from a few years ago, Adrian Cox, who've been spending the past year in the U.S., running specialty lines. He's going to give a flavor of what's going on in the specialty lines world post-recession and what he's found in our U.S. platform as we celebrate the 10th anniversary of our U.S. initiative this year. And then I'll come back and give a flavor of the outlook.

So, if I go into the overview, profit before tax up strongly year-on-year. It's maybe driven by investment income and Martin will go through that. Because if you remember, last year, we hardly had any investment income as U.S. interest rates rose in May and June. We had mark-to-market losses on our investment portfolio, so we had $0.3 million. And this year, we've got $46.8 million. Gross premiums written, up 1%. Growth is quite hard to come by. With plenty of capacity and competition out there, it's good to actually show some growth in the top line.

Combined ratio of 90%. So, we've been relatively consistent. 90% is our target, and we've been around the 90% mark for several years now. It's been an okay claims environment; one or two notable claims, but generally an okay claims environment. We've also got the premiums coming through from prior years. We have not seen premiums with rate reductions yet, and we'll look at that going forward. And then the prior year reserve releases are holding up. And again, Martin will go through the prior year reserve releases.

Life, accident and health had much a better performance in the first half; still slightly underwater in terms of profit, but greatly reduced from the first half of last year and the full-year last year. Rate changes. There's a mixed bag of rate changes where we are seeing relatively large rate changes on catastrophe-exposed businesses in the first half. Rate reductions also on other short tail lines such as aviation, hull, aviation war and so on, while specialty lines continues to pick up. So, 1% to 2% rate increases on our specialty lines portfolio. So, it's probably the third or fourth year we've shown rate increases.

Annualized return on equity, all that gives an annualized return on equity of 17% post-tax, great return on equity. And our dividend not surprisingly is up 7% between the 5% and 10% in line with our dividend strategy. So, I'll give you a flavor of business update and say the third year of increases in terms of specialty lines. Rates on the short tail lines definitely under pressure. We're probably folding slightly more quickly than we originally planned for (03:28) talked beginning of the year. And we're seeing opportunities in the smaller lines. So, it's the large risk business at Lloyd's where we're seeing most rating pressure.

So our focus over this year and into next year will be on the smaller business lines, and that links into the whole logic of our U.S. initiative 10 years ago. Why did we go into the U.S.? We went into the U.S. to get at the same lines of business we've historically written at Lloyd's but on the medium and small size. So we've seen our U.S. onshore premiums grow at 14% this six months over the last six months – the six months – first six months of 2013, where last year we saw the whole 2013 premiums increased 17% year-on-year. So, we've definitely seen growth in the U.S., and Adrian has been helping with that.

Continue to attract good people, so we've got a reasonable number of people we've attracted in the first half. We announced that Jonathan Gray would be leaving us at the end of June 2015. We've recruited a couple of open market property underwriters to take over from Jonathan when he leaves. Added to our terrorism offering out of New York – added to our terrorism team in London, but a couple of underwriters in New York going to surety reinsurance that fits under our specialty lines reinsurance part.

And we've recruited a Senior Investment Officer to complement Philip Howard, who is our Chief Investment Officer, amongst others we've attracted people in other areas. So, we continue to attract good people. I am now going to hand over to Martin. I just wanted to make one further welcome, which is my father, who's here for his first analyst presentation who's just made it, which is good news. He is not going to initiate coverage on us, but he does give feedback to me on the quality of the presenters. So, good luck, Martin and Adrian.

Martin Lindsay Bride {BIO 15458196 <GO>}

All right, thank you, Andrew. Good morning, everyone. Welcome, Mr. Horton. I'm Martin Bride, the Finance Director, and I'm going to take you through the usual slides that those of you who are regulars will be familiar with around our investment performance, our reserve strength, and the one or two other things that have been happening in the finance fair.

So, overall on the KPIs, the finance KPIs, just a couple of things I really wanted to highlight. GWP growth is slowing down a bit. But you can see a healthy NEP growth, net earned premium growth. So, that's the benefit where you have flowing through of the activities over the last year or two to continue to grow the top line still flowing through net earned premium. So, a slightly larger business this half than the same half last year, and that is always very encouraging.

As far as the net tangible assets per share, they're actually down in sterling. So, the two things I'd say about that, first of all, shareholders have had 24.9p of dividends since this time last year and we carry our net assets in U.S. dollars. So there's also been a 10% move from FX. So if you've looked at our U.S. dollar NTA including dividends, the organization has actually delivered a very strong performance over the last 12 months, which is very encouraging.

On to investments, so we're on track for the 2%. This time last year, having had the effects of the rising U.S. interest rates very freshly in our minds and a virtually zero investment return for the first half 2013, we said we expected to make 2% going forward, because we expected the loss position on the bond portfolio to unwind, and that's exactly what's happened. We're still looking at 2% for 2014. Exactly how the U.S. interest rate picture evolves will be the key determinant of whether or not we can achieve that, but we're very comfortable with what was achieved in the first half.

