Y 2018 Earnings Call

Company Participants

- Inder Singh, Group Chief Financial Officer
- Patrick Regan, Group Chief Executive Officer

Other Participants

- Andrew Buncombe, Analyst
- Brett Le Mesurier, Analyst
- Daniel Toohey, Analyst
- David Ellis, Analyst
- James Coghill, Analyst
- Kieren Chidgey, Analyst
- Mark Hancock, Analyst
- Matt Dunger, Analyst
- Nigel Pittaway, Analyst
- Ross Curran, Analyst
- Siddharth Parameswaran, Analyst

Presentation

Patrick Regan {BIO 15131018 <GO>}

Good morning everybody. Thank you for joining us here today. At the beginning of 2018, we outlined a significant program of change to create a stronger and simpler QBE. This included a plan to exit a number of under-performing businesses, to implement a rigorous performance management framework and to upgrade our core capabilities through what we call our Brilliant Basics program.

We've moved quickly to execute against these objectives and together they have helped us lead to a significantly improved result. And this has seen us improve the underwriting result by AUD900 million, reduce the Group's attritional loss ratio by almost 3%, grow topline by 4%, drive rate increases across the Group by 5% and deliver a net combined operating ratio of 95.7, in line with our guidance and underpinned by a much improved current accident year combined ratio. And also significantly strengthen our balance sheet while at the same time returning just over AUD1 billion to shareholders through dividend and buyback.

We are now a much more simplified and focused company, having announced the exits from a range of under-performing businesses and portfolios. This includes our entire Latin America division, Thailand, The Philippines, Indonesia, Hong Kong construction workers' comp business, ancillary travel business and the North American personal lines business. And I'm really pleased we're able to complete our portfolio rationalization within a year, and importantly we're able to sell each of the businesses that we set out to sell and we're able to do so in the aggregate at a significant premium to book value.

This has allowed us to further simplify QBE, and we've now announced the streamlining of our operations into three divisions going forward, effective the 1st of January, from what used to be six divisions. Our business in Asia combines with European operations to form the newly created International division while Pacific Islands and India combined with ANZO to form the newly formed Australia Pacific division.

In addition to the disposals, we've also taken a number of underwriting actions to improve the consistency of our results. This includes reducing cat exposures in both peak and non-peak zones, ceasing underwriting things like beachfront hotels, reducing cat aggregates in cat-prone areas such as the Pacific Islands.

We've also reduced commercial property hazard-grade profiles right across the Group, reduced our exposure to large losses and made targeted reduction of line sizes in our restricted property and financial lines. And these targeted derisking activities place us well to maximize the benefits from our new reinsurance structure in 2019.

Well, my personal favorite is the cell review process, which is now fully established across the Group. I've personally conducted over 500 cell review meetings in person and in country in 2018. And if you include the reviews done by the divisions themselves this would number well over 1,000. This rigorous approach to performance management is achieving its objective of improving the quality and consistency of our earnings, best measured probably by our attritional loss ratio. It allows us to target rate increases and make risk selection changes where they're required. The cell reviews have also been a big driver of cultural change at QBE, improving our discipline, our transparency and our accountability.

Our Brilliant Basics program continues to accelerate and will I think be the key driver of longer-term performance improvement at QBE. We now have fully implemented group claim standards and fully implemented group underwriting standards, and is significantly upgrading our pricing capabilities.

The global pricing environment has been more supportive in 2018. However, our approach to monitoring price at a portfolio level in those cell reviews has been a key differentiator for us and helps us achieve full-year premium rate increases of 5% or 5.5% in the second half. And this level of price increases is in excess of almost all of our peer group and the cell review process does allow us to target rate in the right portfolios that are the least price adequate, including segments, sub-segments and sub sub-segments of the business.

And finally, we've strengthened our balance sheet over 2018. This hasn't been by accident. The portfolio actions on the underwriting actions we've taken have significantly reduced our regulatory and rating agency risk charges. Combined with increased earnings, our PCA has strengthened from 1.64 times to 1.78 times and gearing has reduced. And this is all while completing the 2018 buyback commitment of AUD333 million, and when you include that final dividend distributing AUD1 billion to shareholders. We plan to continue our active buyback and buy back a bit more debt in 2019.

