S1 2020 Earnings Call

Company Participants

- Alexander Maloney, Group CEO & Director
- Natalie Kershaw, Group CFO, Group CAO & Director
- Paul Gregory, Group Chief Underwriting Officer
- Unidentified Speaker, Company Representative

Other Participants

- Edward Morris, Analyst
- Emanuele Musio, Analyst
- Jonathan Urwin, Analyst
- Kamran Hossain, Analyst
- Ming Chu, Analyst
- Oliver Troop, Analyst
- Paris Hadjiantonis, Analyst
- Thomas Fossard, Analyst

Presentation

Operator

Hello. Welcome to the Lancashire Holdings Limited First Half 2020 Results. (Operator Instructions)

Please note this call is being recorded.

Today I'm pleased to present Alex Maloney, Group CEO; Paul Gregory, Group CUO; Natalie Kershaw, Group CFO.

Please begin with your meeting.

Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you, everyone.

As we close our half year, I'm immensely proud of how the Lancashire group has continued to operate seamlessly through this difficult period. Following our strong financial position during 2019, we entered the 2020 underwriting year in a strong capital position with increased optimism as we witnessed the first real signs of the improving underwriting conditions.

Therefore, our plan for 2020 underwriting year was one of growth weighted to the underwriting opportunity, which prior to the COVID-19 pandemic was steadily building during the first quarter. During the second quarter, underwriting conditions, particularly for catastrophe-exposed product lines changed materially, leading us to decide to raise additional equity capital.

We have always believed that to generate superior returns for our shareholders, active capital management is key. Therefore, if you truly believe in the underwriting cycle as we do, there are times when it's proven to return capital to shareholders, and it's essential that additional capital must be put to work as underwriting conditions improve.

We continue to be in a strong capital position despite growing our underwriting substantially during the first half of 2020.

We have grown our top line premiums by 15%, but more interestingly, our underlying premium growth of 24% shows what we believe to be a more accurate picture of the progress our business has made.

Equally pleasing has been a continued rate improvement of 111% across our portfolio of comparable renewable business when compared to the corresponding half year of 2019. Of course the new business we have written has been done at very favorable terms too.

COVID-19 is an ongoing event and a loss which will take years to mature.

We have seen little material change to the claims data we have and believe for us and the wider industry, the first-party claims picture will not be clear until 2021. Clearly for those with casualty portfolios, we would expect a much longer tail due to the complicated nature of the loss and the likely long-term health issues this terrible virus has caused. Therefore, we would caution any commentary which suggests that the industry has enough data at this point to suggest the ultimate loss quantum is lower than originally felt. I believe it's far too early in the life of this event to make such a call.

The outlook for the Lancashire group is the brightest it's been in years.

We are finally seeing a return to profit-based underwriting for the market and not purely chasing revenue or diversification.

We do believe that certain product lines, mainly catastrophe-focused, are firmly hard market territory, but other lines, even with large price adjustments still require more retention after years of (inaudible) soft market conditions.

Therefore, we will always continue to grow our portfolio where we believe to be the best underwriting opportunities.

We are not driven by our underwriting portfolio composition, just the best possible risk-adjusted returns for our shareholders.

Following our capital raise, we expect to deploy these additional funds over the next six to 12 months. But clearly, if we are to witness any further industry events such as a hurricane, this may well accelerate. There is much uncertainty at the current time, and during the rest of 2020, we see many hurdles which could disrupt the market dynamics even further. An active hurricane season, another bout of COVID, the U.S. election, the U.K. leaving Europe are to name but a few. I believe the larger the market disruption, the greater opportunity for the Lancashire group.

In summary, I couldn't be happier with our current market positioning.

We have no legacy issues, excellent people and a strong capital base. It's impossible to predict how long the hardening phase of the cycle will last, but those with the least disruptions will be able to prosper the most and build better businesses at the right time in the cycle.

Lastly, I would like to thank all our shareholders for their patience and all my colleagues for their continued hard work, making our company what it is today.

I'll now hand it over to Paul.

Paul Gregory {BIO 16314515 <GO>}

Thank you, Alex.

We came into 2020 with the expectation that we would see improving market conditions across most of our product lines.

We saw this through the third quarter, and during the second quarter, this momentum has picked up pace. The group's RPI for the first half of the year is 111%. The majority of our product lines saw an acceleration of rate improvement during Q2, with the group's RPI being 113% in Q2 versus 108% in Q1.

From the start of 2018, the market has been moving steadily forward.

Now things have shifted gears and clearly COVID-19 has impacted the pace of change. COVID-19 is a lot like no other market that we perform [ph], and there will be ramifications in years to come, not just on the underwriting environment, but also in the way our market operates.

Even excluding the impact of COVID-19, there are several other fundamentals that are propelling the market forward. Capacity continues to retract in numerous product lines as carriers struggle to make adequate underwriting returns on portfolios that grew during the softer cycle. The strength of casualty reserving remains an issue the market will continue to address. Third-party capital in its various guises is likely to be less abundant in the immediate future.

When you add COVID-19 into this mix, it provides us with the confidence that writing levels should continue to improve. With the writing environment strengthening, it should be no surprise that we continue to expand our underwriting footprint.

