S1 2018 Earnings Call

Company Participants

- Inder Singh, Group CFO
- Patrick Regan, Group CEO

Other Participants

- Daniel Toohey, Analyst
- Kieren Chidgey, Analyst
- Nigel Pittaway, Analyst
- Ross Curran, Analyst
- Unidentified Participant

Presentation

Patrick Regan {BIO 15131018 <GO>}

Good morning, everybody, and welcome to our 2018 First Half Results Presentation. I'm pleased to have with me today our Group CFO, Inder Singh. And Inder is going to talk you through the financial results in a bit more detail in a moment.

In February this year we outlined our strategic agenda to deliver a stronger and simpler QBE and we've moved quickly to execute against those seven priorities. The actions we've taken in the first half, including exiting some loss-making businesses, mobilization of our Brilliant Basics program and the implementation of the Cell Review process have I think contributed directly to our financial results.

However, there is still much room to drive further performance improvements and to build QBE for the future. Let me give you a few of my kind of real big picture highlights. We have made significant progress in simplifying the business this year, exit a number of countries and the number of portfolios in the first half, the historically combined and contributed both volatility and last year 200 million in underwriting losses for our 2017 results. We are now a more focused organization on the markets and on the products where we can have scale and can deliver an acceptable return to our shareholders.

The Cell Review process is now fully established across the Group. To date, I've personally conducted three full rounds in Cell reviews, more actually in some places, including over 300 individual Cell Review meetings in person and in country. We're also really pleased with how the organization is mobilized around the Brilliant Basics agenda. We've completed detailed round of assessments of underwriting, of pricing, of claims, and we're addressing some short-term gaps but also we're implementing brand new global standards and a number of genuinely leading best practices across the Group.

As per the results itself, I'm pleased to report a combined operating ratio of 95.8% for the half, in line with our guidance. Importantly, I think the quality of results has improved with a little bit less reliance on prior reserve releases and an improvement in our attritional loss ratio of about 120 basis points measured against the full-year 2017.

Certainly one feature I'm pleased with is the rate increases. Obviously, we had a period of -- extended period of declining rates globally, and we've now achieved positive rate increases across each of our major divisions. When we joined it was pretty hard for our Cell Review process, and it's not a coincidence that the average we've accrued -- achieved across the Group of nearly 5% is higher than virtually all of our global competitors while also improving our retention level. And the strengthening of the balance sheet during the half has also been important. The balance sheet improved pretty materially over the first half, with the PCA multiple increasing 100 basis points to 1.74 times, due in part to the lower risk charges from that portfolio work that we've been undertaking.

Just a little bit from me on the results itself; the combined ratio of 95.8% reflects a strong result in the Australia/New Zealand business, which has again seen an improvement in our attritional loss ratio. Our European results -- with an improved current accident year combined ratio, less reliance on prior year and an improving performance in both North America and in Asia.

And on attritional loss ratio, it was really pleasing to see improvements in all four of our divisions in the first half of 2018 when measured against the first full-year 2017 and the continuation of our improving trend in ANZO[ph]. Acquisition cost is slightly down on the half, as we managed costs as well as investing in things like Brilliant Basics, and the headline number of 31% also benefited from the disposal of Latin America. Legal [ph] contributed to return on equity of 8.9% for the half-year, we're already in line with the previous half-year, notwithstanding a lower, more subdued interest rate and investment environment.

While our focus is been very much still is very much delivering much on bottom line improvement, it's worth looking at the topline in just a tiny bit more detail. The reason I say that is a few people have perhaps understandably wondered whether we'll suffer from a shrinking premium base if we implement underwriting review, Cell Review, Brilliant Basics, all of that.

But as well as re-improvising on profitable business, which we are, we're very focused on really targeting retaining our more profitable business at the same time. And I'm going to show you our retention levels in a moment, but as you can see there, if you adjust for the impact of obviously foreign exchange and the New South Wales CTP reforms, we reported underlying growth of 2% across the Group. Even notwithstanding the work we're doing in Asia, we're 3% across our big provisions, indeed all of them reporting 3% growth. That's obviously primarily driven by rate increases but also strong retention and some targeted -- very targeted new business lines.

Just on rate itself, this is I think my favorite slide, we've achieved average rate increases across each of the three major divisions, coming in at 4.6% overall for the Group. This isn't just something that happened by accident though. Our detailed portfolio analysis is designed really to target the right increase in the right segments, sub-segments and sub sub-segments and indeed down the quality level to drive overall strong rate increases, increase our rate adequacy and also keep strong retention levels.

North America, as you can see, we achieved rate of just over 3%. Accident & Health is particularly strong at around 10%, great growth. Homebuilders spoke about 8% and property rates generally were more supported in the cat affected areas. In Europe, we saw overall rate increases across five. Again, cat impacted classes have seen positive rate, international properties plus 12, QBE REIT property plus 7, but also elsewhere UK Motor plus 10, international liability plus 5 were also encouraging.

At Australia/Zealand we show rate increases of nearly 7% and you can see we are now getting rate on previous year's rate. Increases were particularly strong in commercial property up 18%, commercial motor plus 8%, workers' comp plus 9%. And we're using increasingly sophisticated pricing tools to allow us to target rate and risk selection in the right areas to meaningfully increase our rate adequacy, which I'm going to come back to in a moment.

