S1 2013 Earnings Call

Company Participants

- John Neal, CEO
- Neil Drabsch, CFO

Other Participants

- Andrew Cannon, Analyst
- Andrew Kearnan, Analyst
- Brett Le Mesurier, Analyst
- Daniel Toohey, Analyst
- James Coghill, Analyst
- Kieren Chidgey, Analyst
- Nigel Pittaway, Analyst
- Ross Curran, Analyst
- Siddharth Parameswaran, Analyst
- Toby Langley, Analyst

Presentation

Neil Drabsch {BIO 2093435 <GO>}

Good morning, everybody. This is QBE Insurance Group's 2013 full year results announcement. My name's Neil Drabsch, chief financial officer and you'll soon be presented by our chief executive officer, Mr John Neal.

So just a few housekeeping items. This is a webcast and we'd kindly ask that you turn your telephones and mobiles off. At question time we will be taking questions both from the floor and also online. When question time comes would you kindly raise your hand and wait for the microphone to be delivered so that those on the line can hear you and we will take questions obviously at the end of the presentation.

With that I'd like now to hand over to our CEO, Mr John Neal. Thanks very much John.

John Neal {BIO 15681439 <GO>}

Thanks Neil, morning everyone. I'll get straight into the 2013 results. I don't think there's a great deal in here to surprise the market in view of the update and the detailed update we provided on 9 December. So the majority of the numbers we're discussing are in line with what we communicated then and where there are some differences I'll explain them as we go through.

Cash profit is perhaps the one item I'll call out but let me cover that as I do with the results in a little bit more detail including a direct comparison to the 9 December result on the upcoming slides.

So net profit before amortisation and tax came in at $797 million which equates to a net loss after tax of $254 million, pretty much exactly in line with the numbers we communicated on 9 December. Cash profit $761 million and an insurance profit margin of 5.5%.

If I may I'd like to dwell just for 30 seconds on the underlying insurance business, where our current accident year central estimate combined operating ratio is in fact 92.5% which equates to an insurance profit margin of 10% to 11%. We've also carried out some more detailed analysis on the attritional claims ratio and when you get two minutes if you have a look at slide 26 you'll see that being called out. What we've done here is pulled out the crop attritional claims ratio which as you know is always very high at 67% and also the attritional claims ratio for our US lender-placed insurer which runs at a very low level and of course the income's fallen 40% on that book this year.

So those two accounts or portfolios have a distorting impact on the attritional claims ratio. So if you adjust for those to get a feel as to how the P&C book's running then our attritional claims ratio's at 48.2% and very importantly 1.6% better than it was in 2012.

Large individual risk and catastrophe claims coming in at 9.7% which is 0.8% inside our allowances. Just to give you a bit of breakdown there, catastrophe claims are pretty quiet in 2013 at only 2.2%. The crop catastrophe claims have come in at 2.3% and large individual risk claims make up the majority of that number at 5.2%. If you recall we had quite a frequency and severity of large individual risk losses in the first half of the year.

Our prior accident year central estimate's coming in at $621 million. We called that out at $650 million you will recall in December. So slightly better than we forecast, predominantly for two reasons and that is that Europe is flat in the second half of 2013 and Australia actually improved post-discounting from the figures we were talking about in December.

So on the capital position net tangible assets up 10%, PCA multiple up slightly at 1.59 times and our CET1 ratio sits at 114% or 1.9 times the required minimum.

In terms of dividends, the Board have decided on a final dividend of AUD$0.12 per share which is fully franked so that equates to a full year dividend of AUD$0.32 per share or in line with the Board's statement that they will be paying up to 50% of cash profits in dividends.

So I won't hang on this slide for too long in that there's probably easier detail on the next slide. Just the key ratios called out here are combined operating ratio of 97.8%, the amortisation and impairment charges pre-tax just shy of the $1.25 billion that we spoke about in December and cash profit again shown in there at $761 million. Probably easier to look at as a direct comparison to our 9 December guidance. I think the very complexity of our business points to improving control over our data and our metrics to be able to call as accurately as we did line by line on the numbers on 9 December.

So the $621 million prior accident year claims development again slightly better than was forecast. The two numbers probably to look at the combined ratio of 97.8% is at the slightly upper end of the 97% to 98% we indicated on 9 December and probably on reflection we should have similarly shown a range both the claims ratio and therefore the insurance margin as the three ratios obviously correlate. The reason the claims ratio is up at 64.5% rather than around 64% is predominantly due to a slightly worse than anticipated combined ratio for crop. That's come in at 102.8% being 3.8% higher than we indicated in December.

As you'll see in a moment, discount rates actually came in better than we predicted. But notwithstanding that improvement, we've elected separately to top up the risk margins beyond the levels that we discussed in December and in fact by a further $66 million.

The cash profit number at $761 million versus the $850 million is actually quite easily explained. On 9 December we said that we thought the one-time charges for our lender-placed insurer, QBFPS of $150 million pre-tax would be non-cash items. These were originally sunk costs that were held on the balance sheet that were intended to be written off as part and parcel of a restructure. In the final reckoning it simply proved easier to put these costs through the operating line and that's quite simply the difference between the forecast cash profit and the actual cash profit.

So if we turn to the underwriting performance, the drop in premium income all but exclusively originates in 2013 from North America and substantially as a result of the lender-placed insurer QBEFPS which is actually down by almost 40% in 2013 over 2012.

I'd like to call out the rate increases which at 4% for me at least are a very good indicator of our ability to continue to improve the attritional claims ratio through 2014.