In terms of the portfolio itself, the donuts that show the asset allocation by broad sector are very, very consistent. Within that, there's been a little bit of change, some reallocation of credit to sectors that we think offer better value than others within the capital growth area and allocation to a few funds that are targeting slightly less liquid investments. We think that's something that an insurance company can accommodate very easily for a small percentage of its portfolio.

And with the resistance of the banking sector to lend as much as they used to, there are some opportunities to invest attractively as long as you're prepared to accept some illiquidity. But big picture, a very stable view and no major changes in the pipeline in terms of the allocation. So, moving on now to our reserve release picture, a pretty stable picture half-year 2014, half-year 2013, and reserve releases that are very much in line with our long-term picture. Gratifying to see all six divisions are contributing to the reserve release picture.

We particularly like to focus on the next chart, which is the reserve strength. So, this is showing you how much margin compared to our internal actuaries we believe the reserves on the balance sheet have in them. So, it's an important indicator of whether or not you should expect the reserve releases that you've seen on the previous chart to continue. So, we remain within our range. As you can see, the end of the chart is a little bit more volatile than we've experienced recently.

We run a consistent and bottom-up process for each team, set its reserves in consideration of the experience its had, and all of that adds up to give us the total picture. As you've seen from the previous chart, the reserve release picture coming from the underwriting teams is very consistent. The level of that line is driven by two things, what the underwriters do and what the actuaries think. So, the reason it's moved upwards to last year-end and then downwards again is because there's been a little bit of volatility in how much the syndicate is holding compared to the prudent view of our internal actuaries, but very much within our target range. And our perspective is that our reserves and our reserve releases should continue in a stable picture.

Finally, on capital and one or two other of my favorite subjects, we are moving towards a full Solvency II world. So, we don't have the IFRS-based surplus capital disclosure at this half-year. We will be presenting new disclosures at the year-end with a revised view of how capital buffers should operate in the Solvency II world. We have a very robust capital position at the half-year and expect to have a good capital position at the year-end as well. But we do need, as I say, to identify exactly how to communicate, now that capital is being set in a fully Solvency II compliant way, which means that the – whilst the IFRS balance sheet is part of the picture. It's not the complete picture.

We've said this time last year we're altering the nature of our arrangement with Falcon, and execution of that is very much on track. We will have finished everything by the 30th of September, 2014. And obviously, we're pleased with the investment performance we've had so far this year. So, everything's going well there. And as far as Solvency II is concerned, there is, in my view, no doubt that it goes live on the 1st of January, 2016 now and we remain very much on track to have everything in place within the Beazley Group to make sure that we're fully compliant with the requirements of that regulatory regime when it comes.

So, I'll hand over to Adrian Cox.

Adrian Peter Cox {BIO 16257010 <GO>}

Thank you, Martin. Good morning, everyone. Good morning, Mr. Horton. My name is Adrian Cox. I'm Head of Specialty Lines, and I'm back after six years to give you an update on where we are within specialty lines and also to tell you what I've been doing for the last year or so in the U.S. When I was last up here, the financial crisis was just beginning and the recession was just looming into focus, and we were talking about what we were going to do about it. And six years on, I think is a good opportunity to tell you what we did about it and how the portfolio has evolved since 2008.

Really for the last seven years, there's been two strategies that we've been employing side-by-side, mutually reinforcing; the first of which is to underwrite and claims manage our way through the recession, and the second of which is to steer ourselves to where we think our long-term competitive advantage lies. Broadly speaking, our view of the recession was that it was concentrated around the property market and the financial services arena.

So if you remember, last time when I talked, we had isolated which parts of our portfolio we thought were most exposed to the recession. We put together underwriting plans to tackle those both in terms of segmentation, risk selection, pricing structure and so on and so forth. And that has been a process which we've been going through really for the past six years, and I'll take you through what happened to the portfolio over there.

Overlaying that, as I said, we've been spending some time investing in where we think our long-term competitive advantage lies, and that really is around what we sell. And what we sell in specialty lines is similar to what we sell in Beazley, which is individual risk underwriting and claims expertise. So, we like to deploy relatively small teams of underwriters and claims managers with expertise in their fields and are empowered to make decisions. That's a competitive advantage if the clients like it, and it's a competitive advantage, if by having expertise in those fields, we can out-underwrite or out-claims-manage our peers.

Now, why would our clients like and pay for that expertise? Well, it's either because their exposures are changing or their insurance needs are relatively complex and will change from time-to-time and they want the relationship with an underwriter over a period of time, so they can evolve their insurance needs, and/or because the claims are complex and can take some time to adjust and involve new theories of liability and laws and so on and so forth. And they want a relationship with their claims manager that can last over many years.