Inder is really going to talk you through the results but just a couple of key highlights from me. GWP growth for the year, constant currency like-for-like basis, was a little bit stronger. On an underlying basis, we actually grew by 4%. Our end COR improved significantly to 95.7%, a reduction of 8% from the previous year, very much underpinned by significant improvement in our current accident year-end COR with lower reliance on prior year releases.

Our attritional loss ratio improved meaningfully during the second half in all divisions. As you can see, it's 5 points lower than it was in the second half of 2017. And the cash ROE was 8% for the year, notwithstanding the significant investment market volatility in the final quarter of 2018. Despite investment income being towards the lower end of our guidance range, we've declared a dividend of AUD0.28 -- final dividend of AUD0.28 and AUD0.50 for the full year.

As you can see there and as I mentioned earlier, rate conditions in all of our major markets have remained supportive in the second half. The full year rate increase was 5%, up from 1.8% the previous year, and retention remained strong and stable across the Group at 81%. You will see we've got a really nice trend half-on-half from all the way back in first half of 2017 at 1% up to 5.5% rate increase for the second half of 2018.

In Australia-New Zealand, we show right increases ex the CTP reforms of over 7% for the full year and 8% in the second half. And rate was targeted at the portfolios and sub-portfolios that were less rate adequate, including commercial property where we saw plus 18%, strata at plus 10%, workers' comp of plus 9%, engineering of plus 8.

North America, we achieved strong rate in some of our specialty lines, specifically accident and health plus 10%, homebuilders was also a positive of plus 8% and there was also some strength in property rates in cat-affected areas. In Europe, we saw a positive rate on international liability at plus 10%, UK motor at plus 8% and international property -- sorry, probably international property at plus 10%, international liability at plus 6%.

Overall pricing at 1-1 [ph] was broadly in line with what we saw in 2018. And the focus from Lloyd's on addressing under-performing classes does like it's having a positive impact on the loan-to-market, our renewals there for 1st of January demonstrating pricing in the London insurance market remains reasonably strong albeit flatter in the reinsurance pricing.

This is my favorite slide I think. Here we've shown you the trajectory of the attritional loss ratio since we started the cell overview. So, the shaded area representing the period during which the cell reviews have been in effect, obviously that's 18 months longer in the Australia-New Zealand business.

And you can see now in -- the Australia-New Zealand business is now -- the attritional ratio is now 9% lower than it was in the first half of 2016 but obviously, with 8 points of rate in the second half of 2018, you would certainly hope that trend could continue into 2019. Europe's attritional is trended downwards for the last couple of years as a result of more targeted underwriting and more recently rate increases. And North America's attritional at 48.7% is the best we've seen for a few years there. And obviously in Asia, the very large attritional decline in the second half of some 10 points reflects the success of the remediation activity there.

With the momentum we have, we are targeting further improvements in the attritional loss ratio in 2019, obviously underpinned by the rate increases in second half of 2018, the continuation of our cell review process, combined with the positive impacts of risk selection, pricing benefits arising from the Brilliant Basics program.

One of our key priorities for 2018 was fixing Asia. And I'm really pleased to report the remediation of Asia is now largely complete, with the division returning to a small underwriting profit in the second half after recording an underwriting loss of AUD22 million in the first half and AUD100 million in 2017, a terrific achievement from Jason Brown and the whole team there.

The actions we've taken to decisively re-underwrite under-performing portfolios and more disciplined risk taking have led to a 10-point improvement in the attritional loss ratio. And pleasingly, these improvements were evident in nearly all of our major markets. Overall, Singapore, Malaysia, Vietnam, Papua New Guinea had very good second half combined ratios. On top of all of that, we've also started to experience a small amount of positive rate.

Our challenge in Asia, having shrunk the book a bit, is to right-size the expense base. On top of the expense savings we've already made in region, the combination of Asia with Europe as part of the International division will contribute to further cost savings while also leveraging the underwriting expertise of the European business into Asia.

So having done remediation of Asia, cell reviews, trying to improve our attritional loss ratios, it's also nice to see a little bit of growth. Our formula at the moment is very much targeted rate increases, strong retention of our good accounts and very selective new business. And while we can certainly get better at all of those elements, overall that's a playbook that's working.

On an underlying basis, we achieved GWP growth of approximately 4% in 2018; 6% in Europe, 5% in Australia and 3% in North America. In North America, we saw good growth in areas like Accident and Health and Crop. Europe benefited from continued growth in parts of QBE Re and momentum across our continental European portfolios. And in Australia, commercial packages saw good growth year-on-year. In November, we launched our customer commitment program, which we called EQUITY. It seeks to ensure we deliver consistently for our customers and place them at the forefront of everything we do. And there are plenty of opportunities for us to work more closely with our broker partners and our customers, deliver excellent service and drive strong retention.