I'm really pleased with the premium growth seen during the first half of the year, which has been visible in every segments of our portfolio. In our property segment, we've seen good growth, particularly in property catastrophe and direct property. In property catastrophe, we grew across most territories, but most notably, Japan and Florida as market conditions improved.

Within direct property, we started underwriting from our company platform to complement our existing Lloyd's offering, and this has allowed us to generate good premium growth in this subclass. The only area of our property segment that's seeing reduced premium is the political and sovereign risk portfolio. This is predominantly nonrenewable business that is always lumpy and can skew the property segment premiums.

Within the energy segment, most of the premium growth comes from our build-out of our downstream and power accounts, where rates have been improving consistently, and we are seeing numerous new business opportunities.

Within marine, growth is delivered by rate rises across all subclasses as well as new business in areas such as hull and cargo. While the first half of the year is not hugely indicative for aviation, we have also seen good premium growth there as well as very strong rate improvements.

We do know there will be demand headwinds in some of our classes of business as a result of COVID-19 and the economic impact it will bring. However, we do not believe that at a macro portfolio level, this will stop us growing as rates continue to strengthen.

We will also continue to add underwriters and teams in new and complementary lines of business.

As the market continues to improve, we will continue to expand. This is not just through top line premiums, but also refining our reinsurance purchasing to optimize our underwriting returns, and this will start in 2021.

We often say that we do not sell widget [ph], we sell units of risk, and there's a right and wrong time to sell units of risk.

We're incredibly well-placed to maximize the opportunity we believe will present itself in the coming year.

Our working capital raise has given us the flexibility to grow into the opportunity and accept more risk at better pricing.

We have an underwriting team that has remained very patient and is now prepared to execute the company's underwriting strategy in its different phase cycle.

Lastly, I'd like to thank the underwriting teams, and everyone across the business who supports them, for their efforts thus far this year, particularly thanking those who work from home model. Despite the very different set of circumstances, we've been able to continue to execute our underwriting strategy.

I'll now pass over to Natalie.

Natalie Kershaw {BIO 21394441 <GO>}

Thanks, Paul.

Our financial results can best be described as a tale of two quarters. In Q1, attritional losses, adverse development and late reported claims from prior years, plus the impact of COVID-19, negatively impacted our numbers. In comparison, Q2 was very much a normal business-as-usual quarter.

As a result, our combined ratio was 106.9% for H1. Absent COVID-19, it would have been 88.9%.

The growth momentum in gross premiums written continued into Q2, with quarterly gross premiums written increasing by 19% compared to 2019.

Underlying premium growth, excluding the impact of multiyear contracts and reinstatement premiums in the second quarter of 2019 was around 29%. Whilst all segments contributed to the growth, in dollar terms, this was particularly pronounced in the direct property and property cat excessive loss classes, which increased by just over 20% in the first half of the year compared to 2019.

The ratio of new business to rate and exposure increases was split approximately 55% due to new business and 45% due to rates increases, consistent with the growth drivers across the book as a whole.

As a reminder, the positive impact of top line growth earns out on average over 12 to 18 months.

So the majority of the benefit of the increase in business we have seen will not impact the bottom line until 2021. Although we expect the rate momentum to continue, the second half of the year is a less significant renewal period for us.

Although we have not yet felt it, we also still expect that there will be some reduction in demand across a number of our business lines due to the impact of COVID-19 in the second half of the year.

Our reinsurance spend for the half year is only marginally higher than last year, had an increase at a significantly lower rate than the inventory [ph] book. The increases that we have seen are largely due to growth on the (inaudible) book on lines where we have quota share cover in place. Most of our programming is in January, so we were able to benefit from locking in rates early in the year.

Ceded premiums were also impacted in the first half of 2019 by outwards reinsurance [ph] premiums. The percentage of premiums earned is lower relative to that of the first half of 2019. This is largely driven by the significant inwards premium growth occurring in Q2 that will earn-out in future period.

Turning to our loss experience. The COVID-19 event is still ongoing, which makes any estimates of losses exceptionally difficult.

Our current estimate of $42 million of ultimate losses for the first half of 2020 is largely focused on the property classes. The majority of this estimate is IBNR.

The small increase in the COVID estimate in the second quarter reflects refinement in approach for our Lloyd's platform rather than a change in the quantum or pace of loss notifications.

Excluding COVID, we haven't had any significant losses reported for the current accident year, which is reflected in our underlying accident year ratio of 38%.

As noted last quarter, we saw some adverse development on prior accident years in Q1 2020. This development was across a number of different and unrelated risk and natural event losses.

We do not believe this is indicative of any increasing trend. These loss events are very much in line with what we expect from our book of business, which can be lumpy in terms of claims.

As mentioned earlier, Q2 saw a return to normal with overall reserve releases for the quarter. However, these were not sufficient to offset the Q1 development. There has been no change in our approach or philosophy on reserving.

Given the Q1 experience and the potential for secondary impact from COVID-19 on the cost of parts and labor for claims arising across the book, we would keep our guidance of attritional loss ratio at 36% to 37% for the year, even given the positive RPI rates that we have seen. You would expect this to come down slightly next year, although now that some of the new lines of business we have entered into recently are more attritional in nature.