And what we try to do within specialty lines is target those industries and areas where we believe those characteristics are present. Overlying all that is we also like to compete in areas where the pie is growing. We've been talking a lot the last couple of years about growth and where growth is going to come from. We strongly believe that it's much easier to grow in the areas where the pie is growing, either because the industries that we're insuring are growing or because the products that we are providing are growing alongside that.

So if you look at specialty lines overall since 2008, you can see that we've grown from just over $650 million to just under $900 million. We had a bit of a pause in 2010 and 2011 as our recession underwriting really bit and we started to reduce some of the areas that we thought are most recession-exposed and then grow after that with some of our investments into the areas where we thought our competitive advantage lay, really took hold.

And if we go through briefly line-by-line, you can see the two big moving parts; the pink area, which has grown between 2008 and 2014, which is our technology and cyber area, which have grown for the two reasons. One, we didn't believe they're exposed to the recession, and indeed, they weren't. And also that those pies were growing. Cyber liability is the fastest-growing product we have. The technology industry continues to be the dominant force in growth across the U.S.

The corollary of that is the black bars are shrinking. Those are our traditional E&O areas, our lawyers, our architects and engineers and so on and so forth. We believe that they were very exposed to recession, and indeed, they did have a difficult recession, and the percentage of the business that they are now has shrunk accordingly. The different bars across there in a mild way also reflect that our healthcare, which is the red one, has grown a little bit.

Our small business, which is the blue one, has remained the same, although interestingly the U.S. portion of that has grown and the international portion of that has shrunk, because the U.S. one is much more focused on healthcare and technology. So, the mix of our business between 2008 and 2014 has changed quite substantially actually, reflecting both our recession underwriting and our investment in areas where we think it reflects what it is that we sell and where the pie is growing. And we really are continuing to invest in technology and cyber and healthcare and management liability.

From an industry perspective, we continue to believe that healthcare and technology are going to be the leading industries in the U.S. And from a product perspective, cyber liability continues to be the fastest-growing product that we have, and management liability is also a product that is growing quite strongly in the U.S., particularly in the private industries. So, D&O and EPL have long been bought by public companies across the U.S. The penetration of management liability in private companies has increased quite markedly over the last three years, because a lot of the private companies had a fairly difficult recession when it came to D&O and EPL experience also.

Wrong way. I thought I'd share a little bit about what's happened to our rates over the last few years. Really, it's a tale of two halves, what happened between 2008 and 2011 and what's happened in 2011 and post. Rates, I think, are strongly correlated to two things. First is paid claims. Insurance markets generally only move when claims are paid. And then secondly is marked increases in supply or changes in supply.

2008 was an interesting year for us. We were, as I mentioned earlier, believing that the claims environment was about to get markedly worse due to the financial crisis and the recession. But because claims weren't being paid out of that, the market wasn't reacting terribly. Also, for those of you who remember, in 2008, various insurance companies got themselves into a little bit of trouble, AIG, XL, Hartford and the rest of them.

What that caused to happen was that a lot of people were leaving those companies and joining other insurance companies and starting new teams, particularly in specialty lines. So we saw a lot of new capacity in D&O. We saw a lot of new capacity in healthcare, environmental E&O and basically across our product set. So we had a marked increase in supply of insurance in specialty lines combined with a lack of paid claims, and that caused the downward spike you see there.

In 2011, that really stopped. There wasn't much new capacity entering the market for a couple of years and claims started to be paid. And the angle of increase reflects how much claims have been paid since 2011. You can see a contrast between the two, pink and red lines, which continue to go down and the other lines which have gone up. As I've mentioned earlier, healthcare and technology industries really haven't had much recession exposure. So, there haven't been many paid claims there. It's a slightly different story on the architects and engineers, lawyers and the EPL part of our management liability book.

As we look forward now, as Andrew said, we've had – it's our third year of rate increases. We got 3% in 2012 and 2013. I think we'll end up with just about 1% in 2014. The expectation is for 2015 that we'll be broadly flat. Why is that? Essentially it's because we've done the re-underwriting that we think needed to have done for our recession-exposed classes. And broadly speaking, we are through the recession. Looking forward to 2015, the marketplace has to be broadly flat, I think. We believe that the U.S. economy has reached escape velocity, and so the economic growth should continue.

For us, it's a real Goldilocks economy in the U.S., which represents about 85% of our business. So it's not too hot, not too cold. We like it when our businesses are growing. We like it when their order books are full. We like it when they have some money to spend and to spare. We don't like things getting to frothy, because people get overexcited and then disappointed. But we do like it when our clients are growing and when they're more interested in trading rather than suing if things go wrong with their clients or suppliers. So, it's quite a good environment for us, good strong insurance demand.