Moving into 2019, we see opportunities for very targeted growth in all of our divisions. But we will continue to be disciplined about our risk selection, seeking margin over growth, broadly repeating our 2018 playbook. In 2019, we will try and maintain the same intensity and rhythm of cell reviews that worked for us in 2018. We will also try increase the granularity and sophistication of the cell review reporting where we can, whether that's more detailed exposure analysis, more forward looking data generally, more forward looking rate adequacy data.

And ultimately these reviews are about all -- are all about having the best available data to improve our underwriting insights, our portfolio management and our underwriting culture. It's also an opportunity to think a little bit more macro, tech [ph] attractiveness over time, where you want to dial down, where you want to dial up; capital optimization, where we can use different forms of reinsurance, where and how we use data analytics more, artificial intelligence, our distribution strategy or where indeed we want to target selective growth.

There's also so much more we can do to build on our Brilliant Basics foundations that we built in 2018. And in 2019, this will include even more detailed global underwriting guidelines but particularly for priority sales and portfolios, more leading edge MI and optimization of things like our aggregate management. I think we are well priced to deliver on these objectives with the appointment of Jason Brown as our first ever Group Chief Underwriting Officer, supported by the Divisional Chief Underwriting Officer teams, we've established our the last 12 months or so.

Thank you. With that, I will hand over to Inder.

Inder Singh {BIO 20594382 <GO>}

Thank you, Pat. Good morning all. So, I'll take you through some of the detail of our full-year results, which demonstrates the strong progress we've made in improving the quality of our business in 2018 . I'll start with our overall Group P&L. The numbers presented here exclude our now sold Latin American operations and the impact of the transaction to reinsure our Hong Kong construction workers' comp book.

Headline gross written premium increased by a little more than 2%, but as Pat referenced earlier, underlying premium growth was stronger at around 4%. The combined operating ratio improved by just over 8 points to 95.7%, reflecting the significant improvement in the attritional claims ratio coupled with a lower level of cat activity after record industry losses in 2017. I'll touch on this in a bit more detail shortly.

The annualized net investment return of 2.24% was at the bottom end of our target range, primarily due to significant market volatility in November and December of 2018. And we've seen a very strong bounce-back in market valuations in January 2019. I'll circle back on this in a bit more detail as well.

Cash profit after tax for the year was AUD715 million, which equates to a return on equity of 8%. A couple of points worth calling out here. Firstly, financing and other costs at around AUD300 million have run a bit higher over the last 2 years or 3 years due to the class-action settlement, FX movements and other one-time charges. We expect the go-forward run rate of these costs to be around AUD30 million per annum lower. Secondly, our 2018 amortization charge includes the write-down of some capitalized technology costs, also to the tune of around AUD30 million.

We've declared a final dividend of AUD0.28 per share, which brings the total dividend for 2018 to AUD0.50 per share. This equates to a payout ratio of 70% of cash profit, slightly above our target payout of 65%, which primarily reflects the temporary dip in investment income in Q4 of 2018 and our confidence in the underlying momentum of our business.

Overall, I'm encouraged by the strong recovery in earnings and the significant strengthening of our balance sheet in 2018. This has allowed us to return AUD1 billion to shareholders this year through a combination of ordinary dividends and our own market share buyback.

Turning to the Group combined operating ratio, just a few brief observations here. As you can see from the waterfall, our headline combined operating ratio improved by 8 points from around 104% in 2017 to 95.7% in 2018. You may recall that 2017 was a record year of cat losses for the insurance industry globally.

Adjusting for excess cat, the Group's combined operating ratio improved by around 2.5 points. This improvement was driven by a close to 3-point reduction in the attritional claims ratio, which was partly offset by a slightly lower contribution to current accident year profitability from our Crop and LMI businesses. Releases from prior accident year reserves contributed a modest 80 basis points to our underwriting result. Our good momentum on premium rate increases positions us well to deliver further improvement in earnings quality in 2019.

Turning to divisional performance in a bit more detail, I'll start with our Australian and New Zealand operations. Gross written premium of AUD3.9 billion was up 5% over the prior year, excluding the impact of scheme reform in CTP New South Wales. This was underpinned by rate increases of over 7%, with retention stable at 84%.

