Q2 2016 Earnings Call

Company Participants

- <Q >
- Clive Andrew Washbourn
- David Andrew Horton
- Martin Lindsay Bride

Other Participants

- Andrew J. Ritchie
- Barrie Cornes
- Ben Cohen
- John A. Borgars
- John D. Irwin, Jr.
- Kamran Hossain
- Nick Johnson

MANAGEMENT DISCUSSION SECTION

David Andrew Horton {BIO 5697110 <GO>}

Good morning, ladies and gentlemen to our Interim Results Presentation. If we quickly look at the agenda, I'm going to give the usual high level financials and a business overview. And then, I'm going to hand over to Martin who'll go through the financials in a little more depth including investments, reserves and our capital position. This half year, we have as a special guest, Clive Washbourn, who heads our Marine division. He was a special guest back in 2009. And so, in his turn, he's going to go into the marine book in a bit more depth. And then, I'll come back with a crystal ball and try and determine what's actually going to happen from here on for the rest of the year and into 2017.

So you'll have seen the high level financials, really pleased to announce a profit of just over $150 million. It's down to 3% on last year. And if we go through the element, we'll see why that is. It's great to be able to grow a bit. Growth is really tough, so we're up 2%. Within that, our specialty lines business is up 17% year-on-year and we continue to grow with our U.S. onshore platform. Short tail lines, especially catastrophe exposed lines, it is very tough, and you're seeing decreases in our property and our marine division year-on-year.

Combined ratio, in line with the long-term average at 90%. Rate changes across the whole portfolio are down 2%, but again, reductions in our short tail lines of business and still rate positive in our specialty lines business. Prior-year reserves market and we'll go through virtually the same year-on-year. Investment returns up a bit as yields track down and the value of bond portfolio increased. Return on equity, I think is still pretty healthy at 19% post-tax annualized and the interim dividend in line with our dividend policy of about between 5% and 10%, up 6% to £0.035.

So from a business point of view, what has been going on, I think the main thing we want to highlight is the number of underwriters who've joined us in the first half, which I think is a record for us in the first half of having 36 new underwriters and they're spread quite broadly across the organization, so within the UK and within the U.S., because the Singapore and Paris, we've managed to add underwriters in the first half of the year.

A bit of stress I think in the insurance at this point in time, which means we have the opportunities as some companies withdraw from lines of business to pickup underwriters. One or two have gone through M&A over the past two years or three years and again, we better pickup underwriters. We've highlighted a few here. The UK and international Med Mal Group that joined us from Marketform earlier in this year, which was good; fine art, specie here in London, and expanding the environmental team as one or two carriers have withdrawn from environmental in the U.S.

Clive will also talk about two marine underwriters we added in Singapore at the beginning of the year, which has been great. U.S. economy probably doing better than most other Western economies at this point, which is very good for our specialty lines business. So specialty lines continues to grow well within the U.S.

We also going to start now focusing on Europe. So, prior for the Brexit vote on the June 23, we had and recruited Gerard, who was going to look at international specialty lines. Our specialty lines book, as you know, is manly a U.S. book, and he is going to look at growing E&O, D&O and FI within Europe.

We're also looking at, prior to the Brexit vote, the conversion of our Irish reinsurance company into an insurance company. But it obviously takes a reasonable amount of time, that's subject to regulatory approval, but we've only started the project, convert the reinsurance company to an insurance company, because when Gerard joins us, we would like to write business both on Lloyd's paper and EU carrier paper.

Partner with Munich Re, we had a very long-term relationship with Munich Re and a big supporter of us as a company and we announced a $100 million cyber line. Okay. And as most people in the audience will know, our cyber business generally is mid and small business and we only write a small amount of larger business and with the partnership of Munich Re, we're going to look at writing more large risk business and to highlight something which is obvious to everybody, the rating environment that remains pretty challenging.

I will now hand over to Martin, who will go through the financials.

Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you very much, Andrew. Good morning, everyone. I'm Martin Bride, CFO of Beazley, and I'd just like to take you through a few finance KPIs, and then, talk briefly about investments, reserves and capital.

So, Andrew has already talked about our top line growth. Net written premiums grew slightly more strongly, the math is really two aspects to that; on our short tail areas, where we've actually been reducing our risk appetite due to the rating environment, more reinsurances being purchased; and then, our specialty lines business has actually purchased slightly less reinsurance despite the fact it is growing quite strongly. So that's what drove that.

In terms of the per share statistics, there's obviously been quite a lot of volatility in the dollar sterling exchange rate. So, the dollar stats are very good. The sterling stats look absolutely fantastic, as you can see there, because unfortunately, sterling has weakened. So, in dollars, we've managed to increase the net asset value per share by between 1% and 2% over the last 12 months, but shareholders have had £0.283 in dividends as well during that 12-month period. So, we think that's a very good financial performance.

So, moving on to investment returns, a very strong performance in the first half of 2016. It's a slight double edged sword, a massive aspect of market that have driven that more than anything else is interest rates going down, after the Brexit vote, which has created capital gains in the bond portfolio, but has made the future slightly more challenging for Stuart Simpson and his team. Notwithstanding that, delighted to have 1.4% returns and nearly 3% annualized and we can hopefully continue to deliver very respectable returns in the future, albeit that got to support that they got to be lower than what we've achieved in this first half in the short-term.