We don't think however though that the claims environment is going to be like it was 10 years ago. So back in 2003, 2004, 2005, the claims environment was very positive. And why was that? Well, we were just coming out of a – a lot of med mal crisis, dot-com crisis and so on and so forth, a huge amount of litigation across the U.S. And the U.S. saw the social consequences of that. There were stories in Philadelphia that you couldn't give birth to a child there because you couldn't get obstetric care. They had to go out of state to find a doctor, because doctors couldn't buy insurance.

That sort of thing have sparked a huge reversal in how juries behaved and the sorts of laws that states were passing. A big wave of tort reforms swept through the U.S. 2003 to 2006. We're not in that environment anymore. There's no fear of what large jackpot verdicts will do to the business and the economy. So, the litigation environment is not as positive as it was back in 2003 to 2006. So we're in a good environment from a macroeconomic perspective. I don't think the litigation environment is going to be quite as positive as it was back then.

But there is growth. And where there's growth, there's opportunity. What are we going to continue to do? Exactly what we have been doing, investing where we think the pie is growing and where we think we have expertise and a competitive advantage. Cyber liability still has only got about 25% to 30% penetration across most brokers. There's business to grow there. A lot of the businesses that we've invested in the last few years are beginning to gain critical mass now, environmental, miscellaneous medical and so on and so forth, all areas we think which play to our strengths.

The business mix and the positive economy that we have now mean that we will be reverting to our long-term opening loss ratio in specialty lines of 85% net of brokerage, slightly down from where we have been through the recession years, reflecting our positive view. And the last piece of what we're trying to do is really leverage the different platforms that we have.

The offering that we have in the U.S. with local access to underwriters, small and mid-market business, admitted paper, is a different offering from that we have in London, where we have the syndicated marketplace, consortia and largest capability and so on and so forth. We really started to leverage those two differences there and really play to the strengths of both platforms.

I mentioned the U.S. slightly. So, I've been spending a lot of time in the U.S. I've been living there in Chicago since August last year. And why did I go out there? Well, as Andrew said, the U.S. has been a strategic initiative for us now since 2004. We're celebrating our 10th birthday, which is primarily why I'm out there. It's been a very positive investment for us. Last year, 2013, we wrote about $450 million of business onshore in the U.S. We've got over 350 people there.

We have a lot of ambitions for our U.S. platform. It's a great positive force for us. In order for it to meet our ambitions and to be able to scale efficiently, what we wanted to do is to have a little more coordination there. We're organized by product at Beazley. I've been spending the last 10 minutes saying what is it that we sell. Well, we sell product expertise on the underwriting and claims side. That's how we're organized. We have a global D&O team, we have a global property team, a global marine team and so on and so forth. There is no geographic overlay to the way that we're organized.

But if we're going to achieve our ambitions in the U.S., which is a very big geography and has a lot of people in there, there is some coordination that we need to do to make sure we do that in an efficient and scalable way. And that's what I went over last year to try to do, really to make sure two things; one, that we did coordinate well and actively across the teams, both internally for stuff we're trying to do internally and externally with the way that we act with our brokers. And secondly, that we start to embrace some standardization and automation processes, systems and controls, et cetera, so that we were scalable in a relatively efficient way.

What does that meant? Well, to go through the four priorities that we have; at distribution, we've really started to focus on a distinct distribution strategy now; distribution, how we act with brokers, which brokers we want to trade with and how. It's a massively fascinating subject. It's a very complex subject. Some companies do that very, very well. Most companies don't. It's a real benefit from being good at distribution.

And what being good at distribution means is being very clear about who you want to deal with and how, being very clear about what your retail strategies versus your wholesale strategy, picking out which brokers you really want to trade with and make sure you service them properly and that you have a proper functioning corporate relationship with those guys. It's a subject that a lot of insurance companies spend a lot of time on.

We have decided to focus more on that, because it's not something that we've done naturally ground-up. And I've been working with the Head of our Broker Relations over the last year to figure out how best to do that. The upshot of that was that this year we decided to concentrate on nine brokers in six cities. So across the business as a whole, we tried to figure out which were the brokers we felt we had the best cultural fits with, so we could really gain some traction with them, make sure that we service them properly. All the underwriting teams spend time in those offices every month that we service the quotes and the binders (25:06) and we made sure that we're providing excellent services as brokers.

So, we've been really focusing our fire power. We only have 100 - by the end of 2015, we'll only have 115 underwriters in the U.S. We're not an AIG or a Chubb or Travelers. So, we really have to focus our fire power. So, we've started this year what we call the six-by-nine initiative. The good news is, as Andrew said, we grew 14% in the U.S. this year, but we're up 35% with those nine brokers. So that strategy really is paying benefits. And as we move forward, we will be getting, I hope, better and better in how we organize ourselves and our brokers.