The headline combined operating ratio of 91.9% is a shade better than prior year, But as you can see on the right-hand side, the mix of our earnings is materially better. The current accident year combined ratio improved by close to 1.5 points and the contribution from prior-reserve releases reduced by an equivalent amount. Importantly, our attritional claims ratio has improved by almost 3 points and we continue to see improving current accident year profitability in almost all our key products, including CTP, commercial packages, workers' comp, householders and commercial property.

A brief comment on our lenders mortgage insurance business. The combined operating ratio of this business increased from 50.7% in 2017 to 55% in 2018. All key credit metrics in this business are trending broadly in line with our expectations, including arrears, transition rates from arrears to claims, and average claims costs. We've also seen a good level of capacity in the reinsurance market for mortgage insurance risk and have taken the opportunity to place a 30% quota share on the 2019 underwriting year with a panel of external reinsurers at relatively favorable terms.

Moving now to Europe, gross written premium of AUD4.3 billion was up 6%, reflecting premium rate increases and some modest volume growth. As many of you know, we've seen several years of rate declines in Europe, and in this context achieving an almost 4.5% rate increase in 2018 has been very encouraging, particularly when you couple this with our strong retention rate of 83%. The business reported another strong underwriting result with the combined operating ratio improving almost 0.5% to 94.8%. And similar to the Australia-New Zealand operations, this improvement was really driven by an underlying improvement in the current accident year performance.

The attritional claims ratio reduced by almost 3 points, reflecting portfolio -- underlying portfolio improvement, premium rate increases and the non-recurrence of a number of factors which adversely impacted 2017, including post-Brexit vote, fall in Sterling and a one-off reinsurance spend.

As you can also see from the waterfall, positive prior accident year releases contributed only 2.5 points compared with 4.5 points in 2017. Given significant ongoing uncertainty around Brexit, it is important to note that we have a fully operational and well capitalized insurance and reinsurance company located in Belgium and successfully renewed our Continental European business at the recently completed 1 January, 2019 renewals.

Turning now to North America, gross written premium of AUD4.7 billion was up 3%, driven by average premium rate increases of around 4% compared with 0.5% in the prior year. We saw good premium rate growth in areas such as Accident and Health, on the back of strong rate increases and targeted new business, while Crop premium was up 5% due to increased coverage and higher policy count.

The combined operating ratio of 97.9% represents a very significant improvement from the 109% in 2017, which was heavily impacted by the extreme cat losses. Normalizing for excess cat claims in both 2017 and 2018, the current accident year combined ratio improved by around 1 point, primarily driven by a strong improvement in the attritional claims ratio. Importantly, the business reported a modest released from prior accident year reserves compared with the significant strengthening we have seen in the last few reporting periods.

Touching briefly on Crop, after an exceptional 2017 our Crop business reported a current accident year combined ratio of around 90% in 2018, with some impact from adverse weather and a modest fall in soy prices due to the effects of the US/China trade tensions. We continue to enjoy solid growth in policy count. And the signing of the US Farm Bill for the next 5 years gives us comfort around the outlook for this business. The recently announced sale of personal lines business in North America is a significant milestone for us, as it enables further material cost efficiencies through the decommissioning of legacy systems and the downsizing of our regional office footprint.

Turning now to Asia-Pacific, I'll keep my comments here brief as Pat has discussed this in some detail earlier. The turnaround of the performance of our Asia-Pacific business is one of our success stories in 2018. To deliver a second half combined operating ratio of 99.5% was an exceptional outcome and represents a 16-point improvement on 2017. As we move the Asia segment under Richard as part of International and the Pacific under Vivek as part of Australia Pacific, we expect to see continued improvement in the underwriting performance of both these segments in 2019.

Moving now to investment returns, as I noted earlier, our net investment return of 2.24% was at the bottom end of our target range. The significant market volatility in December impacted our investment income by around AUD50 million, absent which our investment return would have been around 2.5%. We've seen a strong bounce-back in markets in early 2019 and the valuation gains in January have more than offset the adverse impact we saw in our portfolio in December.

Fixed-income assets returned 1.8% in 2018 compared with 2% in the prior year, primarily due to higher US Treasury yields and wider global credit spreads. Importantly, on a look-forward basis, both these factors contributed to a substantial 50-basis points increase in our running yield, which as you can see from the middle of the page, is up 50 basis points to 2.2%. And this will underpin our higher investment targets in 2019.