Our investment valuations rebounded in the second quarter as market conditions improved to produce an overall investment return of 1.3% for the year-to-date. The gains in the second quarter came from all asset classes, resulting from declining rates, tightening spreads and the Fed purchasing program. Fixed maturities have increased more of the losses from the third quarter with hedge funds, bank loan and private debt funds still showing small losses on a year-to-date basis.

The improvement in our portfolio credit quality, AA-, reflects the investment of the equity placement proceeds in high-quality treasuries in the short term.

We do not intend to change our investment strategy over the medium term, and a proportion of the proceed is likely to be reinvested in risk assets in the second half of the year.

With that, I'll now hand over to the operator for questions.

Questions And Answers

Operator

The first question is from Kamran Hossain from RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

Three questions. The first one is just about the, I guess the adverse development or the (inaudible) reserve deterioration. Could you maybe give an idea of how much was Q1 versus how much was Q2?

So that's the first question.

The second question is I saw the PML from some areas went up fairly substantially, which kind of, I guess demonstrates the opportunity out there. Would you expect these to go up further at 1/1 [ph]?

Then the third question, it's a bit of a strange one. I know you've only raised capital fairly recently, but it sounds like if there was a larger loss during hurricane season, you think you could actually put things to work a lot faster than maybe even six to 12 months. Do you think there's potential in the next year that you come back to the market for more money?

So I know that last one is quite difficult to answer.

A - Alexander Maloney {BIO 16314494 <GO>}

Yes. Sure. I'll take three first.

Yes. I think there is a lot of uncertainty at the moment.

Obviously hurricane season always brings a high level of uncertainty anyway. You've got uncertainty of financial markets. You've got U.S. elections, Brexit and obviously do we get another bout of COVID.

So I think there are a lot of hurdles, and that could bring disruption to our market, which could change the picture further.

So we do have a lot of headroom.

We are very well-positioned. And clearly, we would optimize that capital as much as we could.

We would always consider another raise. But if you believe in -- if you think about our capital management strategy, if the market is good enough, and we believe the market is there, yes, of course we would consider further capital raise at whatever period of time.

A - Paul Gregory {BIO 16314515 <GO>}

On the PML, Kamran, I think at 1/1, yes. You would expect to see our PMLs increase, as you've seen the increase that we started to write more catastrophe business through this year and our expectation, obviously the reason that we raised the capital was that we feel market conditions will improve.

And therefore, we'll be prepared to write more catastrophe-exposed business, wherever that may be and that could come in various lines for us, whether it be retro property cat D&F, et cetera.

So I think, yes. That's a fair assumption.

Obviously as well and as I mentioned in my commentary, it's not always just about what you're doing on the inwards portfolio, we'd also consider how much catastrophe reinsurance we purchased.

We expect that to be a tight market anyway.

So some of that might be forced upon us, quite frankly, but then there will be other areas that we will look to refine how we purchase our outwards, which can obviously have a direct correlation with our PMLs.

So long answer, but the short one is, yes, you would expect them to go up.

Q - Kamran Hossain {BIO 17666412 <GO>}

Got it.

A - Natalie Kershaw {BIO 21394441 <GO>}

Hi, Kamran.

On the adverse development, most of it was in Q1.

So in Q1, we had adverse development on two separate marine claims in the 2017 and 2019 accident year.

Also, we had a relatively unusual high number of attritional losses reported in the end of 2019 that were reported to us in 2020.

So not much of a time line, but actually falling into the prior accident year. The only notable development we had in Q2 was on the New Zealand quake where we increased reserves in line with the rest of the industry.

Operator

Our next question is from Paris Hadjiantonis from Exane BNP Paribas.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

I guess the first question will be on reinsurance. I think you've touched a bit on it.

I mean what are your plans going into 1/1 in terms of the coverage that you are buying?

I'm also trying to get a better feeling of how we should be expecting your net to develop relative to your gross premiums, I assume higher growth in net as you do flag that it might be forced upon you to retain slightly more business given pricing developments?

Then on growth, could you give us a better idea of where you're trying to underwrite from?

So is it Bermuda rather than Lloyd's?

Or are you trying to essentially push growth through both books?

The reason I'm asking is, is that we've seen Lloyd's being, again, a bit cautious on -- in terms of growth, on -- especially on volumes rather than pricing.

I mean since we are touching on growth, I think I've seen something that you have had a couple of new hires in terms of underwriters entering I think accident (inaudible). Can you basically talk about these developments?

A - Paul Gregory {BIO 16314515 <GO>}

Yes.

So on the general point on reinsurance as we guide for 2021, obviously for 2020 most of our reinsurance is already purchased, that we will look at our program.

As a general point, I think we'll be looking to assume more risk as we go into 2021. It will be different across product lines.

Some parts of the reinsurance as retro market are harder than other parts. I think in the natural catastrophe exposed areas, as I said to Kamran, we'll be forced in some areas to retain more. And in others, we'll look to retain more as the underlying dynamics look back up.