Improving our underwriting process, we have a great underwriting and policy production system in Beazley Pro (25:42). Unfortunately, not everyone's on it. So, we've got projects in place to make sure all the teams are leveraging our platform as best as they can. One of the things we sell onshore in the U.S. is that we are an innovative insurance company. We proudly say we're a specialist insurer and one that releases new products fairly regularly in tune with what we're trying to do in the marketplace.

If that's what we're selling, we have to make sure we do it properly. So we've resourced that up and coordinated that to make sure that we can. And then the last priority is to say, if we are concentrating, if we can figure out where we want to concentrate our production, let's populate those offices, so that we have all our major products in those offices. And as I mentioned, we decided to concentrate on six. So, as you'll see in a couple of slides time, we'll be building out our underwriting footprint in New York, Chicago, San Francisco, LA, Dallas and Atlanta.

This is what we've done in the U.S. since 2008. We've grown from $300 million to $450 million in 2013. We will finish some 14%, 15% above that I think in 2014. You can see we took a little pause for breath 2009 and 2010. There's a couple of reasons for that. Firstly, from the specialty lines perspective, we did cut back a little bit on some of our recession-exposed classes, as we underwrote our way through that recession. We also shut-down our admitted property portfolio at that time. So there was a little pause there.

There's been some very strong growth in 2012, 2013 and 2014, and we really think there's a lot of scale for some more. Our market share is fairly small on the small and mid-market arenas in the U.S. Local access and admitted paper really does give us the ability to scale, and the products that we have are generally in areas where the pie is growing. So, it really is a very exciting time to be in the U.S.

So, these are the offices that we have. You can see that we have 11. By the end of 2015, we should have grown our underwriting force by over 35% and really concentrating on the areas in green there. We'll not go into too much detail on this, but you can see that we're focusing our underwriters, so that we really build out our presence in those hubs where we're averaging 15 underwriters per office by the end of 2015 and a broad spectrum of products. And I'm not sure (28:05) that's what we're trying to do onshore in the U.S.

Martin Lindsay Bride {BIO 15458196 <GO>}

Andrew?

David Andrew Horton {BIO 5697110 <GO>}

Great, thanks Adrian. Thanks for that. The feedback will be in your year-end appraisal.

Adrian Peter Cox {BIO 16257010 <GO>}

Exactly (28:23).

David Andrew Horton {BIO 5697110 <GO>}

What I want to do now is roll out the crystal ball and have a look at what's actually going to go on in the future and the rest of 2014 and 2015. Before we do that, let's just have a brief overlook of where the rates have gone in the first half of 2014. So running through the divisions, the top line is our reinsurance division. We all know that rates are off quite considerably in the first half of the year. Our expectation is that is going to continue to go down and sort of gather pace during the year, and we're planning at this point for 2015 for it to continue to reduce. So, that's dependent upon losses in the second half of this year.

Next line is the specialty lines, where Adrian just blown up the 2008 to 2014 part of that curve. You see from 2011 onwards, it was actually gently increasing. Next line down is our property where we're seeing rate reductions on the large risk open market property. We've seen rates flat and up a bit on the small and mid-sized risk. We have the right to binders (29:24) in the U.K. Through Lloyd's, we write onshore through our E&S property operation.

Marine, most lines of marine, especially energy, hull, aviation, aviation war have seen rate decreases in the first half of the year. So, the pale blue line continues to edge down. The black line, life, accident and health, and we talked about we needed rate increases in this line of business with the losses we suffered in 2013, have seen those rates increases. And the final line continues to edge down, not as probably as quickly as it has done with the terrorism line still showing rate reduction as there hardly been any losses.

On to what we actually see going forward, as you all know, there's plenty of capital around in the world. A lot of it wants to enter the insurance market, and therefore, competition in many lines remains intense. Margins are definitely under pressure, and the rating environment, we're down 1%. We would expect that sort of rate reduction that need to happen again in 2015, maybe slightly larger than 1% down in 2015.

Neil is working on our business plans, leading our business planning process at this point in time with many crystal balls, maybe 45 (30:33) different crystal balls trying to determine what's happening line-by-line. But we can't see any major change based on where we are at the moment with profitability in the industry being pretty good as our results have shown and slightly the margins are going to come under pressure. While that's happening, it's going to happen more in the large risk business, we're going to focus more on the small risk.

This brings into play Adrian's presentation and the fact that we've been in the U.S. now 10 years. It was great. I was on a U.S. trip the week before last. The recognition in the six cities, even in a city like LA, where we have no presence, the recognition of Beazley now is much greater than it was, and therefore, they're comfortable to put a Beazley quote up against some of the companies that have been in the States for a lot longer than we have, which I think means we can continue to grow on the back of the growth we have shown over the past two years in the U.S.