In 2018, we started moving our investment portfolio to what we call a more neutral setting. As you know, our asset duration has historically been significantly shorter than our liability duration. As we move forward, we intend to manage our asset duration in a 2 years to 2.5-year range. Asset duration currently sits at around 2.1 years, up from 1.6 years at the end of 2017. We executed most of our duration extension in the second half of 2018, and this allowed us to capture the benefits of the December global bond market rally. Overall, we believe the current positioning of our portfolio and our investment strategy supports a higher net investment return target, and Pat will cover this in the outlook section shortly.

Turning now to the Group's balance sheet, as you can see on this slide, our capital position has recovered strongly following the impact of severe cat losses in 2017. We exited 2018 with a PCI multiple of 1.78 times, up from 1.64 times at the end of 2017. This ratio is now towards the upper end of our 1.6 times to 1.8 times range. Our improved capital strength reflects the recovery in our earnings in 2018, the benefit of de-risking initiatives undertaken during the year, such as disposal of businesses and reduction in our cat exposure, and a material reduction in insurance risk charges under our new reinsurance program, which we updated the market on in December.

Gearing is down 2.8 points to 38%, reflecting debt buybacks undertaken during 2018, partly offset by the impact of the stronger US dollar. We are planning to further reduce our gearing ratio in 2019 through the senior debt buyback we have announced this morning. We'll also continue to execute our existing share buyback program with the aim of repurchasing a further 333 million of our shares on market in 2019.

Before I hand back to Pat to talk about our 2019 outlook, I wanted to touch briefly on our large risk and cat allowances which are embedded within our 2019 plans. In December, we noted we would increase our budgeted allowance for large risk and cut claims by AUD200 million from AUD1.2 billion in 2018 to AUD1.4 billion in 2019. As you can see from this slide, the AUD1.4 billion allowance is split AUD850 million for large risks, that is claims greater than AUD2.5 million each, and AUD550 million for cat.

The AUD850 million allowance for large risk is slightly below our 2018 exit run rate of around AUD900 million and reflects the benefit of work that is ongoing around the Group under the Brilliant Basics program and the confidence in our improved risk selection processes. The construction of our cat allowance reflects a combination of factors, including reduced peak and non-peak exposures from both asset sales and de-risking initiatives as well as the impact of our new cat reinsurance program.

As Pat referenced earlier, we've exited a number of cat-prone countries including the Philippines, Thailand, Chile, Puerto Rico and Ecuador. We've also exited North America personal lines and reduced our exposure in places like Fiji. We formulate our cat allowance by synthesizing the output from our cat models with our recent loss experience.

To give you some context, our total losses from small and medium sized cat events, that is events less than AUD50 million, have averaged around AUD350 million over the last few years. In essence, our allowance of AUD550 million gives us around a AUD200 million headroom for larger events where we have stronger reinsurance protection in place. Overall, our allowance reflects a net cost of large -- net cost of cat losses of around 4.5% of net earned premium, which is in line with our global peers.

With that, I'll hand back to Pat to talk through our 2019 focus and outlook.

Patrick Regan {BIO 15131018 <GO>}

Great, thank you Inder. Overall, I'm encouraged by the progress we made in 2018. We've done what we set out to do, executing against the strategic priorities for the year. We now have a business that's more focused on the markets where we have scale. With embedded and rigorous performance management process, we've upgraded our capabilities in the core areas of insurance, pricing, underwriting and claims. These actions have helped us deliver both an improved result for 2018 and lay the foundation for future profitability and growth.

That said, I think there's a lot more that we can still do. As we did in 2018, we've put in place a clear set of priorities for the year ahead. And this does include a big dose of repeating what worked well in 2018. First and foremost, we will focus on delivering our plan through a continue to duration of a CEO-led cell review process combined with the ongoing development of Brilliant Basics program. We will also execute on the first phase of our cost reduction program. We'll continue to add high quality channels across the Group, particularly in underwriting and data analytics roles. And we'll focus on creating a distinctive, diverse, high performance culture QBE as we embed our QBE DNA across the organization.

We will increase our focus on customer in 2019 through the rollout of our global customer commitment program and we will continue to ensure we make a sustainable contribution to the communities in which we operate, including the implementation of TCFD recommendations. And like for every other financial services company in Australia, there have been some important recommendations and learnings from the Royal Commission that we'll apply to our business to make sure our customer service risk management is as good as it can be.