In terms of the specialty classes where the reinsurance market maybe isn't quite as dissipated, there may not be as many changes, but we'll look at everything. Trying to call exactly what it's going to look like now, it's very difficult. That reason is because we don't know exactly how reinsurance market is going to look at 1/1. It's a long time to get there. What could happen between now and there, as Alex has mentioned, we're obviously currently in a wind season. But I think if you -- we'll definitely be looking to retain more risk as we move into a better part of the market.

In terms of growth, the short answer is we're looking to grow everywhere that we see opportunity.

We're product and platform agnostic, quite frankly.

We will be asking for growing across all of our platforms, which will include Lloyd's, so obviously we need to work with Lloyd's on that. And if we're to grow, we need to be able to provide sensible underwriting reasons as to why we can grow, but we will be asking for growth. But obviously we do have the flexibility of platforms.

The reason we went into property D&F at the tail end of last year on the company platform was to allow us to have the option to write business on that target business on a different platform from Lloyd's. They complement each other really well but obviously gives us as a group flexibility.

In terms of new hires, yes, you'd have seen that we employed some on the accident and health space. It was an area that we've looked at for a number of years that can find the right individual.

We feel we've found the right individual, relatively short term, complementary to what we do. They have joined, but in reality, that's going to be built out in 2021.

We have also recently hired a person that had expertise in the longer tail areas of our world, so casualty. That won't be till 2021.

Obviously that's a market that is very dissipated and we believe there are times to enter markets.

We don't currently have the expertise in-house, so bringing someone in-house to analyze and look at those opportunities is the prudent thing to do. There are a number of other conversations ongoing at the moment, but we always have (inaudible) fee and we will be looking to add more people and product lines to kind of the existing classes with new niches or completely new classes. But as always, we'll only add people and teams if, one, we think we can make money over the longer term; and two, those people or teams can fit our underwriting culture.

Operator

Our next question is from Johnnie Urwin, UBS.

Q - Jonathan Urwin

So first -- three questions, please. Firstly, the RPI is 111%, so renewal business is tracking well. But presumably, the new business is seeing even stronger price increases.

So any color there would be great, please. Secondly, on the attrition, I guess obviously pricing should improve the attrition from next year. That's the first step. Then you've got some more attritional lines of business that you picked up.

So can you just talk us through the dynamics?

And perhaps, you might give some updates to guidance at some point.

Then finally, more philosophically, I guess if windstorm season runs clean, could this be enough to kind of derail the repricing story?

Do you think there's enough justification to sustain repricing anyway?

A - Paul Gregory {BIO 16314515 <GO>}

Yes. Hi John, it's PG.

So I'll take RPI question. You're quite right.

Obviously new business doesn't get rolled up into those RPI numbers we published.

As a general comment, the new business we write tends to see stronger RPIs to business we haven't written in, in the past and therefore needs to move further from a rating perspective for us to want to underwrite it.

I think we've seen that particularly in areas such as property D&F and property cat, where the new business we've written, for example, in Florida, the new business we wrote there certainly was a higher RPI than the weighted average of the book. It's very difficult to give specific numbers because you don't always know what contracted the paper for, albeit you have a reasonable idea. But as a general point, yes, you tend to get -- if you were to RPI, you would have stronger rate movement on new business.

A - Natalie Kershaw {BIO 21394441 <GO>}

Yes.

Okay.

So on the attrition, I think it's -- yes, it's too early to give guidance for next year because there's a number of different things going on.

So obviously there's RPIS. There's also the potential impact of COVID on the attritional ratios, plus the impact of the new lines of business that we're going into.

So I'd say we'll try and update on that first half of next year.

A - Alexander Maloney {BIO 16314494 <GO>}

Then, Johnnie, on the derailment, I think I'm not usually as bold as (inaudible) around that, but I think actually -- I think hurricane season goes completely clean. I just -- I don't see that derailing the current momentum of what's happening in our market. I think you've got -- with COVID, you're going to have this capital that's trapped at the end of the year. It's clearly a hole in casualty reserving. There's various different views on that, but the hole is substantial.

Then the uncertainty that COVID is going to bring I think just adds to that. You've also got investment yields are now going to be lower. You've got product lines that have just been at the wrong price for years.

So I can't see a clean hurricane season derailing the current momentum of the market. But clearly, if you do get electoral hurricane, that's definitely going to accelerate an already complicated and messy picture.

So I'm super relaxed if the (inaudible) goes to plan.

Operator

Our next question is from Thomas Fossard, HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Couple of questions for me. First question would be, could you quantify the amount of capital you deployed year-to-date in writing new business?

The second question will be -- yes, looking at the -- your gross and net claims in your financial statement, it looks like the recoveries from reinsurance are pretty low in H1. I'm getting a 17% relief from reinsurance, which compare usually to like 35% on an interim basis and more like 50% over the past two years.

So -- and actually, in H1, you've got the COVID-19 losses.

So I was wondering if maybe this was indicative of how low recovery you were getting on COVID-19 losses so far.

Or any comments would be interesting on that side of things. The third question would be -- yes, on the casualty side.

So it seems to be that if casualty is providing more opportunities for you, you would be considering entering the casualty market. It seems to be very different from what you've been doing on a short-term side so far.