Aiming for some moderate growth into 2014, back of the U.S. small business and some of the new products we've gone into. Similarly into 2015, we're aiming for some moderate growth. We always end up with the line we continue to focus on profitable, disciplined underwriting. That's what we've been well-known for across a diversified portfolio. I think the portfolio is diversified enough, and I think it's the combination of the quality of the people we have and the balance of book we have that means we should perform relatively well in the future.

I'm going to end there and it's going to go over to Q&A. I think there is a mic. Wendy's (31:58) got a microphone. So, it'd be great if you announce who you are and ideally what the question is.

Q&A

Q - Ben Cohen {BIO 1541726 <GO>}

Hi, Ben Cohen at Canaccord. On the points on moderate growth, you had 1% top line growth in the first half. Maybe you could be sort of more specific in terms of why – presumably you're looking for stronger growth in the second half, does it relate to timing of reinsurance renewals? Just give us a bit more color there, please.

A - David Andrew Horton {BIO 5697110 <GO>}

I think – Ben, I think we're looking at a sub-5% growth for the year. And when we say we may continue with moderate growth, I do like to get it sort of 2% to 3%. There has been some – perhaps this is a reflection of the market. There's definitely some extensions to some premiums, and therefore, people have extended the policy with renewal later in the year. So, we're expecting some of those to come in, which we won't have booked in the first half in the gross written premium. And that should take the 1% up to a slightly larger number. But when I say increased growth, I'm not expecting to hit the 5% to 10% that we originally planned for mainly because the rating environment and the competition is more intense than we originally thought.

Q - Ben Cohen {BIO 1541726 <GO>}

And can I ask, on the margin – on the margin impact going forward, the impact I guess of lower prices coming through, could you give any more clarity in terms of where you would see the greatest pressure, maybe outside of reinsurance, which I guess is fairly self-evident, but where you would actually expect to start to see it through in a kind of loss ratio?

A - David Andrew Horton {BIO 5697110 <GO>}

I think it would be the open market property and some of the marine lines, the other short tail, both catastrophe-exposed and non-cat-exposed lines where we're seeing the most rating pressure and have been highly profitable books of business for us. Margins are coming down on those lines.

Q - Chris D. Hitchings {BIO 2034501 <GO>}

Hi, Chris Hitchings, KBW. A couple of things. Capital required, I appreciate that you're indicating that you are going to change the way you present it. But clearly you know what the new presentation or the new underlying Solvency II basis will look like relative to last time or have some idea. Is there any reason to assume that we're going to have any surprises in how you look at that? You've given us some help as to what the capital required has done in the first six months. Would it be misleading for us to assume that on your basis, there won't be an increase in – sorry, the retained profit – sorry, the profit this year will not be needed to finance growth? Question one.

Question two, reserve buffer, it's gone down from 8.2% to 6% (35:05), and I know you gave us some explanation. But I got some (35:11) volatility in what you hold rather than what the actuaries say. I'm just trying to get a little bit more on that. And finally, the net written premiums has gone up. Now, you've noted that is because estimates on a proportional reinsurance. But class by class, there's some very odd movement. In accident and health, gross premiums up a lot, net written premiums down, and there's some other funny moves, if I look at that. Can you just give us some background as to how that's happened? Thanks very much. That's three questions.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. Thanks very much, Chris. I will try and deal with those. So, there's no surprise coming in relation to capital. It's simply that in Solvency II world, the amount of capital you have is larger, the amount of capital you're required to post is larger, and the whole way therefore you discuss capital is simply different. And we will, as I say, have worked out our view of how to present it and how to express our buffers at the year-end. The underlying performance of the business is still strong. Whilst Neil (36:32) is trying hard, realistically growth prospects for 2015 are probably not significant, and our capital management philosophy that if we have capital beyond the buffers that we think we need, we will take action, remains intact.

As far as the reserve position is concerned, our reserve surplus is obviously continually replenished by writing new business that we reserve more prudently than ultimately proves necessary and release of reserves on all the business. So, that's the continued dynamic. So, my perspective on the first half of this year is that the underwriting teams were very consistent with the first half-year for the previous two or three years, and you can see that if you compare the reserve release half-year 2014 to first half 2013, first half 2012 rate, consistent picture, catastrophes permitting.

What is different in this first half-year is that there's been a moderate increase of the prudential view of our actuaries, more so than there have been in previous periods. And so, as I say, that red line is really measuring the gap between what our syndicate's underwriters have estimated and what our internal actuaries think. And in this particular half-year, the gap has closed slightly.