The portfolio itself is really very stable. We have 80% to 85% of our assets in the core portfolio and then, capital growth assets spread across two or three different strategies. The only change that's occurred in the last six months is a little bit of a shift towards investment grade credit away from cash and governments within that core portfolio. There has been no change in risk appetite, simply changes in how we think it is best to apply it.

So, moving onto reserve releases. Reserve releases are a very important part of Beazley's financial results, because our approach is to reserve prudently and then hopefully, to see reserve releases, as we settle out claims. And this chart shows that the 2016 half year has had a very similar contribution from reserve releases to 2015 and indeed, looks like it's very much in line with the five-year trend. Looking into the detail, there is less contribution from short tail classes of business this half year than it was last half year and conversely a slightly higher contribution from the specialty lines business.

The next chart is our view of how strong the reserves on our balance sheet are. The importance of this chart is it's a lead indicator of whether or not the previous chart is likely to continue to look broadly the same as we go forward. And so, Beazley's view is that the reserves on our balance sheet at June 30 have very similar levels of margin across our actuarial team's view as they have had in the past. So, our view is that we've got a consistent reserving strength on our balance sheet and therefore, all other things being equal, those reserve releases will continue in the future growth at similar levels.

Moving on to capital, first an update on debt strategy. In 2006, Beazley issued a 20nc10 subordinated debt instrument, so that 10-year call date is almost upon us, it's in October 2016 and we will be expecting to call that bond, which is what is normally done in bond markets. I've always said in presentations on capital that really the trigger for Beazley increasing leverage would be an opportunity to deploy more underwriting capital – substantially more underwriting capital. And we are considering, as we call, the existing bond a new issuance of up £250 million in the second half of 2016.

And moving on to, therefore, our capital position, we do have a growth perspective in the amount of underwriting capital we think we can deploy. You can see the current position on the previous June 30 position. We, for the first time, are giving a projected position at the year end. We got a first version of our 2017 business plan and that's showing a reasonable increase in the amount of capital we think we can productively deploy. And our perspective is that it was not quite at those levels. We do believe that there are going to be opportunities over the next five years to deploy a growing amount of underwriting capital.

As far as our dividend strategy is concerned, that remains unchanged. So, we've had a dividend strategy of growing the base dividend between 5% and 10% and the dividend the board has declared at this interim is completely in line with that. And then, to the extent that we generate excess capital, then the board will be remained to be very active in managing that capital and not allowing the company's build up of necessary high capital buffers.

Clive Andrew Washbourn {BIO 15471957 <GO>}

Good morning, everyone. I'm Clive Washbourn, Head of the Marine and Aviation team. The last time I spoke to the analysts and for the road shows 2009. I was just trying to imagine this. I have more hair, I didn't have the home to look of an underwriter in a really tough market. Gordon Brown was the Prime Minister, Michael Jackson had just died and had 37 of the Top 100 and the most surprising of all, Manchester United actually won the premiership.

In the insurance business, actually we had a fantastic year. There was very few catastrophes and I think the Swiss Re said, only 12,000 people died, 12,000 in my mind still quite a lot of people, but it was a great year. And what did we have? We had a real marine business, where just a quick run through, energy being up stream, exploration and production, drilling rigs, fixed and mobiles, cargo (11:20) pertaining to ships and ports and et cetera. And the world being aviation and marine more, a lot of piracy in those days and the (11:32) machinery business. $265 million worth of business, a fantastic year we made $74 million worth of profit. We had an 8% rate rise. Those were great heavy days. Obviously, we've moved on somewhat and we're looking at this portfolio.

Now, $248 million dollars, it's less income, but as you all know and as widely reported, a much more challenging environment. But what we've done, which for us for our long-term growth in profitability of this company and for the shareholders, is that we diversified the portfolio. So, as you can see, back in 2009, the main drivers, the energy and the hull was about 80% of our income.

Now, it's only about 50%, and I'll come on to the sort of rate reductions in a minute. But in this period, we've diversified into both aviation and satellites. Again, challenging areas, but at the moment, both of those appeared to be about an 80% loss ratio, so we're actually making a weak profit in a difficult time. Because you've heard me say before, what we try to do as a business is actually get the right people, because you never get the right people at the right time, but if you get the right people over a period, you'll grow your business profitably and you have a very, very, very good business, and that's what we've tried to do.

Now, it is challenging. Of course, it's challenging. It's written all over the papers, but why do we fail as a business optimistic? Well, firstly, this isn't new to us. We put this chart up, just to show you that actually we've been through cycles before. Back in 2006, wow, what a wonderful year that was, 9% rate increase. In 2007, it was 7% reduction; and in 2006, a 6% reduction and as I just said for 2009, we're up. So we've been up and down and we've navigated those profitably. Yes, we've now hit a bit of a – as far as we'd describe as a better run, 5% of 2013, 6% of 2014, 8% of 2015. And I can tell you at the moment, it's about 7% off, so something around 26%, 27% less income. Well, I think all of this will know, it doesn't matter how talented you are, if you got 25%, 26% less premium, you're going to make less profit. But profit is still what we are going to achieve and what we want to achieve.