Even in Asia where market conditions remain very tough, the early benefits for our remediation program are becoming evident with more selective underwriting, exits from certain unprofitable lines of business, reducing retention of design but also starting to drive better growth in our rates there. I think all of that's good, but equally encouraging has been our retention levels at the same time, and actually across the whole Group we were up about a 100 basis points on retention versus first half last year. In Australia/New Zealand, retention actually increased by 1.5%, in Europe also by 1.5% and we were stable in North America.

On now simplification, over the half we've executed a number of initiatives to simplify the Group. These transactions have been undertaken where a business or a portfolio adds unwarranted volatility to Group results or where we don't have sufficient scale to deliver an acceptable return.

As I mentioned, the business group executed -- exited (inaudible) contributed an underwriting loss of $200 million to our 2017 full-year results. Following an agreement to our Latin America, the division is now reported as a discontinued op. The sale of Argentina and Brazil were closed and completed on the 2nd of July for a pre-tax gain of the $125 million and the sales of Ecuador, Colombia and Mexico should complete in the second half. Look, I think it's fair to say our decision to exit the region and the deal we got has probably been reinforced by things like the Argentinian economy where exchange rates have depreciated 40% over the half year, interest rates are now more than 40% and the division reported a combined ratio for the first half of 113%.

In Asia, we executed a loss portfolio transfer for the Hong Kong construction workers' comp portfolio and we disposed of Thailand. We are also exiting North American Personal Lines and today announced a renewal rights deal on the independent agents' portfolio to Liberty Mutual. We also undertook a range of much smaller activities across the Group that also will help volatility in results. So this includes things like reducing our cat exposure (inaudible) Fiji. And in Fiji, aggregate exposure should come down by about 50%; improving property risk hazard profiles, I'll show you that in a moment; exiting sort of challenged lines business, say for example Indonesian marine hull; and also closely managing our exposures to things like crop prices via hedging soybean prices, which we did earlier in the year pre-trade wars As part of simplification and derisking, we've also found some opportunities for focus growth while very much still focusing on margin over volume. In North America, that included Accident & Health; in Europe Natural Resources; and in Australia in Commercial Packages and in CTP.

I thought I'd give you a little bit of -- a couple of insights on Cell Review. So as I mentioned earlier, the Cell Review process is now fully established across the Group. Worth noting in addition to what we do with Group Cell Reviews the divisions do their own Cell Reviews at a more detailed level and a more frequent level. And the Cell Review process is achieving its objectives of allowing us to manage the business at a detailed portfolio level, making frequent small corrective actions as they're needed.

As well as the driver -- it's also been a driver of cultural change in the organization, improving discipline, transparency and accountability. I'll give you a little bit of flavor of some of the things we did up to Cell Reviews. And just a reminder, when I joined as the CEO of the Australia/New Zealand division in the latter half of 2016, we put a number of things in place. A very early version of Brilliant Basics which I would candidly say is the much-improved (inaudible) since then and a full version of the Brilliant -- of Cell Reviews.

We also put in place a brand new Chief Underwriting Officer and team product committees to improve governance and oversight of underwriting and risk selection. One example of that we've shown up there, that's our property book in Australia/New Zealand at the time. The dark color at the bottom there, the Hazard Index 10, and you can see from being a fairly big chunk coming into 2016 it's almost negligible in the first half of 2018. That's things like exiting certain segments, mining risks, pubs and clubs, some of the higher risk agricultural risk there, and that all contributed to a reduction in our average hazard index profile and that itself has contributed a much better large loss record coming into 2018.

The headline benefits of all of that have also been material, and so the attritional loss ratio ex LMI has improved 6% from the first half 2016 of 65% to 59% in this half. We estimate some of the numbers are contributing to that, so over that period of time we think claims inflation has negatively impacted that loss ratio by about 3%, earned rate positively by about 4% and the other 500 or so basis points is the other Brilliant Basics initiatives, underwriting risk selection, pricing and claims broadly evenly, I would say. Some of the portfolio to be the main beneficiaries include the CTP, workers' comp, property and commercial packages.

I think (inaudible) are sort of interesting, so often where you get the main benefit here isn't writing more really good stuff, it's writing less and making less underwriting loss on your less good stuff. So you can see here -- so on the right -- very long hand side there, that's our actual Australia/New Zealand reported combined ratio for the half at 92.3% including positive prior year. As you know, obviously we've had a record at positive prior year for a long time in Australia/New Zealand. But if you strip that out and just look at the accident year results, which are on the slightly left of that, 2016, 2017 and 2018, and when we started roughly 50% of the sales had a demand ratio more than 97% and contributed an aggregate underwriting loss of about $150 million. Since then, a lot of our focus and Cell Reviews have been improving that and that number, both in the number of Cells and the underwriting loss has halved over that period of time and really driven roughly 5 points of current accident year improvement in ANZO ex LMI. Good news is there's still more to go out there and still other classes of business to improve.

Or another similar kind of lends, so it gives you a very high level even some of the rate adequacy what we look at, and obviously we'll look at this in a little more detail. Chart on the left shows you premium rate adequacy for different portfolios on the bottom axis and the rate increases we're achieving on the other axis. And obviously, as part of the Cell Review process, we've set each of our portfolios on this basis and obviously to a (inaudible) level of detail and focus on actions to bring all Cells towards a 100% rate adequacy.

A couple of things, it's fair to say, number one, this chart looks very different from what it did a couple of years ago, much more clustered around 100%. (inaudible) before, everything has gone a much further left. Second thing, any portfolio -- and actually we want -- you want to kind of align those from bottom right up to top left. So any portfolio that is rate adequate is attracting a lot of rate increase as well as lots of attention (inaudible).