Q - Chris D. Hitchings {BIO 2034501 <GO>}

(38:15) mechanically, does the change in the way you reserve the specialty business that was – that you've talked about before and Adrian referred to, does that have any influence on that percentage ratio?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

At this stage, the – so that change will take effect in the 2014 underwriting year. So, that is not material in what's being presented currently. It's a question to ask in a couple of years' time once we actually have a reasonable percentage of our reserve. Clearly, if you open with a slightly lower reserve, the reason we're doing that is because we believe the best estimate claims are also going to be lower. But there's clearly potential for there to be some change driven by that.

On the net written premium growth, the change we've made is to recognize outwards reinsurance on proportional business evenly through the year, or as we used to do, all of it in the first half of the year. So, that change affects the specialty lines division the most. The specialty lines division is the largest user of proportional reinsurance. So, if you compare the net written premiums of the specialty lines division, H1 2014, H1 2013, you see a big increase.

And as far as the life, accident and health business is concerned, we talked about the one large contract that was deferred from Q1 into Q2 that renewed with a very significant rate increase. Also, the structure of how we write that contract is actually now an individual placement rather than a cover is what is causing those half-year on half-year comparisons of life, accident and health to look slightly curious. Full-year 2014, full-year 2013, you'll see a very stable picture across all of the lines of business in my view, because the reinsurance effect would have evened out and the timing of the life, accidents and health renewal was sort of evened out.

Q - David Andrew Horton {BIO 5697110 <GO>}

(40:34). Just coming back to the U.S. business, in terms of your growth ambitions, the way you've been growing today and where you would like to see further growth in the future, can you talk about the differences between growing through excess and surplus lines in the current environment versus admitted and where the biggest opportunity is, please? Thanks.

A - Adrian Peter Cox {BIO 16257010 <GO>}

Okay. I think we believe the opportunities for growth in the U.S. are fairly across the board for most of our products. The thing that I probably didn't mention is that we've been putting new underwriting teams onshore over the last couple of years from all over the business. So we've brought political risk people in, some terrorism people in. We're building our builders' risk team and so on and so forth.

The mix of business between admitted and excess and surplus is fairly even at the moment, and we tend to follow the market in what we write. And a surprising amount actually of specialty lines business is written in the admitted market, as well as a lot of D&O written in the admitted market, a lot of our A&E written in the admitted market, a lot of med mal written in the admitted market, and we tend to follow what our clients want in there.

So, we don't really have a plan that says we want to grow the admitted business by this much and the E&S business by this much, because we're kind of guided by what our brokers and our clients want. But one of the good things about the opportunities in the U.S. is that there are opportunities across a number of our books of business. And one of the reasons why we think that there is opportunity is that so much of what we do is actually done in the admitted market and we don't have access to that from Lloyd's.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Westhouse. Just following out from that, over the years, we know a lot of British companies that have tried to build out in the U.S. and it's never quite worked out in the way that they planned. Obviously, you've been there 10 years. You started as a very small business. You've grown well. What do you think has changed in that marketplace or what are you bringing to that marketplace which makes you feel confident that you will do better than other companies have historically?

A - David Andrew Horton {BIO 5697110 <GO>}

(42:54) I can start and then Adrian can...

A - Adrian Peter Cox {BIO 16257010 <GO>}

Am I?

A - David Andrew Horton {BIO 5697110 <GO>}

Correct me when I get it completely wrong. So, the whole logic, let me start it, was going to be very people-based. So, we're only going to start when we can get the people who fitted the product structure we had and like the empowerment and entrepreneurial spirit that Beazley has always had. So it took probably longer to start than we thought and we've built it on that basis. So, it's been limited acquisition. I think property acquisition being the best one that's really put the property business we had on the map in the U.S. So, it was an empowered underwriter model with as much cultural similarity that we have been doing for Lloyd's over a long period of time, and we built on that. And I think that's been good. We've got four people who actually hit their 10th anniversary this year. So, four of our original recruits, we haven't recruited many, by end of this year are still with us. So, they do like that model.

Now, I think what we had compared with - and Adrian sort of touched on it, because we have empowered underwriters, we have underwriters who can make decisions there and then. So, they don't need to refer too much up through line management, and we're often competing with companies where that does have to happen. And brokers generally are not the most patient people of the planet, and therefore, like a response relatively quickly, and our underwriters can get that. And I think that is a major differentiation is the service we offer, backed up with a great claims team because we also recruited a very good claims team out in the U.S. that covered both our Lloyd's business - U.S. business and the local U.S. business. I don't know if anything else?

A - Adrian Peter Cox {BIO 16257010 <GO>}

I think the other piece to that is that we are - we're doing onshore in the U.S. what we've already been doing in London. So, the products that we're going into, the lines of business that we're writing and the industries that we're writing in are consistent with what we've been doing for many years in London. I think what people - where it's easy to get tripped up...

A - David Andrew Horton {BIO 5697110 <GO>}

Yeah.