So was wondering what would be the USP of Lancashire entering the casualty markets as a longer tail part of the business.

A - Natalie Kershaw {BIO 21394441 <GO>}

All right.

So Thomas, on the capital question, we won't disclose actual numbers, but we've said previously we carried forward more capital into this year by not paying a special dividend last year in order to take advantage of the improving market, and that is what we have done. Then the new capital that we raised recently we're hoping to deploy in the next six to 12 months. Hopefully that gives you a little bit of color on that.

A - Alexander Maloney {BIO 16314494 <GO>}

Sorry, Thomas, could you repeat your second question, please?

Q - Thomas Fossard {BIO 1941215 <GO>}

On the second question, I was in the financial statement.

So in the financial supplement, actually, I was looking at the -- your gross losses, so $159.2 million at the group level. And how much recoveries you were getting, $26.8 million.

So the ratio, the implied ratio is a 17% relief from ceding claims to your retro series. It seems to be a fairly low number compared to -- comparing it to produce interim or the average relief you were getting on a full year basis. It's a bit surprising because, in fact, in H1, you've got the COVID-19 losses.

So 17% or a low relief from retrocession, is that indicative of how low you're going to recover on the COVID-19 losses?

Or I was wondering if there was something special in H1 to be noticed on that front?

A - Paul Gregory {BIO 16314515 <GO>}

No.

On our COVID number, as it says in release, it's net of reinsurance.

So there are no recoveries there. I think what you're seeing there is -- and Nat alluded to this, in Q1, there were a number of small claims in other lines that were small attritional claims. There just happened to be a few of them.

So on things like those, obviously you're not -- we're not probably in our reinsurers with recoveries.

So I think it's more that that you'll see in terms of the change in percentages. It's just a number of small attritional claims across different lines of business.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes.

Okay. That makes sense. Yes.

A - Alexander Maloney {BIO 16314494 <GO>}

Then on the casualty point, for us, when we look at any new product line, clearly, the best time to start writing a new class of business is when there's dislocation in that product line. Obviously there's clearly some (inaudible) in the casualty world. I think for us, we can see the macro opportunity that we need to bring in the expertise, which is what we've done. But to me, very clear, we're not changing the shape of Lancashire.

Probably the casualty income, even if the market is building next year, will be less than 5% of group income.

We'll take a cautious approach to a new class of business as we do with any class of business, but it feels like the time for Lancashire to enter the casualty class.

Operator

Our next question is from Oliver Troop, Autonomous.

Q - Oliver Troop {BIO 20035307 <GO>}

It's Oliver Troop from Autonomous here. I've got three questions, please. Firstly, just one on growth over the next year or so. I know that you don't give guidance on gross written premium, and this isn't an attempt to circumvent that, but just -- I'm trying to come up with a framework for how to think about it.

So for example, if I look at your NEP to capital ratio and say how much would you need to grow NEP to bring that ratio back to like the historical average today, I mean is that a vaguely sensible way to think about it, obviously with the caveat that it depends on conditions?

Then second question on marine. You mentioned some strengthening on marine claims.

I mean I was just looking across your four main lines, and it seems like, to me, like marine has been the least profitable of the four over recent years. What's your interpretation of that?

Is it just a case of inadequate industry pricing and elevated claims at an industry level?

I mean has that book been outperforming or underperforming the market in the specific areas it operates in?

Then finally just a question on COVID losses. I guess I was just wondering why it takes so long to get claims notifications in and you mentioned not getting clarity until 2021. But, yes, why does it take so long?

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. I think we'll do it in reverse.

So I think on COVID, the claims reporting is definitely slower than what I thought it would be.

As Paul always reminds me, arguably it's an ongoing event. You've had a world in lockdown.

So it's definitely slower. It's harder for the industry to predict and for us as well. I just -- again, I may be wrong, but I just think the pace of the claims data, I just don't feel we will have a picture of COVID really till 2021.

Then I think the way it'd be easier to approach the casualty there makes a huge amount of sense. But I think the casualty part of it is even more difficult. Clearly, if you've run a scenario where if you've caught COVID in the U.S. summer and you've recovered from COVID, but then you've got some long-term health issues from COVID, you can just imagine the complication around that single claim.

So I think it's a difficult loss. I do think it's got to run into '21.

I think that's going to lead to some very interesting scenarios for capital and for reinsurance purchasing at 1/1. Clearly, for the ILS market, that's going to be an issue. But I just feel with the pace of claims data, you're not going to get any true clarity into '21. That's not -- everyone wants clarity, but it's just not that kind of loss.

So that's our current estimation of the time when you would get more pictures for us and for the industry. I'm not just talking about our own book here.

A - Paul Gregory {BIO 16314515 <GO>}

On the marine question, I think always start with marine of all of our segments is always going to be the class that produces higher combined ratios than some of the others. It's just the nature of the business. But what I would say is that historically our combined ratio in marine has certainly been at the upper end of what anyone else has produced. In the marine market, and we have been involved in some of the largest marine claims that have been there, whether that be cost of Concordia, whether that be the large hull loss in -- a number of years ago.