There's still more that we can do there. So notwithstanding all the improvements we've made and all the techniques we're using, there's still portfolios we think that we can get better and indeed will get better as we earn through some of that rate increases. Right-hand side then shows you some of the opportunity around the rest of the Group. We've highlighted Asia separately, but actually, right across the Group we've got in the darker blue cover there -- color there quite a bit of opportunity going forward.

Just on Asia, after a lot of work from Jason Brown and his new team that he's constructed there, our profit improvement plan in Asia is getting some good traction. We've taken significant action to address unprofitable business. And as you can see here, we've re-underwritten a number of portfolios there. By design, our 2018 profit improvement plans have decreased GWP by 26% in total, particularly in things like marine down 38% and our remaining workers' comp business down 39%. This has resulted in an improving price adequacy, reduced cat exposure, lower, as you can see, property hazard index on property portfolios and a gradually improving momentum in rate in what remains a very competitive market though.

Notwithstanding these underwriting improvements, reported half-year combined was impacted by 5 points to prior year, due to a late reported shorter claims [ph] in 2017 due to frankly some shortcomings in our claims processes. Fair to say this was disappointing, but we have made changes in those claims processes to ensure this trend won't repeat. More pleasingly on an accident year basis, the performance in Asia improved from 110 full-year 2017 to 103 at the half year.

I'm confident we're taking the right steps to put Asia back on a better footing. I expect the continuation of a disciplined approach to pricing, risk selection will drive further improvements in attritional loss ratio, but it's also probably fair to say a smaller premium pool coming forward means we need to also focus on reducing expenses in that region.

Coverage, quick words on Brilliant Basics, I've said previously Brilliant Basics will be the hallmark of QBE and we must be sure we've got a consistent level of excellence in underwriting and pricing and claims everywhere we do business, in every country, in every portfolio. So with this objective in mind, the Brilliant Basics program has been mobilized across QBE. (inaudible) we've done this initially with an internal team led by Richard Pryce, who many of you know is our European CEO but also a very experienced underwriting himself and that's really enabled us to get much faster traction than I think we otherwise would have done.

We've -- over the first eight months, we've done a comprehensive review of our underwriting standards and rolled out our brand new stated global standards defining the way we underwrite across the Group. We've established fully-staffed now, Chief Underwriting Offices in each of the divisions which we not previously had at QBE. This directly drives consistency and accountability of our underwriting performance. We've done pricing assessments for -- in each of our divisions, identifying specific areas where we need to invest more and improve our pricing tools using machine learning better, data analytics better.

(inaudible) we've developed a global approach to pricing, so commercial property is a good example of that. And we've recently hired a new Global Head of Pricing; he's going to join us in September. And we've also implemented (inaudible) global -- new global claims standards, as well as saving money there also improving our customer service. Second half of the year we will be investing in more Brilliant Basics and happy to do so, whether it be in data analytics, more pricing staff or indeed investments in technology.

Last thing then from me, one of my really big goals has been to reverse some of the trends over the last few years where the Group experienced an increasing attritional loss ratio. All of our Brilliant Basics work, all of our Cell Review work is very much targeted to achieve this. So a new start, (inaudible) period, but I'm pleased with the results for the first half.

When measured against full-year 2017, overall the Group attritional loss ratio, ex Crop and LMI, improved by 120 basis points and reasonably meaningfully in every division. Obviously, we've been at this a little bit longer in Australia/New Zealand and that 600-basis point improvement the first half of 2016 has again been a result of Brilliant Basics, Cell Reviews, et cetera. We're now well into that Cell Review process in North America and Europe and Asia-Pacific and it's encouraging at least to see an attritional improvement in all those divisions from full-year 2017.

With that, I will hand over to Inder to cover the results in a little bit more detail.

Inder Singh {BIO 20594382 <GO>}

Thank you, Pat. Good morning, all. I'm very pleased to present our first-half results, which is starting to show some of the early benefits of the execution of our strategic agenda. I'm particularly encouraged by the improvement in both the quality of our earnings and the strength of our balance sheet. I'll focus my presentation this morning on four key areas. I'll start with the overall Group P&L, I'll then look at the performance of each of our divisions, then our investment performance and then I'll wrap with a review of our key balance sheet metrics and the progress we're making on our capital management actions in the first half.

Turning first to the overall results slide, the numbers presented on the left-hand side here are for our continuing operations and exclude the results of our Latin American business. The finances also exclude the impact of the transaction to reinsure our Hong Kong construction workers' comp book as well as the Ogden rate decision in the UK in 2017.

Starting at the top there, gross written premium increased 4% from 7.6 billion to 7.9 billion on a constant currency basis. And adjusting for the impact of scheme reform in New South Wales' CTP, our underlying premium growth was 2%. All three of our major divisions reported topline growth, underpinned by premium rate increases and improving retention. We are maintaining strong discipline around pricing, underwriting, risk selection and we're prioritizing margin over growth to ensure that we achieve acceptable returns across all segments of our business.

The combined operating ratio of 95.8 was 1.3 points higher than in the first half of 2017, but the quality of our result improved, with the attritional loss ratio reducing behalf of points to 51.3 and the contribution from prior-year reserve releases decreasing from 112 million or 1.9% in the prior period to 40 million or 0.7 of a percent in the first half of 2018.