On the underwriting result, the combined operating ratio's really at 97.8% due to a number of largest items which impact the combined ratio and we'll look at these in a moment as we run through the balance of the presentation.

Central estimate $621 million we've already discussed a couple of times. Net risk margin is strengthening, we've put into $266 million. We were suggesting $200 million in December so a further $66 million going in there and the operational transformation costs and FPS restructuring charges again are pretty much in line with what we previously forecast.

On the insurance profit line the numbers again at $841 million for insurance profit and insurance profit margin of 5.5%. Investment contributions come in at 3.3% which is a good result. It's very important to bear in mind when comparing that to 2012 that the absence of credit spread gains that we saw in 2012 is really driving the difference in the overall investment return. Those factors equate to an underlying insurance profit margin of 10.6% that we'll look at on this slide.

There's two ways I think to look at this slide; obviously there's a simple read left to right to explain what's going on, or alternatively I think you can break it up into some constituent parts and whilst they don't absolutely relate to each other, if you look at notes 2 and 3 for risk margins and risk-free rates, 1.7% and 1.8%, then clearly they broadly offset each other. The big movement of course is the prior year development and I think the point I'd like to make here is that the movement is substantially in IBNR. This is not in reported claims, this is where we've taken a decision to increase our carrying IBNR substantially on the claims central estimate so that's the 3.6% number you're looking at.

Then you've got a couple of one-off items on items 6 and 7 which is the operational transformation program costs and also the charges for QBFPS, those two 0.9% items. Then the fourth item I'd call out is crop where we've normalised or put back the combined operating ratio to 91% which is our budget for 2014.

Actually we've been doing quite a bit of back analysis on crop and for 13 out of the last 16 years crop has run at a combined operating ratio of 91% or better. In 2012 and 2013 we've seen the lag impact of the US drought which has produced losses in 2 out of three years over the last 16 and I think. But I'm sure someone will check up for me, it was 2002 when there was a prior US drought is the only other time in that 16 year period where you've seen a COR higher than 91%.

So for obvious reasons I just wanted to spend a little bit of time on the North American operations. Clearly a very disappointing result and a COR of 115.8% which is above the around 111% we were talking about in December.

Four aspects here to call out, one is crop. Crop's about $30 million higher than we were thinking with the increase in the combined operating ratio. We also took the opportunity going through the year end just to tidy up some aspects around the prior year, not related to program business.

o there's about $30 million that relates to those changes. We also decided to put another $20 million into risk margins specifically around that North American program business and we also took a little bit more caution on the call for the attritional claims ratios on the 2013 accident year. So those are really the four factors that drive the difference between 111% and 115.8%.

On the North American program reserves the reviews there have been certainly exhaustive. In addition to our external reporting actuaries going through those reserves our auditors similarly went through the reserves as well. So as I referred to earlier we took the decision to add to the risk margins. We spoke about adding $50 million specifically to the risk margins on that portfolio in December, in fact we added almost $70 million in the final reckoning and what we've also done is elected to buy a stop loss reinsurance.

The stop loss reinsurance will operate in excess of the claimed central estimate risk margins added together and just give us further protection against the North American program reserves in run off and the premium for that stop loss is modest. On the two specialty insurance businesses in North America, crop is at 102.8% largely driven by revenue claims in the big corn States of Minnesota and Iowa. The corn States tend to be and have been historically the producers of the highest profit margin. So it's a very unusual year to see those States perform as poorly as they did and that's really what's driven a combined operating ratio of 102.8%.

The drop in gross written premium on our lender placed insurer by 37% has been a major contributing factor and a combined operating ratio on that portfolio of 115%, a big turnaround from 80% 12 months ago. I think on a positive note in North America average rate increases are coming in at 4% or 5% if you take out the lender placed insurer. That's the third consecutive year of decent rate increases in North America and again when you've got two minutes have a look at slide 29 in the appendices which gives you far greater detail on the underlying performance in North America which actually comes in at 97% to 98%, therefore giving us real confidence that the business can return to profitability quickly and in 2014.

So moving forwards, the necessary activity to remediate and improve the portfolio is in train. There are significant cost out efforts both related to our Group wide operational transformation program and specific to North America that are already being played out and we're very confident in our ability to reset our North American business as the true US commercial specialty insurer and in addition to appointing Dave Duclos as the CEO of that business he in turn has recruited a very highly experienced North American team to support him in taking our North American business forwards over the next three years.

So I'll run through the divisional results quickly. Again there's much more detail on slides 30 to 35 in the appendices that will give you some background to each of the divisions. North America I've just discussed on a previous slide. In Latin America we've seen good top line growth up by 13% but a pretty challenging year for workers' compensation business in Argentina where claims inflation has obviously outstripped interest rates and has seen us put a further $59 million into the prior year central estimate on that portfolio.

In Europe rate increases were pretty modest, coming in at 1.5% up overall. A quiet cat year was really offset by the frequency and severity of those large individual risk losses which predominantly were in Europe but overall I think a solid performance at a combined operating ratio of 96.1%. They are actually taking the top line down by almost $600 million in 2014 as they look to pull improvement through to that combined operating ratio line.

Australia and New Zealand really absolutely sparkling results, a combined operating ratio of 87.4% and an insurance profit margin of just shy of 19%, I think holds well with any peer in the market place. Gross written premium in Australian dollars was up 4%, rates up 5.6%, attritional claims ratio improved, expenses down by over 2%. It's the first division where the operational transformation program has been completed and the expense line is benefiting quickly there.