Then one of these losses we're talking about here is also a marine loss in the several hundred million dollars. But historically, our marine book has made underwriting profit and continues to. The way we underwrite the class is we do have quarters or years where you're involved in a big claim and the combined ratio can step out. But over time, we've continued to be profitable in marine.

Obviously the rate in marine are improving consistently and have been doing for the last couple of years, which also helps.

We're getting some good new business opportunities in that sector.

So I'm not concerned, obviously two separate incidents in the same quarter is -- doesn't happen very often, but it has been completely unrelated.

So in general, I'm very happy with where our marine portfolio is and where it's going, given the rate of environment and our approach to marine over the time has been proving to be correct.

A - Natalie Kershaw {BIO 21394441 <GO>}

On the premium growth question, it's really more about thinking what our exposures compared to the capital rather than the net premium earned compared to capital. Obviously if we go more into the property cat lines, they're more capital-intensive. Then you have to wait, because we did go into casualty and our estimate health are less capital-intensive.

So a bit of a vague answer, but I'm not too sure that looking at net premium earnings to capital is the way forward. I would look at the historical exposures we've had in previous hard markets and try and work from that.

Operator

Our next question is from Ming Chu, (inaudible) Gordon [ph].

Q - Ming Chu {BIO 1826534 <GO>}

Just three questions, please. First, there was a comment on your reserve release that from 2010 New Zealand earthquake. That's been very long time ago. Would you just clarify what exactly that one is for?

Was that on your primary property or reinsurance side, please?

And my second question was on the -- as we enter the second half of the year, where the net cat season start and where you had -- what have you allowed for in your headroom for a normal year hurricane season, please?

And my third question is when you increase your estimate loss estimate of the COVID-19 from the $35 million to $42 million, I just want to get a sense what assumption have you exactly changed in terms of your loss estimate?

And how conservative or realistic that $42 million is?

A - Alexander Maloney {BIO 16314494 <GO>}

Sure.

Okay.

On the hurricane plane, the way we run our business is we clearly -- the hurricane season is a point in the year where there's great uncertainty and the (inaudible) obviously go up for any catastrophe-exposed insurer or reinsurer. The level of headroom we run actually this year is probably the highest it's been because we've done the equity raise in Q2.

So although we've grown, although we bring more hurricane risk, if you like, this year, the headroom that we have actually over what we usually have is higher.

So there's been no changes the way we run the business, but because of the capital we're sitting on at the moment, we actually have a higher buffer than what we normally do.

As we said earlier, we expect to deploy that capital and go back to more normal times as the opportunity increases. I think on COVID, we're very much saying that our COVID loss is a refinement of what we had in Q1.

We don't have material changes in claims data.

We have slightly better information probably at a (inaudible) level.

Nothing has changed.

We would stick by what we said in Q1 about uncertainty around COVID loss numbers for us and the industry. And unfortunately, we don't want certainly, but that's just going to continue. But there's no change. It's a small refinement. It's immaterial.

A - Natalie Kershaw {BIO 21394441 <GO>}

Then on the New Zealand earthquake, that came through our property reinsurance book. I think it's just an example of how quake claims can take a long time to develop.

As you said, it is a very long time ago. These things can develop for a very long time.

Operator

Our next question is from Emanuele Musio of Morgan Stanley.

Q - Emanuele Musio {BIO 22451155 <GO>}

I have three questions from me as well. The first one is another one on prior year development.

So my question is what is your guidance for 2020?

Do you think you can meet the guidance for -- maybe for prior year developments?

Or maybe we should look at a different number?

Then I have two question on growth. The first one is related to the slowdown that comes on the back of COVID-19.

Given the slowdown, you think you can have more volume growth in 2021?

Then again, on growth, I have another question.

I mean you have an appetite for multiyear contracts when rates are attractive. Has your appetite changed at all given the current market conditions?

A - Alexander Maloney {BIO 16314494 <GO>}

Sorry, what was that last question?

Q - Emanuele Musio {BIO 22451155 <GO>}

Multiyear contracts, has your appetite changed –

A - Alexander Maloney {BIO 16314494 <GO>}

Multiyear.

Q - Emanuele Musio {BIO 22451155 <GO>}

-- for -- yes.

A - Natalie Kershaw {BIO 21394441 <GO>}

Okay.

So on the prior year guidance, we previously guide for reserve releases of about $10 million to $15 million a quarter. I still think that over time that is reasonable guidance.

Actually, our releases in Q2 were within that range. It's just that Q1 popped out as a bit of an unusual quarter. But going forward, I think $10 million to $15 million is still reasonable.

A - Paul Gregory {BIO 16314515 <GO>}

Emanuele, hi.

On kind of the demand side and growth, I mean I think over the last past few months we've been reasonably clear that we feel there could be clearly some headwinds on demand in some of our product lines. The obvious ones are things like aviation, energy and marine.

Our view on that hasn't changed, albeit what I would say, if you look at the premium numbers through the first half, we haven't really seen any impact from that yet. Kind of offsetting that, though, the other things we point out, obviously is that we are still the right momentum in those classes, which obviously helped offset any demand reduction you may see.