Why do we feel positive? Well, the income is not only been hit by the fact of rate reduction, but the industries we insure have been struggling. The shipping industry, property buyer, tankers, the freight market, the ships are losing money. So that's always difficult with dropping values and dropping maintenance to continue to make a good profit. And the oil and gas industry is absolutely driven by oil price, less than $50, all the construction offshore development start, half of the drilling rigs that are out looking for a laid off, all the supply boats and all the other offshore support vessels, all struggling. So, that all has an effect on values and on premium, and on our ability to grow.

But within one year to three years, both the oil and gas business and the shipping business will begin to come back into a growth area and hopefully profitable. Like all side, supply and demand sectors are trying to predict exactly when they pick up is really difficult, but we know it will. So we just have to stick to what we know. We have a very high retention rate at the moment, the (15:05) we've had in five years, and that is because as we've constructed our portfolio, we believe to be and identifies our core clients, we're holding onto the guys that are going to see us through this difficult marketplace.

Trying to call when rate rises will occur is difficult, but there is one thing that makes me sort of vaguely optimistic of that happening soon. What this chart basically shows is 30 or so operations in Lloyd's with their whole cargo and marine liability gross incurred running over five years. Now, if you think that 15% expense ratio is probably an average expense ratio, anything over 85% and you're losing money. But as you can see from that, from the upwards, you're losing money. These are the people we're competing with. These are the people that are still reducing prices. In that, we have about a 72% gross incurred running over five years from 2015 backwards. So, we're not talking about what's going on, but we believe as we've been pushed to give write back, we can afford to do it for longer than everyone else.

Now, I don't like the idea of its poker chip to the table and those that are left with one chip win, but it feels a little bit like that. I mean, for those that are (16:31) my analogy is that, guy in the corner on the fruit machine, he's poured coins in all afternoon and does not want to walk away, and that's what it feels like for most of these over there. They cannot make money, they haven't made money, but they don't want to walk away and that means they pick up all the profit, well, Beazley and one or two of the others.

So, what does that say? So I think it's going to change. But, I hear in the market people moaning about the state of the market, so there's always someone else is fault, et cetera, et cetera. The most important thing my guys know is: one, never get cocky about our business; and two, we always try to adopt an attitude which is not let free (17:12) the market is always good. What does that mean? Whatever is happening, we're in command of our own destiny, you just got to keep going and looking for where we can add value or mix in value or have a little bit of differential to someone else and the rest of the market.

So we've continued to actually invest across the cycle. Yes, it does contract your profit a little bit by buying an expensive people and going to expensive locations. But in the long-term, and this business is about long-term growth, make no bones about it, you have to do this to keep growing your business. Lloyd's has become a much more tougher market to do business, so we got to go out and look for the business elsewhere. So, we put to you guys, local guys, not expats, who are having their last hurrah in Singapore, but two smart guys who are working hard to make money for us, and we will make money over a period of time.

We got a new pleasure craft and yacht operation. We started in a really small scale way, but you know we're halfway through the year; they've done their budget for the year, absolutely terrific. And they're beginning to find all these little niche (18:15) MGAs which we can pick up, bolt into the account, and our regional book sort of settles around 65%. Yes, it's not big ticket, but it's very sticky business and it makes us a nice profit and again, great diversification for Beazley.

We got a new fishing vessel and small craft underwriter, again exactly the same. Set him a fairly modest budget this year, he's done it, which is terrific; small, sticky business where the actual operational efficiency is really important. And we have a fantastic IT department which is really thinking ways of how we can beat the competition, not through rate, not by being beaten up by the brokers, but the fact that we can deliver these products really efficiently. So, small ticket business, we're going to really try and push a greater emphasis on.

We bought Leviathan, which is an MGA which does underwater, streamers, ROVs and business like that. Yes, it's contracted at the moment, because it's very, very associated and driven by offshore development, but as that takes off, we fully expect that to grow really aggressively. We've always written 60% of it, we now own 100%. We know the people; we understand the culture, absolutely us. Niche business, long-term profit, I think, it made something like $30 million or $40 million over last 10 years, so a great acquisition for us.

And finally, we're continuing to analyze those countries which we are already in. Like France, like America, we've never been onshore America, but we're looking at it very closely to make sure we're not missing the trick. And if we think it's important to go there and try and intercept the business, whoever that comes over here and gets into the hands of the big brokers, then that's what we'll do, so lots of really interesting things going on. Yes, not a great market, but it's not the best at times; it's not the worst at times. But we got good people, we like the diversification that we have, we continue to look at different geographies and different types of business, and hopefully, when I come back in seven years' time, we'll know probably – Andrew would have probably retired in seven years' time, I might come back with two or three new other products.

But we're here, we're organized, not one of our classes is losing money at the moment, we feel really enthusiastic about the future. Look, we have good times, we have bad times. There is no cocking us about what we're doing. We remain sort of healthily frightened by our business. It's a very, very, very volatile business, but we're focused. We continue to grow. And hopefully, we'll continue to make a reasonable contribution to this company's balance sheet.