In 2014 we're only forecasting modest rate increases on the portfolio but targeting top line growth of 6% to 7%. In Asia Pacific good organic growth coming in at 26%, very stable claims ratio on this portfolio and the continued good results with a superb combined ratio of 84% are encouraging us to maintain our investment in both people and technology to support a strong organic growth plan.

Equator Re at the end actually has an improved combined ratio over 2012. Actually the underlying is much more improved than that because of course there is a quota share in place between the North American division and Equator Re. So Equator if you like has inherited or absorbed $221 million of prior year from the North American business. So absent that the underlying combined ratio for Equator is doing exactly what we would hope it would do which I think puts us in a very positive frame of mind for 2014.

I'll just hand over to Neil on the capital position.

Neil Drabsch {BIO 2093435 <GO>}

Thanks, John. Just on the capital balance sheet showed during the year some strengthening. There's a little bit of confusion as usual with currency and I'll just take you through that in a moment. I think it's important that despite the reported loss which of course was impacted by the very large write off of intangibles that the underlying cash profit a number of initiatives that we had undertaken during 2013 such as the debt conversions, et cetera and also the strengthening of the outstanding claims provisions, particularly those relating to risk margins, have had a significant benefit to the overall balance sheet strength.

You'll note from the slide, particularly in the shareholders' funds there's just over $1 billion impact of foreign exchange and just to explain that as an AUD company we have significant investments in overseas countries and you will see in other comprehensive income there's a $371 million gain in that but because we report in US dollars at the reporting date it's been translated at the spot rate and the US dollar which was 14.4% up compared to the same time in December then converts all of the equity back into US dollars at that rate.

So you get this odd change of $1.4 billion one way and $300 million the other, resulting in on a reporting basis a reduction in US dollars.

The identifiable intangibles clearly have come down quite significantly, they're down at $579 million there at the moment and these represents those intangibles with a finite life and I would expect you would see that $579 million now amortise on an annual basis somewhere between $45 million and $50 million a year. That's down from $1240 million at the beginning of the year, partly due obviously to normal amortisation but obviously the significant adjustment that we put through relating to the US Balboa business particularly.

Goodwill also down reflecting the assessment of the carrying value of the US business, that was a $600 million charge in the period. Some part of that is tax affected and you will see in the tax line -- perhaps I'm happy to talk to some of the analysts after how the tax is constructed -- but it does have an impact on the overall adjustment. There is a slight tax adjustment for it. Importantly the central estimate of outstanding claims and the risk margins were significantly strengthened during the year.

The central estimate directly because of the upgrade of the IBNRs as John mentioned earlier for the North American business for some of the prior year, also our European business there was some prior year adjustments and Latin America and of course an explicit $266 million strengthening of risk margins which has taken the probability of adequacy over 90% and I think it's important to note that that's the first time over 90% since 2007.

The capital levels we meter using our Australian regulator, APRA, assessment of our total capital base there, prescribed capital requirements and you'll see it's gone up in metering it from 1.57 to 1.59 times. This is under the new LAGIC criteria that's applicable for 2013 and included in that there is significant change to the way that the regulator looks at constructing the minimum requirements and a company such as QBE which is quite complex due to its global spread and diversity means that we have to spend quite a bit of time with APRA but I can say that we're down to a number now that we think we can control and understand but it's a structure that is impacted by this diversity and our broad spread of risk around the globe.

The net tangible assets were up 10% or 24% in the constant currency and the rating agencies have affirmed during the year. But it should be pointed out some of those we still are on negative outlook and we believe that just some normalising of earnings this year we should see that outlook removed but we obviously need to put some results on the table.

The borrowing share in the year reflects an overall reduction and there was quite a bit of work in relation to the borrowings. There was some redemption and conversion of some of our hybrid securities which resulted in just under $500 million of equity issuance but also during the period we took advantage of taking up some subordinated convertible securities, particularly with APRA's approval. These securities now meet Basel III criteria for loss absorption and I think that was quite an important security to get in place to give flexibility for the future.

The debt equity ratio was above our benchmark. We nominated that we would try to get below 40% by this year, obviously the write off of the intangibles had an impact on the net tangible assets however by end of 2014 we believe we'll be below that. We've got some maturity coming through in 2014 and we should be well on track to meet that benchmark over time.

Investments was a great performance again in the year of probably less volatility, unlike the prior year where we saw very strong credit spread volatility which impacted the 2012 reported result. Just in context we had over $400 million unrealised gains on the fixed interest book at the end of 2012. 2013 was more stable. The book is well set and remains a very liquid and very high quality book. You'll see in the back of the appendices, I think slides 39 and 40, have a lot more detail on the detail of those securities that we're holding, particularly for the Government and also our corporate bonds which are very strong quality.

We're comfortable with the running yield of this remembering though that 60% of this portfolio is exposed to the very low interest rate environment prevailing for securities, particularly in the US, euro and in the sterling books and you'll see in the outlook that we're suggesting for 2014 that this portfolio should be able to maintain around 2.25%. With that, John I'll hand over to you now to finish off on the reinsurance. John Neal Thanks, Neil. Just three slides to the finish, including one slide on our 2014 reinsurance program. The diagrams are actually in slide 36 and slide 37 in the back and we've actually got Jim Fiore, our Group chief reinsurance officer in the room so anybody that's here who wants to ask further questions of him please don't hesitate to do so afterwards.