And also, in those classes particularly, you're still seeing a number of other carriers reduce or pull out of those classes, which means that we can use that as an opportunity to increase our market share at a time where rates are improving, and that can obviously also help offset any demand headwinds.

So it's an overall view, yes, there will be some headwinds, but as an overall portfolio, we believe we can still grow through '20 and into 2021. There will be a number of lines that we -- that have seen any impact from kind of recessionary effects of COVID-19.

A - Alexander Maloney {BIO 16314494 <GO>}

Then on the multiyear question, obviously multiyear comes in very different shapes and forms at Lancashire.

So a sovereign risk contract is going to be multiyear and offshore energy construction risk by the nature is going to be multiyear.

So that's very different, I would say. I think if you look at our property capital, some clients do buy multiyear. It's part of their buying strategy so that they hedge, I suppose. I believe that those clients will continue to sort of buy on that basis.

So you may get a client buys 1/3, 1/3, 1/3 on different policy periods.

But logically, if you think the market is getting better, we probably would resist selling more multiyear because clearly, we think the opportunity is going to get better. But it's a hedge for the clients, and it's a hedge for insurers at certain parts of the cycle. But on my last point, clearly, we're not going to look to sort of locking prices today if you think prices is going up. But clearly, for clients that are long-term customers of the Lancashire group, we will continue to give them the products they want.

Operator

Our next question is from Edward Morris, JPMorgan.

Q - Edward Morris {BIO 16274236 <GO>}

Most have been answered actually, but one that I just want to just come back to is I wonder if you could just sort of talk in general terms about this improved opportunity, because on the one hand, obviously you sound quite positive at the moment, probably more positive than I can remember in the last few years. And yet on the other hand, when I sort of think about your guidance on the improvement in the attritional, that seems, at this point, fairly conservative for the next year or 2. And in fact, the growth, there's a few areas where if demand levels drop, then actually, you could see some headwinds.

So what I'm trying to think about is, given your view of the market at the moment, how would you expect this to come through into your financials?

Is it a case of -- or you need to see how much business you write, if you write that business, then the attritional loss ratio can improve further, and you might see some operational gearing through the expense ratio, et cetera as well?

Or is it just a case of at the moment where you're really waiting to see the business that you write rather than having a firm view on it?

So just trying to get an overall view on that would be really helpful, please.

The second question, just really, again, you may just point me here on the growth outlook. But one thing I'm trying to think about is if your renewal premium is running up double-digit or slightly ahead, should we assume that the volume aspect also grows?

Can you have a positive delta between your renewal price and premium growth for the next couple of years?

A - Alexander Maloney {BIO 16314494 <GO>}

Yes. I think the general sort of commentary about rate is, look, we are definitely more positive than we've been for years. But you also need to balance that way of -- the market has only really got interested in Q2.

So this is all very recent.

So it would be unwise of us to start -- I mean one, we don't give guidance really. Two, this is the start of a better market opportunity. Then you've got a picture in -- we would totally subscribe to commentary that certain classes of business are in a hard market stage. But we would equally say, sometimes as a business even with big rate increases need more retention.

So at this point, in the hardening of the market, we are focusing more on the harder market classes, if you like, so the growth is going to be higher there.

On the headwinds part, and I always point people to this, let's just pick aviation as the best example. If you look at the aviation market, you look at the commentary from big airlines and on post-COVID, there's a lot of commentary about the world not getting back to normal for a couple of years.

So you immediately think we'll clearly have to write as much aviation business.

I think that has to be balanced with the supplier of underwriting capital for that class.

Aviation is a class of business that demonstrates that it's very hard to make money.

Our aviations are really good. They've made money in that class of business. They know that world inside out, but then others are pulling out that class.

So even if the aviation total premium globally goes down, is -- Lancashire aviation income fall to the same degree, I don't think it will because I think there'll be less people writing that class.

So it's hard to predict, but I think, overall on growth, everything that we do pretty much is grow into different degrees.

And as I said earlier, even with a clean wind season, there are so many other factors that are driving our market to a better place. That's why we are very sort of certain we can grow. How far it goes no one ever knows.

No one ever knows what's going to happen, and there's lots of talk about ILS capital at the moment.

We think that's going to be difficult at year-end, but you never know, and you won't know until much later on. But I just think there's enough factors going in the same direction that I don't see the moments about the market being tripped up.

The last thing, again, another good example is, yes, there's been capital raises. If you add up the aggregate capital raises, even if you get three new startups in Bermuda, I don't think that really changes the overall picture of the industry.

So I think there's enough momentum in the system.

A - Paul Gregory {BIO 16314515 <GO>}

On the last point, about the delta between RPI and our growth, I think I'm understanding the question correctly, correct me if I'm wrong.

I mean if you look through the first part of six months, our RPI is 111%.

We've grown gross premiums by 15%.

We've underlying just under 24%. And if you think about our strategy, it is to take on more risk as the market improves, not necessarily just to follow the rate.

So our numbers can move around. I'm always conscious of that. But as a general principle, as the writing improves, we'll be looking not just to get rate on our new business.

We'll be looking to pay new business on as well. And in all of our segments through half year, you can look at the delta between RPI and growth in growth written and the growth is higher than the RPI.