Our investment return for the half was 2.1% on an annualized basis. This is below our plan due to the impact of higher bond yields on our fixed income book, albeit most of this impact was offset by a corresponding benefit in the underwriting results from higher risk free rates used to discount outstanding claims liabilities. As you can see on the right-hand side, our profit after tax increased 4% from 345 million to 358 million. This included a one-off benefit from the recognition of deferred tax assets following our restructuring of the Equator Re in response to US tax reforms.

Our improved earnings profile and strengthened balance sheet has allowed us to declare a dividend of AUD0.22 per share for the first half. In addition, we bought back AUD100 million of shares during the period, taking our total return to shareholders to almost 400 million in the first half. This is up 31% relative to the prior period.

Turning now to divisional performance in more detail, I'll start with our home market of Australia and New Zealand. Gross written premium for the half-year was 2.04 billion. On a constant currency basis and excluding CTP, this represents growth of 3% over the same time last year, and this growth was underpinned by rate increases of 6.6% and a retention ratio of 84%.

The combined operating ratio of 92.3 is in line with the first half of 2017, but as you can see on the right-hand side, the mix of our earnings is better. The current accident year combined ratio improved by 1.1 points and the contribution from prior-year reserve releases reduced by an equivalent amount. Pleasingly, our attritional loss ratio has improved by 2 points from 61% in the first half of 2017 to 59% in the current period. As Pat mentioned, the total improvement since the first half of 2016 is an impressive 6 points.

We continue to see improving current year profitability in almost all key products, including CTP, commercial packages, workers' compensation, householders and commercial property. Importantly, we're also starting to see a material reduction, both in the frequency and severity of large individual risk claims. The cost of large claims reduced from AUD125 million in the first half of 2016 to AUD116 million in 2017 and AUD91 million in the first half of 2018.

A brief comment on our Lenders Mortgage Insurance business or LMI. The combined operating ratio for this business for the half-year was 50.6%, which was in line with the 50.7% for the full-year 2017. The key credit metrics in our LMI business are broadly tracking, in line with our planning assumptions.

Turning now to Europe, gross written premium for the half was 2.6 billion. On a constant currency basis, this represents growth of 3% over the same time last year. This growth was underpinned by rate increases of 4.8% and a retention ratio of 84%. The combined operating ratio of 94.5 is almost 1.0 better than the full year of 2017 but 3.2 points higher than at the same time last year. Importantly, as you can see on the right-hand side, the mix of our earnings is better, with the current accident year combined ratio improving by 3.1 points and the contribution from prior-year reserve releases reducing from 8.6% to 2.3%.

The current year combined ratio is benefiting from an improvement in the attritional loss ratio, with better performance in a number of our classes including UK liabilities, UK financial lines as well as benign large and cat experience in our reinsurance business. The benefit from reserve releases is substantially lower than the cyclical highs we have achieved over the last two years. This reduction is in line with our expectations. We remain (Technical Difficulty) and expect to see continuing albeit modest levels of prior-year releases in future periods. We're also maintaining strong expense discipline with our acquisition cost ratio down 1.7 points versus the prior period.

Turning to North America, our gross written premium grew 3% from 2.8 billion to 2.9 billion in the first half of 2018. This growth was underpinned by rate increases of 3.1% and a retention ratio of 79%.

At the end of last year, for both North America and for Asia, we reviewed our current year loss picks and increased these to what we felt were more appropriate levels. Therefore, our first-half 2018 combined ratio result is more comparable to the full-year 2017 and this is what we've shown in the right-hand side of the slide. Our reported current year combined ratio in North America is 100.3%. This includes a 2-point strain related to strengthening the risk margins and therefore the underlying current year combined is closer to 98%. Importantly, this is one of the first reporting periods in which our North American business has delivered a net release from prior-year reserves. The prior-year release of 43 million or 2.5% is wholly attributable to our crop business but pleasingly, we had net no adverse prior-year development from our broader property and casualty business.

At a segment level, we are pleased with the improvement in the underwriting performance of our program business and the current-year outlook for our Crop business remained stable. Crop conditions for corn and for soybeans are tracking in line with production levels from recent years. The price declines we've seen for both corn and soybean futures remain within the levels purchased by farmers. We are conscious of the potential risks associated with US tariffs, primarily to soybean prices, and took the opportunity to purchase out-of-the-money put options in early 2018 to manage our exposure here.

Looking forward, as Pat referenced, we're in the process of divesting our personal lines business. This will facilitate simplification of our operating infrastructure in North America and deliver significant cost savings, which will support a further improvement in our combined ratio.

Turning to Asia, I'll keep my comments here relatively brief, as Pat has already covered the detail of our remediation program. On a constant currency basis, our gross written premium declined 17%, as we re-underwrote a number of our portfolios and refocused this business on more profitable segments. The remediation program is starting to deliver some early improvements, most notably, as you can see on the right-hand side, with the reduction in our current year combined ratio from a 110% in the full year 2017 to 103% in the first half. However, it's fair to say, we still have a lot of work to do to improve our returns to an acceptable level and this involves a continuing program award, both on the underwriting side as well as aligning our expense base with what is now a lower premium tool in this market.

Turning to investment performance, the chart on the top left-hand side shows our investment return versus the guidance range we provided at the start of the year. We have adjusted both these numbers to exclude the results of our Latin American business. Investment returns for the half were 2.1% on an annualized basis. Notionally, this was below our plan due to the adverse impact of rising yields and a modest widening of credit spreads. However, on the other hand -- on the other side of the balance sheet, we recognize a corresponding benefit of 40 million via an increase in the risk-free rate used to discount liabilities. Including this benefit, our pro forma investment return is closer to 2.4%, which is in line with our plan.