So our 2014 reinsurance program has been renewed on a multi-year basis. So 2/3 of the panel have a price for two years and 1/3 for one year. In real terms there's not actually been that much structural change in the reinsurance programs and the way in which they're constructed. Probably in December, partly through me I think, too much attention was placed on the increase in the retention on the cat treaty of $100 million. As you can see in the second box down on a risk adjusted basis our reinsurance costs actually reduced by $200 million. $106 million of that $200 million directly results from us electing to increase the retention by $100 million. So it's a dollar by dollar saving for increasing the retention.

More importantly, the protections, the aggregate protections we purchased around Equator Re are more exposed, obviously because of taking an increased retention and our Group aggregate catastrophe cover locks into the protections behind Equator and we reduced the attachment on that protection by $75 million. So that's why at the bottom of the slide we're saying that whilst there are structural changes there is no additional volatility in our decision to increase our account retention. And in fact in almost all scenarios there is a positive P&L impact.

I guess a different way to look at it, if you were going to use more betting language, is that the push on the aggregate covers is a lot closer to the money in 2014 than it was in 2013. The only other item I would add on reinsurance is really the bottom point where we've actually put in place an innovative cat bond for the first time in 2014. In fact, I think it was the first cat bond for P&C insurance in Australia. It's unusual in that the cat bond provides protection for US earthquake cover and Australian earthquake and cyclone cover. So it protects two territories and multi-peril. And that's in place for $250 million, pretty much at the same cost as conventional reinsurance.

So then just turning to the outlook for 2014, we're looking at a market that's stable. It's not a marketplace where price is hardening quickly globally but conditions are certainly stable. We're forecasting rate increases of 2.5% overall. Again, that's largely driven by rate increases here in Australia and in North America. We're not focused at all on premium or top line in 2014. We're continuing to insure that we improve the combined operating ratio and the insurance margin and it's for that reason you're seeing both gross written premium and net earned premium fall, 2014 over 2013.

We're continuing to hold allowances of 10.5% for large individual risk and catastrophe claims. And we continue to believe that the rate increases we've seen over the past 2 to three years will allow the underlying attritional claims ratio to improve again in 2014. So total commission and expense ratios should be broadly around 32% or slightly better. We will see benefits coming in, net benefits coming into the operational transformation program in 2014. So all of that, coupled with a net investment contribution of 3%, add up to a combined operating ratio of 93% and an insurance profit margin of 10% and the Board have decided that dividend policies shall be unchanged where we will continue to pay out up to 50% of cash profit in dividends.

So just in closing, clearly 2013 was a particularly tough year for our investors and a tough year for QBE. I think we've taken the right actions. We have put in place a very experienced leadership around the world. The actions on the liability side, both in the claims central estimate and indeed in the risk margins are very robust in terms of strengthening the claims position. We've not hesitated to shed the top line to ensure that we can get sustainable short and medium term profitability going forwards. Frankly, it would have been easy to have deferred our operational transformation program in a pretty tough year. But the early benefits of that program are remarkable and well worth the effort. So the program has continued through 2013 and through 2014.

The fundamentals in 2013 leading into 2014 really do encourage us. Our combined operating ratios as we said earlier for the 2013 accident year stands at 92.5%. As Neil said a moment ago, our probably of adequacy for claims reserving at 90.7% is the first time we've seen that figure jump through 90% since 2007. So premium rate increases, whilst quite nominal in 2014 will still counter claims inflation and our North American business will return to profit in 2014 and see further improvement through 2015 and 2016.

We continue to maintain a high focus on the balance sheet. We're looking to improve all of the key capital ratios through 2014 again, as we did in 2013 and indeed as we did in 2012. And we're targeting significantly lower gearing over the medium term. So the priority for us in 2014 is to stabilise earnings and to offer a predictable return to our shareholders. So I'll actually now hand over to questions. Thank you.

Questions And Answers

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. Kieren Chidgey, Deutsche Bank. Just a couple of question if I could, starting on the crop business. John, can you just go into a little bit more detail around the development between 9 December and what happened? Some suggest that your reporting lines within that crop business of the Group is still not as good as they can be given the harvest presumably (inaudible) October I thought you'd have much better (inaudible).

A - John Neal {BIO 15681439 <GO>}

I think in December, Kieren, if you recall, I think everyone was a little shocked when we suggested the combined operating ratio could be 99%. I think we were well ahead of the marketplace in calling out what we thought the result would be. The claims don't really come through in final form until the first week of February. That's just the way that book actually settles and develops. And with one notable exception.

You're now seeing combined ratios for crop coming in across the market between 102%, 103% and 122% at the low end. I think it's a function of the way in which the claims come through on the reinsurance arrangements that it just takes a little bit of time to consolidate. The one thing I would say that it's an incredibly short tail book. So from our point of view it's pretty definitive when we're stood up today talking about the result.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Just a follow-on question related to your adjustments on slide 7. So the underlying margin for that. You seem to be adjusting your large cat budget back to 10.5% of premium which presumably already has the crop adjustment within it and then separately you're adjusting for crop again. Is that not a double count?

A - John Neal {BIO 15681439 <GO>}

Yes. We had a quite a bit of debate on this in terms of whether there was a double count or not in reversing back the crop combined ratio to 91% and reversing up the large risk and cat allowance to 10.5%. I guess the challenge for me is we construct the business from the bottom up, not from the top down. So that's the way in which we actually build our business plans. Sitting down with Tony Jackson, I'm conscious of not having an A1 slide that looks at reversing out underlying margins and being criticised in the past for having too many moving parts on the underlying.