Thank you very much. Do I take questions now? No. Thank you.

David Andrew Horton {BIO 5697110 <GO>}

Yes. Obviously, a race to retirement taking place between Clive and myself, and I guess, we'll be around in seven years' time when Clive comes round again.

Right, let me move into the outlook. So, look at the outlook. So, I think Clive has covered part of this from marine point of view. The key to this chart, which we've shown several times before, is the dotted line. So the dotted line is the overall portfolio. This is the rate change on a risk adjusted basis, so it takes into account the actual price change with the price differential; it also takes into account any terms and conditions changes. So, on a risk adjusted basis, the price in the portfolio has only just about dipped under a 100%, and why is that, because we try and rebalance the portfolio as much as we can, while staying in all the lines of business we like, because as Clive has touched on, we have invested heavily in underwriting talent, so we haven't withdrawn from many things, but we have rebalanced. (22:04)

And what we've been doing over the past few years, we've been growing the specialty lines business, which is the dark red line which still shows an upward trajectory from 2011 onwards, sort of the end of the recession, so that is good. And other lines of business, as we can see, are under quite a lot of rating pressure, especially property and marine, which Clive has just talked about. So marine is the pale blue line which has now gone to 80%, just under 80% of what it was three years ago.

This is actually showing the premium growth and again, what I was trying to show with this chart was how we hold back when the rating around us is just not good, and then grow when it is good. So, picking up in the bottom line which is the specialty line, as you can see from 2008 to 2011, actually shrinking the book slightly and now is a good opportunity for growth. Some of the growth within SL over that period of time has been the cyber book, and if you go back to 2008 and 2009, we virtually wrote no cyber business, so it does help that grow. But the rest of the book is also growing.

It's harder to see within the other lines, but we have taken the opportunity to grow in the property book, when we acquired First State back in 2009, and as Clive's number showed, we were growing Clive's book for a number of years. The smaller ones are harder to see, but we also have shown growth in political risk and contingency, and the reinsurance book, and of course life, accident and health only started with us back in 2008.

So, what has that done by percentage? All it's done really from 2012 to 2015, at the end of last year, with new specialty lines up a bit including cyber, so it has gone up 6 percentage points, and property and marine have given up 3 percentage points over that period of time. The aim of these two charts is to show that we're still building a balanced portfolio. So, even within the specialty lines, the balance of that portfolio has changed over those three years.

So I think we've covered this. Competitive pressures remain strong. I'm slightly concerned about mentioning the second bullet point; return should be expected to reduce. Because Martin and I have been saying this now for almost four years, and generally returns haven't reduced. But if you just take a simple view of life, we have got a 2% reduction across our whole portfolio this year and the previous year, and I think it was reduction in previous year. Claims generally are quieter than they have been on a long-term average. We will expect our returns to fall and I think high-teens ROEs are unsustainable going forwards.

Rate pressure, specifically on the short tail catastrophe exposed lines, expectation that is going to continue into the second half. Hope, that we're hitting close to the floor, there are some early signs that we may be hitting the floor, but the rate of rate decreases has definitely reduced.

Continue to focus on our strategic initiatives. Our strategic initiatives include growing in Europe. As I touched on, growing in the U.S., which we've been doing for the past 11 years or 12 years. And looking at our Singapore operations to growing in Asia-Pacific, remain innovative and looking at innovation and focusing on some of our small business lines, which Clive talked about some of the smaller business lines where business tends to be stickier. It's difficult to grow materially in the top-line, because (25:09) but it's something we've been very successful at and we've got initiative of, can we be more successful at that.

U.S. economy as I touched upon is stronger than most, and therefore, growth in U.S. remains a key priority to us. Attracting people, it's been great to attract so many people in the first half of the year. Our aim is to continue to do that, despite the margin compression. The political and economic uncertainty, we're a major U.S. player and elsewhere. So, I think we can weather any political uncertainty over the next two years or three years, although as I mentioned, EU growth or European growth, international growth to us is really important, and we are investing in both people and organizing our platforms accordingly. And specialty lines growth has been great, we had 17% growth in 2016, and our expectation is that, that is going to continue for the foreseeable future into 2017 when we've looked at early versions of the business plan.

We are now opened to questions, Clive. Come and squeeze in.

Q&A

Q - Kamran Hossain {BIO 17666412 <GO>}

Good morning. It's Kamran Hossain from RBC. Three questions. The first one coming back to Martin's comments about capital and the business plan for next year; obviously, you've got the 12% increase in capital requirements for next year. What does that mean in terms of the outlook and the growth? I know you've mentioned that specialty is very exciting, for the half year, taking into account the reductions elsewhere, is a 2% increase. So, what's that mean for next year's premium?

Secondly, do you know the yield that you're getting on new money at the moment in the investment portfolio?

And the third question is on the specialty lines combined ratio, it's coming at a pretty low level compared to history sort of at 91%. Previously, that was kind of in the high-90%s. Where do you see that (27:08) normalized level going forward? Thanks.