Finally, we will continue to invest in our technology, digital and data capabilities. We want to offer our customers the best digital solutions, to automate and simplify our processes, to reduce cost and to enable us to take a data-driven approach for all aspects of our business. QBE Ventures, which has now made five investments, will play an important role in that. Our partnerships with emerging insurtech companies are having an impact on the way we run our business. This includes Cytora which uses artificial intelligence and machine learning to price risk, Jupiter Intelligence which is improving our understanding of client-related risks, HyperScience and RiskGenius which help us to automate our processes, or Zeguro which allows us to provide automated cyber security services to our small business customers.

And finally on guidance, for 2019 we have a target combined operating ratio of 94.5% to 96.5%. This assumes higher large and cat allowance and a continued improvement in our attritional loss ratios. And on the investment return, we're targeting a range of 3% and 3.5%, an increase of 75 basis points over the 2018 range, which as Inder said, is supported by our high running yield on our portfolio.

In closing, I'm really pleased with the progress we made in 2018 and the momentum we have going into 2019. We've positioned ourselves well for 2019. There is a lot more that we can still improve on in the future. Thank you.

Questions And Answers

A - Patrick Regan {BIO 15131018 <GO>}

Right, happy to take questions.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Thanks. Andrew Buncombe, Macquarie Securities. A couple of questions on guidance if I can, please . The first one on the guidance for the Group combined ratio, appreciate that you've mentioned neutralization of risk free rates, but it would be interesting to get some extra color on some of the other assumptions that sit behind that, particularly reserve releases and what you assume for US Crop.

A - Patrick Regan {BIO 15131018 <GO>}

So, Andrew. You'll remember, this is why I get kind of shy. We -- I'm not going to give you a huge amount more color on the individual assumptions, particularly on prior year. Crop we'll say, we sort of assume it's similar to this year. We had a -- Inder mentioned I think the current action year combined was around 90, we're assuming similar level this year. LMI we've assumed is a similar kind of combined ratio for this year, if that helps.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Yeah, excellent. And then the other question, just interested in the willingness to use extra derivatives on the US Crop portfolio going forward, you obviously did it (multiple speakers).

A - Patrick Regan {BIO 15131018 <GO>}

Look it's a good and kind of topical question. You remember, last year we saw quite a volatile period, particularly for the price of soybeans which are directly impacted by the US-China trade war. The price setting period for crop is kind of now, we're going through that as we speak. So, that's sort of one factor we'll see over the next few days. And then obviously, you've got some important deadlines coming up for US-China. So I think as we go into March armed with both of those pieces of information, we'll certainly have a look.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. And then maybe one final one, sorry, on the Australian LMI portfolio. You mentioned that the step-up in combined ratio this year to 55% odd was in line with what you're expecting. With the new 30% quota share, what are you expecting that moves to in 2020?

A - Inder Singh {BIO 20594382 <GO>}

Sure. Just to, Andrew, give you some context, if you look at the NEP of that business, it's down very meaningfully from prior years in a way, it's now at around AUD250 million or so. So every point in net combined is only AUD2.5 million. In terms of 30% quota share, that's really on the 2019 underwriting year. That earns over a number of years. We're not really expecting that to have a meaningful impact in the next couple of years . It's just as the earnings start to come through on that, that will make a difference. But as I said, we've got reasonably favorable terms when we transacted on that with a very decent commission on that. So, we're comfortable that that's within our parameters.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. Thanks.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Yeah. Hi. It's Nigel Pittaway here from Citi. Just first of all focusing back on LMI, my understanding was FY17 had about 5 points or 6 points of risk margin top-up. So can you comment on where the combined has been sort of ex-risk margin top-ups in that business?

A - Inder Singh {BIO 20594382 <GO>}

Yeah, sure, Nigel. I mean, look, I think it's -- we've seen over the last 2 years to 3 years just some very modest uptick in the combined ratio. There has been a few things that moved that obviously. There's been a tick up in arrears rates and some of that translating into higher claims, mainly in the rural areas of Australia, but it is modest and there are also some other moving parts around how we earn the commission on reinsurance -- on historical reinsurance treaties. So that's contributed a little bit. Risk margin we've strengthened a bit last year, this year we've sort of held it at where it was. Look, it's modest uptick in the underlying loss ratio really.