Looking forward, and as you can see on the right-hand side -- top right-hand side, the rising rate environment, particularly in US dollars, will support a higher investment yield going forward. The running yield on our fixed income book now sits at 2.1% versus 1.7% as at December. On the bottom left, you see that our funds under management have reduced from 26.1 billion at the start of the period to 23.3 billion. This is the direct result of some of the strategic actions we've taken to derisk the Group, including the sale of Latin America which is now reported as a discontinued operation, the settlement of the North American reinsurance transactions reported with our FY17 results, the reinsurance of Hong Kong construction workers' comp portfolio and the impact of our capital management activities, including debt and share buybacks. The stronger US dollar also contributed significantly to the reduction in sum with a corresponding reduction in claims liability.

On duration, the duration of our fixed income book currently 1.6 days, as we have flagged. We would look to lengthen our asset duration in selected currencies as interest rates reverse to more normal levels. This is particularly the case in US dollars, and you would see this translate to a modestly higher overall asset duration as we close out FY18. On balance sheet and capital management, as you can see from the metrics on this slide, our balance sheet strength -- our balance sheet has considerably on all metrics since the end of 2017. Our PCA multiple has increased from 1.64 times to 1.74 times, due to lower insurance and asset discharges, driven by the derisking activities we referred to earlier, including the exit from Hong Kong workers' comp and reducing our exposure to cat exposed business in places like Fiji, as Pat referenced, but also in North America.

Our gearing ratio on the right-hand side has decreased by almost 4 points from 40.8% to 36.9% as we bought back around 400 million of senior debt during the period. We remain focused on bringing our gearing back within our target range of 25% to 35%. Our holding company cash position remained strong and this increased to our 900 million after factoring in the proceeds from the sale of Argentina and Brazil that we received in early July.

I'll make a couple of comments on reinsurance. During the second half, we will complete the negotiation of our 2019 program. As you're aware, since 2015 a key feature of our program has been a deep in the money risk and cat aggregate program, which we have placed with a single reinsurer. This program served us well in 2017. However, a growing exposure to a single insurer is not optimal and the time value of money is an important consideration, particularly in a rising interest rate environment. Whilst we're still developing our thoughts around our 2019 program, we plan to move to a more conventional out-of-the-money reinsurance structure with significantly higher protection for cat risk, including lower retention, higher limit and broader coverage for non-peak signs.

Our objective is to optimize balance sheet protection, capital credit, costs and earnings variability. While our overall reinsurance spend is expected to be lower, given the more out of the money structure we will probably budget for a slightly higher net cost of large impact in 2019. We will update you when we firm up the terms of our program at the back end of this year.

In conclusion, I'm pleased with the progress we're making. We have achieved strong premium rate increases, we've preserved topline, we've demonstrated some early improvements in the underlying quality of our earnings and we've strengthened our balance sheet. I'm confident that we are focused on the right things and there is strong alignment across the Group to deliver on our strategic agenda.

With that, I'll hand back to Pat to talk through the outlook for the rest of the year.

Patrick Regan {BIO 15131018 <GO>}

Great, thanks very much Inder. Just a couple of words really from me to finish. I'm encouraged by the progress we've made in the first half and I'm encouraged. There is still much work do to drive further improvements in the business. At the core of this is building on the progress we're making on the Brilliant Basics agenda while continuing to maintain intensity and the discipline of the Cell Review process. We could do both of these things. I'm comfortable we'll see further benefits. It's important for us also to invest in Brilliant Basics and we'll continue to do that in the second half. This may mean a very slightly higher expense ratio in half-two versus half-one, but this should be offset by a lower attritional loss ratio.

Going forward, I think there's a lot more we can do on our expense base. We are looking at our Group operating model and ways to drive further efficiencies across the Group. And as a team, we are committed to driving further cost savings at QBE. And we'll will come back to you and provide a specific update on our cost-out plans during the second half of this year.

While most of our strategic priorities are focused on addressing the nearer-term issues, we're also conscious of the need to build a QBE for the future. I'm really pleased we're adding some high quality talents across the Group. This includes Peter Grewal, our new Chief Risk Officer; Matt Mansour, our new Chief Information Officer; Andrew Gayle [ph], our new CSO [ph]; and Tim Page [ph] in our newly created role of Global Head of Pricing.

We're also rolling out our new QBE DNA, our key cultural attribute of being fast-paced, being accountable, being technically excellent, being courageous and high integrity, being diverse, being customer-centered and being team-oriented. And we do want to continue to invest in innovation. We've just (inaudible) just recently made its fourth investment, this time into a company called Jupiter Intelligence, a Silicon Valley-based start-up who builds sophisticated models to manage climate change risk. And we plan on doing more of those investments this year.

A real simple close for me; I'm just going to update you really briefly on our 2018 target. The 2018 targets for combined ratio and investment ranges have only been updated to reflect the removal of the Latin American division, which is now presented both in our comparatives and our 2018 numbers as a discontinued operation. Therefore, we expect a combined operating ratio in the range of 95 to 97 and investment range of 2.25 to 2.75.

We're now eight months into a significant program change. I'm pleased with the progress we've made and with the results for the half-year. Having said that, there is still much we need to do, and I look forward to updating you all on our progress.