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

It's Clive again. I can go from that, you can fill in all the bits (27:16) So the growth for next year is an interesting one, because we're in the early thoughts of planning for 2017. So I think the element which we've covered this morning, which we're more certain, obviously, the specialty lines growth in our view is definitely going to continue into 2017. With the way we're going about distribution in the U.S., having underwriters on both sides of the Atlantic, and that's that side of the business we're going to continue to grow. So we're comfortable at that.

On the short tail lines, as I mentioned, we're hoping we're hitting a bit of a flow. And therefore, the reductions that we're seeing in the short tail lines, we're hoping are not going to repeat and that not rate, (27:48) but actually premium reductions. And therefore, overall growth next year, we feel more comfortable out than growth this year. We started this year with this 5% growth target for 2016 and hope we can still get close to 5%, but what we found in the first half is that the short tail lines were under more pressure, although the rates have gone down, virtually in line with what we expected, we've actually shed (28:10) more business than we thought. So, growth is expected to be greater into 2017 than 2016. I want to put a caveat on that we're still going to do the business funding process and we're only halfway through this year. So, as we get closer to the end - I mean, as we get to the end of the year, we'll be able to give more comfort on that.

On the SL combined ratio (28:27) On the combined ratio, the SL combined ratio has gone down for a couple of reasons. One is we're actually opening the book at a lower loss ratio - lower claims ratio than we were. If you remember what we did in 2000 - and I think, we started in 2010, we started opening the SL book at a higher loss ratio, because we realized in the recession we're going to pick up more claims. We feel it's now a better book and we've came out of the recession, so we're now bringing the opening loss ratio down a bit. We're talking about 1% or 2% down.

We're also likely more cyber, which we opened at a lower loss ratio anyway. So, we opened the medium tail book of SL at a certain loss ratio. We've opened cyber at lower loss ratio, because it has performed better. And as you can see from the years we've been, historic years we've been writing, we're starting to see reserve releases come through again, when we've had a period of relatively low SL reserve releases. So, if you plotted that chart back to 2006, you'll see SL reserve releases being quite high then dropping during recession, and now we feel they're coming back. So where will we expect, we expect the SL combined ratio to be in the low-90%s.

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

Yeah. They did also achieve a modest expense ratio improvement which hopefully, if they can continue to grow and where they have been, it may be able to continue to achieve a little bit of improvement now.

As far as the running yield on new money is concerned, I've got like Stuart right in my line of sight, so if I say the wrong thing, he will correct me. On the core portfolio, I would say that we're getting about 70 basis points of credit spread and about 50 basis points of duration, so about 120 basis points in total.

Q - Nick Johnson {BIO 1774629 <GO>}

Good morning. Nick Johnson from Numis. Two questions, first of all, the press release out the other day from you guys saying that data breach, BBR. Data breach has increased, I think, from 600 to 900 in the first half of this year. Just wondering whether that was within expectations or have there been any change in loss ratio assumptions within that? Was it just a function of the growth in the business?

And then secondly, just a follow-up on Kamran's question already, (30:44) says that you anticipate net double-digit growth in capital over the next five years. Just wondered if you could elaborate on whether - well, how much of that is down to business growth and how much is down to perhaps the change in the capital ratio you envisage for the portfolio? Thanks.

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

Okay. So, the data breach is, Nick, is in line with expectations. So the book continues to grow. There's nothing unusual in the amount of breaches, and if you remember that, and how many years ago, it's two years ago, when we said we dealt with 1,000 breaches, two years later (31:12) two years later, we're up to 3,000 breaches. So no surprise in we're dealing with more and more breaches, as we're writing more and more policies, and the book does continue to grow, and we support that by recruiting more people who are looking after our data breaches.

We have the recruit out of (31:26) Philadelphia, who manage our data breach. So there is nothing unusual in it, and generally the product is performing well. And because there were more beaches, people tend to buy more of the product. Just to take a quick setback, our cyber book tends to be a mid-market and small cyber book rather than large. So the data breaches we manage are of those mid and small sized clients.

What was the second question?

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

So, the second question is on the capital (31:52) Yeah. So, I've been thinking we have two scenarios in our medium-term planning there. There is one end of the scenario is capital and premium grow together, and then the other is the capital probably outstretch premium growth by about 2%. And we don't know the exact mix of our portfolio over that five-year period. It's obviously going to depend upon market circumstances in the different markets, so if capital grows at 10% to take a figure, and for that to happen, premiums need to be growing in high-single-digits.

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

Thanks. It's Andrew Ritchie from Autonomous. Three questions. Martin, can you just remind us what – you talked in the press release about using more of our debt capacity. What – just remind me, what do you think your debt capacity is and nature of any debt issuance? I'm assuming it's going to be very similar to what you got in place already.

Secondly, on the target capital coverage, I mean given you talk about low returns going forward, it's very hard, it could be very hard for a large event to regenerate capital. It's going to be harder than after previous events. Do you think it's more prudent for you to stay at the upper end of that target capital coverage in the current environment or may be even consider to remain above that? Just a comment on what's the appropriate level in today's environment.