There are actually a lot of other benefits which we've simply not put in the slide. FPS clearly improves from its 115% COR in 2014. The operational transformation program actually has benefits that come through in 2014. There are benefits on the claims line that come through in 2014. We think the attritional claims ratio will improve still further. Plus the benefits of the changes in the reinsurance program.

So there are a lot of other factors in there which bottom up actually give us confidence around a call of a 93% COR or 10% margin. So I don't think it is a double count but I think there are enough other factors in there that would allow me to confidently predict a margin of 10% to 11%.

Q - Kieren Chidgey {BIO 7268946 <GO>}

That's 11% on a reported basis?

A - John Neal {BIO 15681439 <GO>}

On a reported basis, yes.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Finally, just on your reserve disclosure in the Annual Report, Note 21. It just shows that out of there there is a top-up because we did see I think it was about $130 million in the 2012 year, whereas I had expected most of the top-ups to be 2007 prior. Can you just talk about what's coming through (inaudible)? Thanks.

John Neal Do you want to deal with that, Neil?

A - Neil Drabsch {BIO 2093435 <GO>}

Yes. Sorry, Kieren. You're talking about this claims development total?

Q - Kieren Chidgey {BIO 7268946 <GO>}

Yes.

A - Neil Drabsch {BIO 2093435 <GO>}

Right. The various years reflect as you said the -- what you're looking at is the movement in the accident year, talking about 2010 and 2009 and 2008 we have got between those around about $380 million, $400 million and again, most of that will come from the US book. But there's also -- in the European book there's a medical malpractice book which tends back into that period also, the Latin American book. I can take you offline I think, I'm happy to take you through some of the break-up, that is probably the best way to do it.

Q - Kieren Chidgey {BIO 7268946 <GO>}

I'm just more interested in what was coming through for the 2012 accident year.

A - Neil Drabsch {BIO 2093435 <GO>}

2012, 139 -- I think some of that would be the Latin American book where they'd have to restate there between the discount and inflation that gets allocated in the current year rather than back in the prior years.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Andrew Kearnan, Merrill Lynch. Still on the insurance profit underlying margin analysis, can you just help us understand the prior accident year development $552 million number vis-Ã -vis the $621 million stated and the $69 million of adjustments for discount on certain long tail portfolios, just specifically what that is. Also, why use an undiscounted number in here instead of a discounted when you're trying to get back to a margin impact?

A - Neil Drabsch {BIO 2093435 <GO>}

Andrew, it's Neil. The adjustment we're talking about here is a -- $621 million is the nominated prior year adjustment. In relation to our long tail books in Australia, particularly the dust diseases, which is impacted by inflationary factors and also our Latin American business, which obviously has a very, very high inflation, the actuaries when they are determining the undiscounted central estimate movement. And particularly for those longer tail classes where there are inflationary factors, in order for it not to be misleading -- and I think that's the word we've used -- pick up an adjustment which is the impact of the unusual movement of inflation which is usually offset by a compensating discount. And between the two they adjust for it.

In the claims development table you'll see it at $621 million but when we do, Note 7(c) which is in the balance sheet, if you break up the $552 million it's the net of the two. So it's an adjustment. I'm sure Declan, our actuary is in here. And he'd be able to have a chat to you about it but that's what it is. It's literally an inflation and discount factor that would be misleading to show it. So it's shown separately.

A - John Neal {BIO 15681439 <GO>}

I think on the second question convention just dictates that you report the movement in the central estimate on an undiscounted basis. I agree it's not the impact on the P&L. But that's just the way the numbers are reported.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Thank you for the clarity on that. Second question relates to Europe and Argentina. Several of the market commentators have suggested that both markets could be problematic for QBE in the future. I'd love your perspective of why you're comfortable with Europe and there's not going to be another (black box) a la the US and same-same for Argentina.

A - John Neal {BIO 15681439 <GO>}

Yes. So I'll deal with Europe first I think. I might have said -- you might have heard me say in December I was a little bit surprised by some of the comments that were pushing around on Europe. We had one particular issue that in fact we called out at the half year last year in terms of reserve strengthening on our medical malpractice portfolios in Italy and Spain that are in run-off. But absent that I think if you go back over seven, eight, possibly even 10 years, half year on half year we've seen either positive movement from the prior years or stability coming out the prior years.

In fact, going through this year-end as I called out there, Europe was flat. So Europe certainly doesn't give me any concern in terms of the carrying value of the claims liabilities. Argentina on the other hand does bring a bit of complexity to it. You've got challenges with the currency. We're working with claims inflation of potentially up to 35% and interest rates up to 25%. So we do a lot of scenario planning and a lot of scenario analysis around that portfolio. And if you were to look at a scenario that saw, let's say the pay sale rate (8.5) to the dollar. If you did see claims inflation go up to 35% and interest rates at 25%, i.e. a gap, the impact on our claims on a discounted basis is around about $15 million.

So it's a number. But it's not a number that gives us huge cause for concern overall on either the Latin America portfolio or our overall book of reserves.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Just on that John, you talked about the use of a bulk IBNR in Argentina and your feeling that that was a conservative approach. And I think Declan went across and investigated.

Can you give us some colour on that, please?

A - John Neal {BIO 15681439 <GO>}

Yes, I think what we were doing was two different things. The IBNRs held on the actual claim, if you like, on the claimant's claim against us. And we were tearing bulk IBNR on potential litigation costs. What we've attempted to do is to allocate that bulk IBNR for litigation across the appropriate years of account. And that task is being completed.