A - Natalie Kershaw {BIO 21394441 <GO>}

Okay.

So on the attrition, I think there's two separate things that are making us seem somewhat conservative.

One is, as Alex was pointing out, we're in quite uncertain times, and the market really has literally just started to shift in the last few months.

So to try and predict where we'll be next year is relatively difficult. Then the second point is that this business obviously takes a while to earn-out.

We wrote the better-rated business towards the end of H1, and that will earn-out over the next 12-18 months.

But then also, we've still got business now earning three from the last 12 to 18 months when rates weren't as good.

So you -- there's always a bit of a lag between your RPIs going up and then the impact on the attrition ratios afterwards. Does that make sense?

Q - Edward Morris {BIO 16274236 <GO>}

Yes. So you're sort of saying that the attritional will improve perhaps with a 1- or 2-year lag. But then might it also be the case that actually the business you're writing today results in higher reserve releases further down the line as well?

Do you take time to recognize some of that pricing improvement?

I know that's more a casualty area usually, but I'm just trying to think, on the one hand, you're talking about a return profile which is significantly better. But on the other hand, you're quite cautious on the financial components that make up that return profile is the gist.

A - Natalie Kershaw {BIO 21394441 <GO>}

I think you're right. But I think theoretically it would take a few years to come through. But theoretically, yes, you're right.

So I wouldn't expect great reserve releases, like massive reserve releases next year, for example.

Operator

Our next question is from Thomas Fossard, HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

I just have a -- one last and remaining question, and it was -- this is related to your acquisition cost ratio. In H1, I'm getting a 25.6%. But if I were to look at the acquisition cost as a percentage of your gross written premium, then the ratio is falling quite significantly down to 11.9%.

I think that looking to Jelena in the past, I think that we've been -- I think that we're encouraged to model your acquisition cost ratio on a gross written premium basis and not on a net premium basis. And 11.9% looks to be -- is quite significantly down from the 19%-20% that you had in -- on a full year basis in '17 and '18, '19 was a bit different.

But -- so I was wondering. I mean acquisition costs. I mean any guide you can provide us with?

And if there is enough structural shift in your portfolio to expect, I would say, a structural reduction in the –

A - Alexander Maloney {BIO 16314494 <GO>}

So Thomas, I think, to be honest, the easiest thing you can do is, can we just take this offline and you can talk to Jelena and she can give you some way to think about it, I think that would just be the most efficient way to deal with your question.

Operator

Next question is from Oliver Troop, Autonomous.

Q - Oliver Troop {BIO 20035307 <GO>}

I just had one follow-up. This is actually more of a request than a question. Just on the attritional loss ratio, you gave us this guidance of 36%-37%.

I mean the difficulty I have is it's hard for us to see where the actual is compared with that guidance, the reason being, I think I'm right in saying a midsized loss, so maybe a $7 million loss, say, is excluded from that attritional guidance, but you don't split out midsize losses, say, $7 million loss in the results.

So if you do, I mean it's hard for us to compare the actual attritional loss ratio to see whether it's running above or below the guidance.

So I guess I just wondered whether it'd be possible to provide a bit more information on kind of splitting out midsized losses so that we can observe like a true attritional loss ratio, if that makes sense?

A - Natalie Kershaw {BIO 21394441 <GO>}

Yes.

I mean we can think about that going forward. But what I can point you to this H1 is that we haven't had in the current accident year losses of that size.

We do say in the press release that excluding COVID, our accident year loss ratio is 38.2%.

So it's pretty much in line with guidance.

Operator

Our next question is from Paris Hadjiantonis, Exane BNP Paribas.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Just a quick follow-up. You've touched a bit on third-party capital and that you are seeing more losses essentially lodging in more capital. You say we are seeing some redemptions. I was wondering if you can talk a bit about Kinesis or Lancashire Capital Management as we call it these days. What kind of developments you've seen there, whether you've seen any redemptions from clients?

What are your profitability expectations for that part of the business going forward?

A - Alexander Maloney {BIO 16314494 <GO>}

Sorry, Dan, do you want to take that one?

If we get that on -- the line was (inaudible).

Sorry, I thought we had that one.

So we'll cover that one.

A - Paul Gregory {BIO 16314515 <GO>}

Yes. In general –

A - Unidentified Speaker

Sorry.

Sorry. Regarding the -- and if you like, redemptions were kind of insulated from that because we raised the money annually.

We've been in contact with investors regularly.

I would say most of them, for us, have an appetite to go forward. Regarding, if you like, results and all that, I mean as we've been saying, the COVID, it's way too early to tell yet really what the results are going to be.

Going forward regarding growth and so forth, that's all going to depend on investor appetite as we've discussed.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

But you are confident that into 2021, you will be riding at least the same unit then?

A - Unidentified Speaker

You can never be certain of anything in life, but I mean it's -- the initial expectation would be that.

Operator

(Operator Instructions) We do not have further question at the moment.

I hand the floor back to you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you very much for your questions today. Thank you all.

Operator

Ladies and gentlemen, that concludes our conference call today.

You can now disconnect your line.