And the third question is on marine. So the question is for you (33:32) you're going to miss out. There's been an awful lot of talk about how bad pricing is for years and there's been an awful lot of talk about how bad claims have been for years, and there's been lots of surprises on the claims front, particularly in the cargo area. Not of Beazley, I'm talking for the market as a whole. So, why is it the pricing is still falling? I mean, who is bringing new capacity to this market, and what are the attractions for that new capacity? Because it's always been the market that threatens to get better and it never seems to, at least in the last three years or four years?

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

Shall I tackle that capacity first? So, currently, I think our leverage is in the high-teens. In 2006, when we first issued debt, we had leverage of about 50%. So that was about 50% of equity. So the board doesn't have any fixed maximum limit. So we certainly feel, if you look at our payer group, debt leverage is below 20%, it's quite low. We would expect to be in the mid-20%s, mid-to-high-20%s if we do execute upon the two things that we've highlighted at this phase. And then going forward, we'll just need to take each year as we go, in terms of what is the financing requirements and how will that be met between equity and debt. As a Finance Director, I'm quite keen to pour money in this environment, because (35:00) and it is relatively cheap. So – but, clearly the confidence in our balance sheet is clearly in insurance group, so we also need to factor that in.

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

And the nature of your investments?

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

We can look at that (35:14) So there's no – obviously, the debt markets are quite active at the moment. So we will look at senior debt. We have some senior debt and some subordinated debt. So we're going to look at all options. And obviously, once we've decided, we'll communicate. But at this stage, we just need to see what looks like the most attractive and appropriate option for us.

So your second question was on the target capital buffers and the ease to recapitalized post an event. I mean, certainly, our view about capital is we carry a buffer and we also have a backup program with an NOC. (36:15) I think potentially future growth rate is just as important as anything and thinking about what capital buffer to carry. As a franchise, we've always thought about balancing our portfolio, coming onto your scenario of a big event. We've always thought about balancing our portfolio such that we have a relatively good performance in a year where there is a big event.

And therefore, to the extent that we need to access capital, are able to do so, and that's central to how we run the company. We have been reducing our catastrophe risk appetite, I'd like to stress for the last three years or four years, because of the rating environment. And so, it's putting aside anything other than one in 1,000-year event. We should not get an outcome where a natural catastrophe event creates a really, really major loss for Beazley.

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

Well, let me take the third question. Clive is going to talk briefly (37:11)

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

(37:12) generically, you're not going to talk about specific competitors.

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

The question was around, why the market never seems to get better?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

Yes. Absolutely. That previous chart was heavily sensitive. I'd love to give an eloquent answer to your question but, I think, there's a whole variety of things going on. In the past, where we used to have clear delineation between aviation syndicates and non-marine syndicates and marine syndicates, in those sectors, if they went really wrong, the results were focused on those teams very, very quickly and on those managements to turn things around.

Now, we have these big diversified companies, and if you take the marine figures I've show you does not include energy. So, you can have your marine division doing that, but if your energy is making money and if you put within your, say, your marine division which we don't (38:05) If those high-severity low-frequency business is doing all right, it masks what's going on. I think there is still an attitude that the grass is greener, and we've done it. We look at today's aviation and then looked at satellite to diversify our book. So people (38:24) marine makes some money and they set up a new syndicate. They all think they've always got the best people. We're also being really stressed by the P&I Club. The P&I Clubs are the shipping mutuals, and they wanted to diversify the products to their shipowners, they're coming to Lloyd's and started syndicates. Now Lloyd's is acting through the door, they put their capital up and they're playing. Some of them have loss ratios greater than 200%.

So, I don't know why they want to play this game, but I assume that if they're not into insurance, they'll be into chocolate making or running sport shops. But at the moment, they're ready to be in insurance. I don't think there is really a simple answer. I think what has exaggerated what's going on is, and I really clear enough to understand why we have seen a lower frequency of loss, certainly in the shipping business. And the energy business, we haven't had a major windstorm. So, everything is sort of accelerated and desired to be in this sector, but we've not had the big bangs.

If you know what's going to happen, there's a really low rating environment. Just to give you a dramatic example of that. Our energy book, at the top, we were $126 million. Next year, we're going to write just over $40 million and our exposure isn't that much different. So, loan comes to bank or the frequency goes up to where it was, then I think you'll have people looking at where they're putting their (39:57) and saying, actually, this game is a bit tough for us. But at the moment, I really can't – really understand why they want to play in this sector. It's difficult and it will shred capital very quickly, if it goes back to normalized claims activity. So, I hope that's answered it.

Q - John D. Irwin {BIO 18483735 <GO>}

Hi there. John Irwin from UBS. I just wanted a bit around accident, life, life and health. So quite slowed right down there from GOVP perspective. I mean, I think we were sitting here this time last year and you guys were talking a bit about medical gap insurance. I know, that might be the next $100 million line. Is that still the case or has it changed?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

No, we haven't sort of got medical. That's continuing to grow in the U.S. So just – the accident health breaks down to three books. Loan called and loan book which required in 2008 Australia and U.S. U.S. is new and continues to grow, which is good. The main reason the premiums have not moved up is we lost a major account in Australia and that was a reasonably sizeable amount of money to us. It wasn't that profitable to us. So therefore, it doesn't have a material impact on the overall numbers, but it does have an impact on the top line.