But I think with Argentina it's unusual for most of us now to sort of look at any country that's operating with high inflation, high interest rates. So I think we just need to keep it under watch. As I say, whilst I think there could be an impact, I don't think from a P&L perspective that it's that significant.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Nigel Pittaway here from Citi. First question on the underlying margin and the guidance for next year. Obviously it's saying guidance of 10% to 11%. So that seems to be saying, start with the second half underlying margin of 9.1%, add on the benefits of the ATP and all the other things you mentioned rather than taking the 10.6% full year underlying margin as the base. Is that the same way to look at it or not?

Your underlying margin was 12.2% first half, 9.1% second half.

A - John Neal {BIO 15681439 <GO>}

Yes I think what I'd say, Nigel, is what I was saying earlier on. I think the reconciliation that you see on slide seven is fair. There are other factors that you could put in there on the underlying margin that we've simply not called out. But on a day-to-day basis, I practically look at it the other round. I've got the planned constructed bottom up in front of me which reconcile I think more immediately taking all factors into account, including full loads for large individual risk in cat claims of a 93% COR.

So I think the slide's fair; I think there are other factors you could take into account. But I'm comfortable with what we're calling out for 93% and 10%.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Full year more of a representative as a go forward position or second half?

A - John Neal {BIO 15681439 <GO>}

I think the full year is more representative.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Secondly, just picking you up on this US stop loss. I mean obviously, you were sort of I think at the half year pretty negative about the whole idea of taking on stop losses in the US. Now you've obviously taken one. So why the change in attitude?

A - John Neal {BIO 15681439 <GO>}

I think it's -- I think two factors, really. I think I was pleasantly surprised that we were able to place the stop loss just in excess of risk margins and central estimate. So it's truly protecting the position as we see it from a liability perspective. And the cost is modest. It's not a high cost at all. So on that basis, I think coupled with the sentiment in the marketplace particularly with investors who have got some concern over those carrying reserves, I think it just eliminates some of the noise around that portfolio, perhaps once and for all.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Maybe just finally, can you just update us on where you're thinking is with the mid-market business in the US at the moment? That's obviously subject to some conjecture over the last few months.

A - John Neal {BIO 15681439 <GO>}

Yes. It's a fair question. I think if you look at our construct as a commercial specialty insurer, you'd challenge where the mid-market is in the commercial specialty space. At the moment we're still debating that ourselves. But it's really driven around scale. If we think we can grow that business and grow it at an appropriate margin, then we would be happy to do so. If not, then we will deem it as being non-core and consider whether that business should be disposed.

I've got no concerns either way. I think it's an attractive business in the US market. US P&C business is pretty flat. So there aren't many books of business of around about that size of $900 million, running with a claims ratio of sort of 61%, 62%. So it's an attractive business per se. If we don't think it's scalable, then I think it'll be attractive to other people. So we're keeping our options open on that. But it's under the microscope through the first half.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thank you.

Q - Daniel Toohey {BIO 16751863 <GO>}

Thanks, Daniel Toohey from Morgan Stanley. Just a couple of questions. Firstly just coming back to the European business. Margins look pretty weak at 5.3%. There was benefit from $111 million favourable discount rate adjustment, sort of back at sort of 2.2%, unwinding that. You say the cats came in lighter than expected, larger claims higher than expected. Where should we be thinking where the current underlying is on that business.

A - John Neal {BIO 15681439 <GO>}

Actually, it's probably worth if you go slide 29 if you've got the book in front of you, which I think is a good slide in itself. What we've tried to do there is look at the changes by division to give you probably a better line of sight around what you should be anticipating for 2014. So in Europe you can see the discounted risk margin comment that you've just been making. So $111 million of discount benefit but $140 million put into the risk margins.

So what we've done at the same time is equally unwind some of the operational transformation costs and try and normalise large risk and cat. So in Europe the cost of large individual risk claims was above what we would expect, clearly the cat experience slightly better. There was cat activity, particularly that we saw in Europe. You might remember there were the floods and hailstorms in Germany come through. And some other modest cat events. So it wasn't without cat activity. So we feel that slide accurately reflects what we think the underlying margin is in Europe of just under 94%. In a marketplace where they will struggle to get meaningful rate increase I think that's a fair call as to where that business will sit in 12 months' time.

Q - Daniel Toohey {BIO 16751863 <GO>}

Yes okay. So a better chance of the risk margins going into that business?

A - John Neal {BIO 15681439 <GO>}

Yes.

Q - Daniel Toohey {BIO 16751863 <GO>}

On the reinsurance and just the relationship to your cat budget, you say that the (inaudible) tension is overall unchanged. It's a favourable reinsurance expense outcome. But the cat budget, net of the higher cat risk volume that you get on the QBE on its first remains unchanged at 10.5%. So just wondering how we should think about that, or be conservative in that number?

A - John Neal {BIO 15681439 <GO>}

Yes, I work on the principle that the allowances for both cats and large individual risk losses should really take account of the majority of the years we encounter. You might get a -- one year in seven, one year in eight, that could go outside of that. So if you get a slightly better than normal year then I'd expect it to come inside the allowances.

So they still feel appropriate to me and I think that's evidenced by 2013, where you had a low frequency of cats, a high frequency of crop cat and a high cost of emerging large individual risk claims. And it's still coming in slightly inside the allowance. So it would take another 2 or three years in my mind of seeing benign cat activity to bring those allowances down.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. Just finally, the softer outlook on the NEP. Previously you'd guided to a view that the NEP in 2014 being higher than the actual in 2013. In light of -- just trying to get my head around the cessation ratio and the reinsurance as well. What's driving that? I think now you're saying that at best it could be (15.2) --

A - John Neal {BIO 15681439 <GO>}

Yes, I --

Q - Daniel Toohey {BIO 16751863 <GO>}

-- that's driving that softer outlook.