Questions And Answers

Q - Daniel Toohey {BIO 16751863 <GO>}

Good morning, guys. Daniel Toohey from Morgan Stanley. Just a few quick questions. First on the tax, obviously (inaudible) restructuring around Equator. How should we think about the tax rate going forward?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. In terms of tax rates, so we've obviously got a one-off benefit in 2018 around the restructuring of Equator Re. I think our full-year tax rate, you should assume sort of low to mid-teens in 2018. As we go forward, our blended rate shapes up around the low 20s. I think there's some prospect for us to continue to recognize some deferred tax assets over the next couple of years. I'd probably say for the next couple of years, a high teens assumption would be a fair one.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. And just on the current accident year turnaround in Europe was quite impressive. The 3% improvement in the attritional line, can you just account how much of that relates to the unwind of the exchange volatility?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, look, I'm glad you raised that, Da. We talked about this last year, nobody believed there was any impact of exchange rate -- probably half a bit or so would be pure kind of unwind of the FX impacts of last year.

Q - Daniel Toohey {BIO 16751863 <GO>}

Just on the buyback, if you stick to that -- I guess, (inaudible) that trendsetting in the year, you've said you're going to achieve that over the time horizon. So will we expect to see increasing levels of buyback activity?

A - Patrick Regan {BIO 15131018 <GO>}

So, I think what you should take away from (inaudible) is carrying on doing what we said. So, this year it's about the execution on the 330 million we said we did this year. But then there are (inaudible) capital is good, pleased with that, cash incentive is good, so we'll just crack on with that and no change (inaudible).

Q - Daniel Toohey {BIO 16751863 <GO>}

And then just finally Mexican earthquakes (inaudible) that the earthquakes (inaudible).

A - Patrick Regan {BIO 15131018 <GO>}

I think, Daniel, referring to the ATV and for the whole of Equator Re, the Mexican is quite -- it was a bit less than half of that number. Actually on the -- generally on the (inaudible) for the last year, we've actually what reinsurance protection for everything else. It just happened not for the Mexican earthquake, so yes.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay, thank you.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Kieren Chidgey, UBS. Couple of questions, maybe just starting on the reinsurance commentary. In the -- I know it's early days and so clearly (inaudible) flagged that budget increase next year. Should we expect an offsetting cost of reinsurance or what do you think (inaudible) changes in the market may make them likely?

A - Patrick Regan {BIO 15131018 <GO>}

Look, I think we will -- and as Inder said, we'll come back later before we get to the full-year results (inaudible) specifically when we've got better idea, I think generally it's (inaudible) lot of people in here, it's just that -- it means here that they tell you really probably prices are not going to go up, they may go down slightly on reinsurance, but we'll know more as we go through the Monte Carlo cycle into and September, but - -for the general market and for QBE, but it looks like prices are going to go down slightly.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. But relative to sort of the pricing when you took this contract out and obviously placed this with a single reinsurer obviously on fairly good terms at the time, is it possible to give any commentary as you move away from that structure to a more traditional structure, what price implications are?

A - Patrick Regan {BIO 15131018 <GO>}

I think the comments we can give you at this point is pretty much what Inder said, which is the total of our reinsurance cost will come at -- a bit lower. But because we have a more traditional, more out-of-the-money structure overall, we'll buy down our cats including convertible cover and we'll buy some sideways cover, and we'll buy down a bit more than we've done. But because you've got a more traditional out-of-the-money we were going to budget for a slightly higher net cost of launching cat and that's probably a good (inaudible).

Q - Kieren Chidgey {BIO 7268946 <GO>}

The balance sheet of (inaudible) -- implications of the change in structure. Are we expecting the same increase (inaudible)?

A - Patrick Regan {BIO 15131018 <GO>}

I think you can probably assume, so to say, that we won't go down.

A - Inder Singh {BIO 20594382 <GO>}

Yeah, look, I think, as we've said, one of the things we're trying to balance is capital protection. So what we're trying to do, obviously we are buying a bit more cat coverage. It's going to help neutralize that. So it will be sort of in and around, it's not a major impact.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Secondly, sort of when we move down the P&L outside the insurance profit line, the side towards the bottom left, the financing and other costs 135 mill, but in your accounts you only called out 105 of interest expense. And there seems to be 30 mill of other costs that have been put outside that insurance profit line. Can you explain what they are? Just (inaudible) seems to be aligned in the last few years where we've continually seen one-off costs come through?

A - Inder Singh {BIO 20594382 <GO>}

Yeah, I think it's a combination of LOC charges, bank charges. I think the -- I think when you compare to prior year, Kieren, you'll see that the number has come down, but last year we had some reinsurance costs around -- (inaudible) actually included in that number for the prior-year comparative. But I think 135 is --

A - Patrick Regan {BIO 15131018 <GO>}

We've obviously been -- we've been active in the first half on debt buybacks and there was activity associated with that, so there was a bit of cost associated with that -- over and above our normal run rate of interest cost (inaudible). So that's more one-off (Multiple Speakers).

A - Inder Singh {BIO 20594382 <GO>}

We've done most of the debt reduction that we set out to do.

Q - Kieren Chidgey {BIO 7268946 <GO>}

And then just finally on Asia, I know there's no (inaudible) this half relative to this time last year. Well, I think you took a $10 million charge but the combined ratio is still above a 100 -- I think around 109 and we still saw 50 million underwriting losses there (inaudible) are you saying the current pricing is prospectively profitable?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, look, I mean that's a look forward test, isn't it. So yes it's (inaudible). Yes, we're expecting to see further benefits of the work we're doing now, with selection primarily because he's got a price increase, it flows through to better current year accident year results that mean that (inaudible) this is more neutral going forward.