Q - John D. Irwin {BIO 18483735 <GO>}

Thank you. And secondly, I was thinking about the cyber market. I mean, some people are saying it might grow three-fold over the next sort of three years, four years. Obviously, you guys have got decent market share in that already and you always say, you don't want to do too much of one thing. I mean, how do you think about your market share going forward, if we do get the level of growth (41:27) inside, but will you pull back a little bit?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

I don't think we'll unnecessarily pull back. I think the market has got massive potential to grow. So even in the U.S., if we look at it by various sectors, most of you would argue, it's between 20% and 50% sold. So, still up to 18% of certain sectors are not buying it. And then, we got the whole European and rest of world opportunity where the EU, earlier on this year, did say in two years time, that it can have a cyber breach, you're going to report it to your regulator and our belief is, in two years' time, it's going to be a much bigger European opportunity in the current years, which is good.

So, I think if we can just keep our market share, I'm not exactly sure what it is, but one of the major markets in the U.S., then the whole market is going to grow and we can grow with it. If we have excess and our balance sheet can't cope with it, then we need to think of maybe buying more reinsurance by the ways that actually continue to rise with our sales, but putting it onto somebody else's balance sheet, which also works well.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. It's Ben Cohen at Canaccord. On the issue of sort of lying off risk, is there any change or likely change that likely into 2017 in terms of reinsurance buying or use of third-party capital given the pressure on prices?

And the second question was just in terms of the business in Europe. How much business do you actually write in continental Europe? And outside of the sort of the cyber piece, how will your business look to differentiate, and can you set out any target there?

And the third thing I wanted to ask was just in terms of dollar strength relative to sterling, is that going to give you any material benefit to your sort of cost income ratios, the expense ratios?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

Okay. So from the RI point of view and at this point of time, there is no major change to the RI (43:16) for 2017, minor changes maybe at the point that we made by more cyber cover, more reinsurance to cover. If we can write more cyber and we can't cover them in our balance sheet, we may buy some more reinsurance for that, but we need to get a detailed planning. And the other potential area where we may buy RI is if we want to reduce our net capital closure into 2017 and still retain the business.

So, we would lay that off to the reinsurance, because as we're reducing that cap exposure, which Martin mentioned, we've done it two ways: one is dropping exposure and the second is buy more reinsurance and we may continue to do that, if we believe that catastrophe is not as good next year as it is this year.

In Europe point of view, we don't actually give specific premiums, but we normally talk about the fact that if our total is 100% portfolio, about 6% of that of is UK and about 6% is European business.

I think in terms of differentiating in those markets, Ben, we intend to bring our specialties high quality products where there is need in those markets and go with our normal formula of really good people and really good service, and that's how we're approaching it.

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

Yeah. So Paris now has political risk, it has healthcare, has cyber. So, we've gone with specialties products, we're not trying to hit head-to-head with AXA writing, probably MGL, AL and so on, the mainstream lines, probably in causality. So we're going with very specific lines of business, some professional indemnity.

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

On the question of cost, yes. Roughly, two-thirds of Beazley's cost base is sterling cost base. So for a company that reports in dollars, there is going to be a tailwind, but obviously, exchange rates can go in two directions, so we will be continuing to focus very intensely on trying to make our cost base as efficient as possible.

Q - Barrie Cornes {BIO 2389115 <GO>}

It's Barrie Cornes from Panmure Gordon. Just one question, please. Specialty lines seems to be going very well, rate increases going through. Is it an area where perhaps you need to be far – put more capital to that? In which case might there be some impact on return the capital to shareholders later on the year as a result of that? I'm not saying it's a bad thing, but is that an area you – perhaps you ought to be concentrating on?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

Barrie, when we look at special dividends itself where (45:52) you talk about return on capital which is where we've returned capital in previous years. We tend to look at that towards the end of the year when we have a more definitive position on the 2017 plan. We got through the North Atlantic windstorm season which can have an impact on profits and we have a better idea of what this year's profitability is, because we still uncertain as to where the investment needs are going to be.

What we're trying to flag is we are going to use more capital for growth than historically we have done. So, by default, there is going to be potentially less surplus capital unless our Solvency II profits are super brilliant between now and the end of the year. And if they are, we will continue down a special dividend route. If they are not, we'll be deploying – we won't have as much to deploy – the more we need – the increase we need into growth. So, we're not trying to flag anything other than we are using – we are going to be using more capital into 2017 with some certainty to fund future growth.

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

Good morning. (46:56) from Macquarie. Two quick questions on the reserves. Firstly, on the specialty lines, I see that reserve release is more than doubled. I was wondering if you could give us a bit more color on that. Secondly, on the marine reserves, I see there's been some reserve strengthening, in particular for the 2013 years and before, and my understanding is this was quite a short-term business, so I was quite surprised to see reserves strengthening there. I was wondering if you could talk more about what's caused this. Thank you.