A - John Neal {BIO 15681439 <GO>}

It was driving the outlook. Really it's taking a slightly more robust position on the European business. So yes we've actively withdrawn from two or three lines of business. And we are in the process of selling our central and eastern European businesses. So the guys have taken a pretty robust position, stronger than we forecast I think a few months back, in terms of pulling out of lines they just don't think are sustainable in the medium term.

Q - Daniel Toohey {BIO 16751863 <GO>}

The cessation ration on the roll-call? Is that an improvement, or flat, or? The reinsurance cessation ratio, is that an improvement on the -- or should we think of that as an improvement or --

A - John Neal {BIO 15681439 <GO>}

It should be the same or slightly better.

Q - Brett Le Mesurier {BIO 5909278 <GO>}

Thanks. Brett Le Mesurier from BBY. You mentioned that the -- there were one-off costs for the FDS restructuring legal and other costs of $134 million. How much for the legal and other costs of that? What do they relate to and why are you so confident that they are one-off, any of those in the 2014 year?

A - John Neal {BIO 15681439 <GO>}

The -- two factors Brett. My memory is failing me. I think it was in April last year that we had the issues with the New York department, which resulted in some fines and some legal costs associated with that business. So that was a very individual set of circumstances. And those costs are in there as well, which are about $20 million. We're also holding about $30 million against further litigation. Not regulatory. But further litigation from claimants across a range of six to eight different scenarios that we're picking.

So overall costs and provisions are around about $50 million. There is some protection around that cover as well. So it's a combination of reasons. One I think we're being sensible in the provisions we're holding. And two there is some protection in place as well.

Q - Ross Curran {BIO 17605313 <GO>}

Hi, it's Ross Curran from CBA. Just the Australian LMI business did do particularly well last year and it got really good rate rises through. It seems to be a very strong market for the Australian LMI business. Maybe if you could just talk about your thoughts there?

A - John Neal {BIO 15681439 <GO>}

Yes it's running very well for us. I think the challenge with the LMI business is that the capital charges that it attracts are pretty onerous. So whilst we can achieve some growth, did through last year, good rate increases, about 9% coming through, we think we can still grow that business this year. We have put some reinsurance -- some proportional reinsurance in place, which is really just to defer any increase in capital charge on it. So we're very happy with it as a business. It's just simply watching the capital costs that are associated with it. But it's performing well.

Q - Ross Curran {BIO 17605313 <GO>}

Those rate rises, that's a one-off (re-basing) in your fees or do you think there's further rate rises this year?

A - John Neal {BIO 15681439 <GO>}

It's 2 consecutive years that we've seen rate rises of that sort of magnitude. I'll get some rate rise this year but not at the same level.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Hi John, Siddharth Parameswaran from JP Morgan. A couple of questions if I can. One just on the inflation environment as you see it. And just your thoughts on how your actuaries might be setting assumptions in relation to those. So are we seeing any inflation, assuming further inflation going forward in your assumption? Bear in mind that we don't seem to be seeing any significant releases in a pretty benign environment.

A - John Neal {BIO 15681439 <GO>}

Yes we thought -- you know since the questions that we were having earlier on in Argentina, than elsewhere in the world, here in the Australia, in the US and in the UK, we're not seeing any signs of superimposed claims inflation. So our liability books will most uniformly a model to anticipate underlying claims of inflation of 3% to 4%. You tend to see some one-off instances of activity so for example there's been an increased frequency of deafness claims in the UK as they've changed some of the court actions and legislation around that particular class of loss. But other than specific understandable and manageable situations we're not seeing any evidence of superimposed claims inflation nor are we assuming it.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

A question on gearing if I can. Just do you have a target of reducing gearing below 40% by the end of this year? Beyond that what's your medium term target? Is that it?

A - Neil Drabsch {BIO 2093435 <GO>}

Sid if you have a look at the maturity profile of the debt you'll see as the security is maturity this year and as they roll in 2015 and 2016 so we see those settled in the ordinary course with a net asset basically just growing we should head towards around 35% or lower and that can happen in the medium term.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Thanks.

A - Neil Drabsch {BIO 2093435 <GO>}

We have a call from James Coghill. We're happy to take that call.

Operator

Thank you. Our question comes from the line of James Coghill from UBS. Please go ahead.

Q - James Coghill {BIO 14006200 <GO>}

Morning. Just a quick question on the program business and the claims there John so I appreciate that this might be somewhat academic given the stop loss but perhaps you could just give us a little bit more detail on how that actually works and whether it applies to the total business there?

Now you've been happy to actually provide quite a bit of detail on the underlying claims reserves. I'm referring to the $1.8 billion of which $1 billion was (IPNR). Perhaps you can just give us an update on that and explain exactly how that stop loss relates to the reserves?

A - John Neal {BIO 15681439 <GO>}

It might take a little while James. I'll give you the best explanation I can briefly but it might be worth having a further conversation later on. What it does is it's looking at the programs that we deem to be truly in runoff. So it's not the go forward business so the $1.8 billion includes the current business which is running pretty well actually. It's running at just inside of 94% COR.