A - Adrian Peter Cox {BIO 16257010 <GO>}

If you're doing things new that you don't have the institutional understanding of, but you're doing it because you want to build a business somewhere else. And we've been very careful to grow only in areas that we're reasonably confident that we understand. And it's been - it's taken some discipline to make sure that we do that, because the focus always is going to try to turn you to doing new and exciting different things. The product focus that we have and structure that we have really helps us to make sure that we stick to what we think we understand.

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

Eamonn Flanagan, Shore Capital. I'm just noting the change in the investment contract, Martin, if you're disappointed a bit or not (45:25). What's the expectation for the expenses - investment expenses for the second half, probably more importantly next year onwards?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. I think if we look at next year, we would certainly hope to see investment expenses get down 15% to 20% over 2013, if we take that as the denominator. But as I say, the - said many times, the reason for making the changes was to make sure we've got the right expertise in investing our assets. It's nice to also have a cost saving, but it was really about making sure we keep the expertise appropriate for the assets that we want to invest in.

Q - Nick H. Johnson {BIO 1774629 <GO>}

Good morning. Nick Johnson from Numis. Just back on the actuarial reserve buffer of 6%, could you just explain the theoretical relationship between that number and future reserve releases? Should the reserve buffer be a lead indicator of future reserve releases or is that the wrong way to think about it? What is the relationship between those two things?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

I think there's clearly a relationship, because if you have zero buffer, there's nothing to release. As I say, there's a continual process that was going on. It was writing new business and reserving prudently and then paying claims on all business and finding that in fact the amount we've got reserved is more than we needed, a move in the buffer of 1% or 2%, as I say, in my view, over one-half year is not - it's just not statistically significant. If you went and talked to a few actuaries and you looked at the uncertainty in the technical provision setting process, essentially a 1% move is noise. So, we're quite comfortable that our reserve release picture going forward is in the same place as the - where we've been for the last few years.

Q - David Andrew Horton {BIO 5697110 <GO>}

(47:48). This is for Martin. Just looking at your capital growth strategy and the investment portfolio, you've reallocated away from hedge funds targeting uncorrelated returns towards funds focused on illiquid investments. Do you think this will enhance the risk-return profile and will we be seeing more volatility in investment returns?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Okay. I don't expect to see more volatility in investment returns. Why have we done this? Philip Howard, our Chief Investment Officer, who joined some 18 months ago, was asked to do a review of what should be the target asset classes and the target asset allocation, and he expanded the universe slightly. So we always had uncorrelated - hedge funds seeking uncorrelated returns as a large allocation.

Philip introduced a couple of additional classes, some equity-related strategies and some liquid strategies. And so, without expanding the total pot of risk assets, we've started to allocate them to a slightly broader set of strategies. So, we don't see that as either increasing risk or increasing volatility, but hopefully, if anything, potentially reducing volatility slightly, because we are spread across more different types of strategies.

Q - David Andrew Horton {BIO 5697110 <GO>}

Thank you.

Q - Chris D. Hitchings {BIO 2034501 <GO>}

Chris Hitchings, KBW again. Sorry, this is a fairly basic question that I thought I'd leave to some of the youngsters, but they haven't asked it. So here it is, two-point rise in expense ratio, what's going on (49:42)?

A - David Andrew Horton {BIO 5697110 <GO>}

It's consistent with the full-year last year, isn't it?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah, yeah.

A - David Andrew Horton {BIO 5697110 <GO>}

So, that's where we ended last year.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. If you look at our expense ratio, there's a little bit of a first half effect. So expense ratio for full-year 2013 was 39%, which actually split 37% for the first half and 41% for second half. Half-year this year is 39%. I'm expecting full-year expense ratio for 2014 to be 39% or 40%. So, the apparent step-up in the expense ratio is more, in my view, to do with the fact that our profit was very second-half-orientated last year and our expenses followed that to a certain extent.

There are some underlying expense inflation impacts. Two-thirds of our expenses is sterling expenses, and converted to dollars, they are higher. There is inflationary pressure on salaries and we are investing in the business. So, in dollar – a constant FX in dollar terms, we are spending more, Chris. Because as you've seen in the presentation, we still believe there are opportunities to grow our business and margins, whilst slightly lower perhaps, rate wise, than we've been over the last couple of years is still good.

Q - Chris D. Hitchings {BIO 2034501 <GO>}

(51:04)?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Well, about – in my view, you have a 10% appreciation of sterling against the dollar half-year-on-half-year and two-thirds of our expenses are sterling. So...

Q - Chris D. Hitchings {BIO 2034501 <GO>}

(51:23)?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Not obviously the commissions, yeah, the management expenses.

A - David Andrew Horton {BIO 5697110 <GO>}

Anything else? Great, thank you for joining us this morning.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you very much, everyone.