Q - Nigel Pittaway {BIO 3406058 <GO>}

It's Nigel Pittaway here from Citi. First question is just on the income on -- investment income on technical reserves. Over 24 million of other income in there. Can we know about (inaudible)?

A - Patrick Regan {BIO 15131018 <GO>}

Sure, it's -- we mentioned we took -- so early in the year, we were -- we've mentioned to you before that we've considered at least whether we should hedge against commodity price movements in our crop business. Some days we decide to do that, some days we don't. When we've done it before we've traditionally done it on corn prices. This year we thought pretty good judgment, probably a little bit of luck as well, but it was smart to take out some protection against soybeans and most of that number we value -- the current value at 30 June is for soybean protection.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Secondly, just on the sort of cat experience in the half, obviously the cat ratio I think was just 1.9%, but you've also taken 7.8% of large risk losses. Can you make any comments on that?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, look, the way that splits out, so the number that's certain is the next number and luckily they're not going to remember the maths, which is our attachment point of 1.2 divided by (inaudible) which is roughly 12 billion. So, that comes out to 10%. How do you split that between the two then, sort of giving you both feeding into the same number. We're only halfway through the year. It's a little bit of an art as well as a little bit of science.

What I would tell you is, we've had very little cat in our portfolio; because of the money structure that is really a tool for -- to our benefit. Other than -- and obviously most of that has been, for us at least, kind of better luck, but also we are doing a lot of work to optimize our cat exposure. I mentioned PG, there'll be lots of examples, whether that be in Australia or in North America. So in North America we've not really had an impact from wildfires kind of at all. In Australia, our cats -- our book is a little bit different profile than our competitors who've had a little impact there.

On the large risk losses, we're sort of seeing a broad and neutral trend, I would say, in North America, Europe and Asia, and in dimension we're seeing an improving trend in Australia compared to kind of previous periods.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And maybe then, just finally, you've obviously said you've finalized your cost-out plans during the second half of the year. Can you make any comments about whether that will actually be additional to divisional target such as North American moving from 98 to 95 or is that sort of all parts of the same thing?

A - Patrick Regan {BIO 15131018 <GO>}

Certainly, we haven't forgotten that North America one. We still have people saying comments in the North America. Number one, I think North America is going to improve from its current 98 level, and of the key components to that is cost reduction and that being a fairly key lever in getting the 98 down to the talked about 95 before. So that remains true. And you should expect that number to be incorporated into our cost-out, but obviously to include that reference as well. Thank you.

Q - Ross Curran {BIO 17605313 <GO>}

Hi, gents, it's Ross Curran here from Deutsche Bank. Just firstly, around investment guidance of 2.25 to 2.75 range for full year, if you have 2.1 in the first half, the midpoint of that range is at 2.5 and implies 2.9 in the second half. Can you just give us a feel what's driving that? What gives you confidence that the 2.1 versus 2.9 (inaudible) midpoint range?

A - Inder Singh {BIO 20594382 <GO>}

Yeah, couple of things as I referenced, I mean I think we are going to see a uptick in the -- from the running yield being higher in the second half. That's definitely a factor. As you've seen, what we've done is we've added back the discount rate benefit on the other side of the balance sheet to kind of give you a proxy for the pro forma NPAT impact of that. And including various tactical initiatives that we're doing on the investment side, we think that achieved -- that guidance is achievable.

A - Patrick Regan {BIO 15131018 <GO>}

We (inaudible) talked about our growth assets adding kind of 70 basis points inside the running yield and the growth assets (inaudible) kind of overall performance you get, you get up to 2.9.

Q - Ross Curran {BIO 17605313 <GO>}

Secondly (inaudible) you mentioned you bought some (inaudible) put up some sort of arrangement for crop. But we have seen some dislocation in crop prices recently. If prices stay where they are through the full year, what impact does that have on the North American result?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, it's a great question. So maybe you would caution me to remember it's only August before I answer and coming to today with crop, and it is only August. There is kind of important months to play out. So far, planting conditions are good/kind of quite good. That was encouraging. Corn price is pretty stable, so that would lead kind of good results on corn. Soybean is actually obviously the one you're referring to in terms of price being down. It's what, about nine books now, Inder? So it's just about still within the average deductible farmer takes and again the soybean planting conditions are good. So if you projected that forward, it would reflect a pretty good year for crop if things held where they are now.

Q - Ross Curran {BIO 17605313 <GO>}

Then finally just on the Asian book, I know that 75% of the Asian book has a combined ratio north of 100. How should we think that remediation -- how quickly can that be turned around or is Asia a lost cause?

A - Patrick Regan {BIO 15131018 <GO>}

No. So look, I've done seven trips up there this year and I was looking forward to my next one. (inaudible) I'm really happy with the work we are doing and how quickly that's turning around. It's quite hard and it's quite a difficult position. So the Hong Kong workers' comp transferring of our balance sheet, moving that portfolio somewhere else is a big deal. You've seen this sort the reduction in things like marine, things like engineering, with focusing back on the book that makes some sense for us.

So give me a couple of minutes to kind of context. The agency business which is a bit more than half of what we do out there has been consistently profitable there. The work we're doing is very much focused around the bigger ticket risks, things like marine, more complex property and coming back to the more kind of profitable core.