So it doesn't include the go forward business. It's specifically the business that we've put in runoff. So the way in which the stop loss works is it will apply in excess of the reported claims -- the claims central estimate for the programs in runoff and then we recognise that we're carrying risk margin. So we're happy to consider the risk margins as part of the claims reserve and then it responds in excess of that figure.

So where we've obviously got programs that are continuing, then it's not designed to offer any protection against those programs nor should it really because we're quite relaxed in that business and that portfolio.

Q - James Coghill {BIO 14006200 <GO>}

Okay thanks I might take that offline and get a bit more detail. Just another question on growth. Just looking again in the report there is a big glossy spread on your Asia Pacific growth strategy and that's obviously still a small part of the business overall and you're guidance is only suggesting on 12% growth there. So I was hoping you could just comment on the outlook for growth because it's growth not only in Asia Pacific but across the Group because that opportunity in Asia is still relatively small.

A - John Neal {BIO 15681439 <GO>}

That's a fair challenge. I mean the growth plans in Asia actually see the business doubling in size organically over a 5 year period. So the numbers that I was talking about today of growth of 20% to 25% are exactly what that business is doing. Our plans going out through 2015 and 2016 show some growth so top line forecast currently is about $500 million to $600 million of growth 12 months out and about $1 billion 12 months out beyond that. That's organic so we're not assuming acquisitions in those assumptions.

What we do believe is that we can grow our domestic business here in Australia. It just wasn't appropriate to push the growth in Australia over the past 12, perhaps even 24 months when we've been putting the operational changes in place -- lot of change in the business, lot of disruption. All of that activity is complete now so I think the Australian team feel ready and enthusiastic and able to grow which is why I'm talking about 6% to 7% here and I think that could be repeated well over a 2-3 year period.

We've got a sense going out probably 12 to 24 months that we will see positive change in the London and international markets which will allow that business to grow as well. So growth for us organically comes in three different ways. One is rate increase. Two is retention which is probably the biggest change. If you get improving market conditions and you can nudge your retentions up 3% that alone is $500 million and the third is actually at the right point in the market cycle just pushing for organic growth. So those numbers don't assume any acquisitive growth at all.

Q - James Coghill {BIO 14006200 <GO>}

Okay thank you.

Q - Toby Langley {BIO 15924432 <GO>}

Hi it's Toby Langley from Nomura. I've got a couple of questions on profitability of the US business. At the time of the December profits warning you said you were confident that the US business would profit in 2014 but the guidance appears to have been slightly softened with an expectation of improvement through 2016. Do you still stand by that statement from December? Should we be modelling profitability this year?

A - John Neal {BIO 15681439 <GO>}

Absolutely yes. The North American business will return to profit in 2014. I think what I'm sort of flagging gently is that for the business to return to the levels of profitability that we're looking for universally across QBE's business that might take another 12 months through to 2015 but no we're forecasting a return to profit this year.

Q - Toby Langley {BIO 15924432 <GO>}

(Nomura, Analyst) Looking a bit further into the future in the back of the account you finally provided your longer and combined ratio that underpinned your goodwill testing. Should we be looking at that as the long run COR for the entire US business or does that only relate to the individual unit level which (inaudible) and if that's the case can you just remind us which they are.

A - Neil Drabsch {BIO 2093435 <GO>}

Toby, I'll respond to that one. When we do our assessment for impairment and take -- looking out in the future for cash flow, we do take into account the variability and volatility and then in that process usually add a factor in as a buffer. So I think using it as a guide would you give you a conservative view of the likelihood of that business to run forward but the actual modelling process is extremely conservative so we don't take into account -- for example the work that we're doing on the transformational program in Australia and which has now emerged into the US, the majority of that's not taken into account in our forward projections.

Q - Toby Langley {BIO 15924432 <GO>}

Did you compare that -- is that kind of blended across the US business?

A - Neil Drabsch {BIO 2093435 <GO>}

You're talking about the US business?

Q - Toby Langley {BIO 15924432 <GO>}

Yes. In the modelling of the carry --

A - Neil Drabsch {BIO 2093435 <GO>}

In the US business we don't take into. And you have to -- under the standards we are quite restricted in what we can take into account going forward. So for example, those costs, a large part of them, or the cost savings in the transformational program is not taken into account in our assessment of impairment.

Q - Toby Langley {BIO 15924432 <GO>}

Thank you.

Q - Andrew Cannon {BIO 16402861 <GO>}

It's Andrew Cannon of Merrill's, apologies. Two quick further questions. Just on the lenders (placed site), assurance in its Fourth Quarter result indicated that they've lost a major contract or would do in the First Quarter of 2014. Is QBE the beneficiary of that?

A - John Neal {BIO 15681439 <GO>}

Not to my knowledge.

Q - Andrew Cannon {BIO 16402861 <GO>}

Thank you for the clarity. Secondly, it's an unusual request/question but I see Mr Burns sitting across the room on the other side of the room there and it would just be fantastic to get some colour from Steven, if it's appropriate, as to his ongoing involvement in Group and whatever colour he might be willing to give around his decisions to step down.

A - John Neal {BIO 15681439 <GO>}

I'm not sure it is, Andrew. I mean, we've actually got him to put a suit and tie on today. So that's probably enough to ask him for on one day.

Q - Andrew Cannon {BIO 16402861 <GO>}

No problem, thanks anyway.

A - Neil Drabsch {BIO 2093435 <GO>}

If there are no other further questions, we don't have any online, I'd just like to thank everybody for their attendance today. Any further questions, I'd please ask you to direct those through Tony Jackson, our head of IR. And also we're happy to take any calls direct. Thank you very much.