Do you want to tackle (47:22).

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

It is generally a short-term business, but we actually do both onshore and offshore construction business and construction can be anything up to five years or six years. And what we've done is, we have two or three very large potential claims in the marketplace, of which most of them, we don't think our layer is going to be impacted, but we've decided to be prudent to put away some IBNR at this half year on those potential claims. So, that's really the briefing up of the prior years from our point of view, but just to rest – to allay your fears, we are still on budget to make a reasonable profit for the whole year.

We've just decided to be prudent at the beginning of the year with these losses now. If they don't come through, there will be a nice release again, but no, we're not looking at our prior years and thinking (48:22) strip the barrel out or we've got the numbers wrong, we've just taken a very prudential approach to a particular segment at this particular time.

All right. Okay. Thank you, Clive. We're (48:34) marine reserve releases for the second half. Hopefully, yes, we do reserve prudently. So, that remains our theme across the business. As far as SL, the specialty lines business is concerned, I think, Sam, as you already alluded to, there was a period 2003-2006, almost extraordinary profitability for that business. That going back four years or five years, generated very significant reserve releases in Beazley, and then, the recession prone years 2008 through 2011, where the SL premiums didn't grow and because we were having to manage a much more difficult environment in the U.S. economy in particular.

And yeah, once we have made acceptable profits during those periods, we believe reserve releases were much lower and then potentially we are hopefully merging into a better environment with our specialty lines business, which is why Adrian Cox and his team have been growing it since 2012 and you're starting to see that come through in the reserve release picture.

The other thing we have is this growing cyber book, which is a much more important part of the specialty lines portfolio than it used to be, which does have a short tail element. And so, there will also be a feature potentially of reserve releases from the specialty lines division as we go forward of even more or less release from that product depending upon the outcome of a particular, yeah.

Q - John A. Borgars {BIO 15015364 <GO>}

John Borgars, Equity Development. Could you comment on your view of how much rate pressure will come from having three divisions out of six divisions with higher expense ratios and claims ratios? It looks as if the focus of making more – getting more out of it than the premium payers.

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

Sorry, John, the question was, are we going to feel the pressure of the combined ratio because of greater action.

Q - John A. Borgars {BIO 15015364 <GO>}

Can we expect to see more pressure put on premium rates in – obviously?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

Yeah. Sorry, hopefully, I'll answer. Yeah, we definitely expect on planning – our planning assumptions in 2017 is continued pressure on the short tail lines, less pressure than what we have seen in the past few years. So I don't know if it was the rate, or rate reduction will slow. We definitely see pressure from brokers who are under pressure to generate extra revenue, where they may want to charge more commission. So, we have two loss of pressure; one is the actual price comes down and the second is the brokerage goes up. And when proxy potentially hits the claims ratio and then that hits the expense ratio and I think we've done a pretty good job of being relatively robust on the pressure from extra brokerage. What will clients do as a company, which is ongoing is the – in lines of business where brokers and clients really want us and need us and if you're in those lines, there is less pressure from a commission point of view, then if you have just another (51:34). Nick (51:36)?

A - <Q >

Just a follow-up. It is again on the capital subjects. Obviously, we are in danger of levering the point, but in terms of the capital buffer, it's 42% of it was – is a way above the 15%, 25% guidance of target range. Could you just give us your thoughts around, how you mind us to change the target range or is there case that you expect the buffer to come down as you use some of that capital to fund growth or will turn to be an area which you think will be – where capital will come down more practically by returning it to shareholders?

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

I don't see any particular change in the range. Debt issuance, if we do excuse on that debt strategy, that sort of comes in lumps, so to speak. We will clearly have far more capital at the end of the year. And I must think of percentage within the 15% to 25% range. And so, I think I will need to find a new way of communicating the board's talks on the equity capital versus debt capital.

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

I think a challenge – its great point, because the challenge with the ranges and it is if we believe and our long-term plan believes we're going to get special lines of growth for a number of years rather than just one year. We can't just have that. We can't just live by one year at a time, when we got a three-year to four-year, five-year plan of growth. So we may – you may see us sitting above the range, because we believe we're going to grow for the next two years rather than come down the range and just hope nothing goes wrong. And we do deliver a reasonable term, which can fund the growth, because if we don't, we'll have problems growing. So you will have that issue of a short-term issue versus a medium-term plan that says growth opportunities are good.

Yeah. But just wondering how to square that with the comments and I think, I'm asked about a question about what you do with the profits. You're saying you may retain more to fund the growth, but then you've got the opportunity of reducing the buffer as well to fund growth and debt. Just wondering how those will stack up together.

A - Clive Andrew Washbourn {BIO 15471957 <GO>}

Yeah. There is an answer to it other than we look at both the short-term position at the end of the year and see what we actually need and what excess we got over (54:00) scenario and we look at the medium-term plan over what we think we're going to need over a three-year, four-year, five-year period. We also have the issue, which we've raised before that under the Solvency II, generally things are more volatile. And that's why, we increased the buffer in the first place.

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

Great.

It is good to see everybody. Thank you very much indeed for coming (54:21).

Yeah. Thank you.

FINAL

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