So current accident year for all that was a 103 at the half. We think there's some -- we've got reasonably good line of sight. The loss ratio is continuing to prove into the second half, so that we've got a shot at getting much closer to overall underwriting profit. Our challenge really is as much as anything we are operating on a 20% or so lower premium. Well, we've got a cost as we do that. Otherwise, we're going to create an expense problem as fast as resulting in the loss ratio problem. So we're very focused on that. We've got some work mobilized around that. But actually I think, when you talk about Hong Kong, Singapore, Malaysia, Vietnam are major countries I'm much pleased with the progress we're making.

A - Inder Singh {BIO 20594382 <GO>}

I guess the only thing I'd add is, obviously Asia we've had a strong record of profitability. If you go back more than two or three years, we've -- the underlying business is strong, the franchise is good and I think the work we're doing gives us confidence so we can improve that.

Q - Unidentified Participant

Thank you. (inaudible). A couple of questions, you mentioned in your document that you've got reduced reinsurance recoveries and that is part of the reason for the adverse development in the Equator Re. Why did you change your expectation about the reinsurance recovery?

A - Patrick Regan {BIO 15131018 <GO>}

So pre -- so just going back a few years, pre-20s, (inaudible) we've got older treaties where you've got aggregate risk free (inaudible) aggregate cat treaties, we just quite -- took a pretty cautious view on some of that business.

Q - Unidentified Participant

How much capacity do you have in your reinsurance recoveries to take a view as to what the number is and what's the potential to get it wrong?

A - Patrick Regan {BIO 15131018 <GO>}

I mean the -- Ross, obviously we've got our overall reserves that then feed into the gross numbers and the net numbers, some large numbers in there. Actually most of our -- kind of good news for our current reinsurance structures is there's a pretty -- a billion just under its limits, so actually it's pretty easy to do those kind of calculations and there's still most of that limit left at the half year. So actually on the big numbers that count, we've actually -- that's a difficult calculation.

Q - Unidentified Participant

Also the claims ratio, you've had in -- a small increase in the probability of that equity that -- which is showed as a cost to that ratio but the actual risk margin fell. Can you comment on why you showed that as a cost to claims while the risk margin is in the other direction?

A - Patrick Regan {BIO 15131018 <GO>}

Sure, happy to. It purely effects, the dollar value fell. I think the -- probably the better ratio is the dollar to risk margins and the dollar to reserves and that went up from 8.8% to 9.1% which is probably a better value attraction.

Q - Unidentified Participant

So that benefit you had from the reducing risk margin actually go through your insurance profit?

A - Patrick Regan {BIO 15131018 <GO>}

No, the risk margin, as I say, went up (inaudible) adequacy went to 90.2 and the potential reserves equally went up, so --

Q - Unidentified Participant

So (inaudible) number went down?

A - Patrick Regan {BIO 15131018 <GO>}

Just because of FX.

A - Inder Singh {BIO 20594382 <GO>}

Yeah, but also a component of that is included in discontinued ops as well, so you've got to look at last year versus what sits in continuing ops versus disc ops.

Q - Unidentified Participant

Andrew Duncan [ph], Macquarie Securities [ph]; two questions If I can please. On the first one on the European division, obviously everybody is going to have a view on what the price cycle is going to do. I'm probably more interested in what's happening with volumes in the context of Brexit. So should we be assuming that volumes leak out of that division or do you think you can recapture them in other jurisdictions?

A - Patrick Regan {BIO 15131018 <GO>}

Can I answer the pricing instead -- that's kind of looking an easier question. Look, it's -- you've got a few things wrapped up in that (inaudible). So what's happening to volumes? Nothing at the moment. So, that's more dictated by our own approach, which in turn have been super-focused on underwriting quality for a long time. So trying to keep retention levels high, that should (inaudible) took them up a notch, which is great, and being really selective on new business. So new business is quite -- high-quality new business is quite hard to find. We delivered some, what, US$300 million also in the first part. That's probably more impacted by -- just is still reasonably competitive in the market, no real impact yet.

On the amount of business coming into the London market, which is to answer your question from Brexit, what does that look like longer-term, is it really tough one to say I think at the moment. You partly got Lloyd's [ph] own strategy that will play into that, what the new CEO does. I think if they really recapture their kind of mojos as a quality underwriter, specialist underwriter essential to (inaudible) I think that could be a good thing. Brexit is just a hard one to call at the moment, but currently no impact on us.

Q - Unidentified Participant

Sure, and then the second question, I appreciate it's in the leads [ph], but given recent history, some of today's leads is tomorrow headlines, the Australian D&O exposure for QBE, just interested in what your exposure is, whether it's underwritten in Australia or London, just to give us perspective, because that's obviously (Multiple Speakers)?

A - Patrick Regan {BIO 15131018 <GO>}

I should've answered that when you asked the second question. I also should have answered it on the previous one that one of the things we do in our European business is we're not reliant on business all coming into the access points obviously for distribution around the world. In our Australian business, our D&O we write is very small ticket stuff, so it's tax preparers, smaller accountants, kind of it was not at all big ticket side C [ph] kind of (inaudible). We do do that -- some of that historically out of London. Our risk (inaudible) for that now is actually much, much lower. So we've got very limited exposure to bigger ticket D&O in Australia. We would have written some historically, but in Europe over the last 12 months we've really kind of pulled back from bigger ticket law firms or financial institutions' D&O exposures.

Q - Unidentified Participant

That's all, thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Looks like we've (inaudible) questions. In that case, thank you all for joining us. We'll see you next time.

A - Inder Singh {BIO 20594382 <GO>}

Thank you.