Q - Nigel Pittaway {BIO 3406058 <GO>}

(technical difficulty) the underlying loss ratio is 10?

A - Patrick Regan {BIO 15131018 <GO>}

Probably a little bit less than that, between 5% and 10%.

Q - Nigel Pittaway {BIO 3406058 <GO>}

There was a Crop hedge profit of AUD24 million in the first half. That seems to have disappeared come full year. Can you make any comments on...

A - Patrick Regan {BIO 15131018 <GO>}

That was purely a factor of how the soybean price moved. So, the mark-to-market was positive at the half year because soybean prices were down.

Q - Nigel Pittaway {BIO 3406058 <GO>}

(technical difficulty) the second half. Okay. And then finally, can you make any comment on what your attitude is to the potential for any acquisitions at this point?

A - Patrick Regan {BIO 15131018 <GO>}

Look, I think Nigel, the -- we think we've got a clear set of priorities for 2019. I still think there's so much to go at in driving performance improvements, the Brilliant Basics program, overtime, seeking out a tiny bit of growth where we can. So, that's really where all of our efforts and focus is on, organically making the place better.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thank you.

Q - Daniel Toohey {BIO 16751863 <GO>}

Yeah, good morning. Dan Toohey from Morgan Stanley. Couple of questions, firstly on the Europe NEP growth; NEP grew 9% or 7% on a constant currency basis. It seems to be -- I mean that growth is outstanding given the GWP trajectory. Can you provide some more color on what's driving that NEP line?

A - Patrick Regan {BIO 15131018 <GO>}

It shows a couple of things, Dan. So, one is we grew obviously GWP a little bit, biggest chunk of which was rate and we had a few pockets of volume growth, both of which for the first time in a while. Obviously, our business there has been kind of hunkered down, watching kind of margin very much over the last few years as rate has been really challenged. We saw one or two opportunities, as I say, a little bit in areas of the reinsurance business and areas of Continental Europe, also things like our natural resources practice grew a little bit. Second thing was we had a higher reinsurance costs in 2017 than we did in '18 and that helped the NEP growth a bit.

Q - Daniel Toohey {BIO 16751863 <GO>}

And then equally in Australia, I mean we've had rate increases rolling through, maybe it's the LMI impact, but we -- on an underlying basis, the NEP growth in Australia was only 1% but we've had pretty good rate rolling through there.

A - Patrick Regan {BIO 15131018 <GO>}

It's the CTP impact -- it's the impact of the CTP reforms on GWP and any peer.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. And then just finally on the US reserves, I know now it's positive, but we have seen across the US reserves being -- in the US market being an increasing issue. Are you comfortable that the setting there is appropriate, there's nothing else?

A - Patrick Regan {BIO 15131018 <GO>}

So look, we said we booked crop at a 90% current accident year, you'll actually see we've got quite a bit of positive prior year of crop. So our financial year for that was closer to 80% and we just took whatever surplus we got, we took a Crop and just said, look, it makes sense rather than taking an overall positive prior year in North America, just book it into various of the longer-tail lines. So nothing we're concerned about, we just thought that was a smart thing to do. As you say, there's a few moving parts in some of the markets there. Things like workers' comp we've got good loss trends. Equally some of the medical based lines, we've got a bit of claims inflation, obviously the financial lines has been fairly halved over there. So, everything that we're watchful of and nothing that we're overly concerned about.

Q - Daniel Toohey {BIO 16751863 <GO>}

Yeah, thank you.

Q - James Coghill {BIO 14006200 <GO>}

James Coghill, UBS. Couple of questions please. Inder, could you just take us through that financing and other income line down the P&L? So there's about a AUD100 million differential between what you reported and the actual underlying borrowing cost in there. And just clarify what you said in your briefing about it being AUD30 million below the recent run rates, I presume the only other item there of significance next year is your one-off costs relating to the efficiency program. Is that correct? Just give us a bit more color on that.

A - Inder Singh {BIO 20594382 <GO>}

Yes, sure. Look, I think if you decompose that, so our borrowing costs are a shade over AUD200 million. In addition to that, you have some meaningful bank charges, some amortization of premium for debt we'd bought back in prior years. We've also got LOC fees, et cetera. So I guess, what I'm -- what I was indicating is that we think our run rate is kind of to AUD260 million, AUD270 million and so that's about AUD30 million lower than what we've printed for 2018.

Q - James Coghill {BIO 14006200 <GO>}

Okay. So that doesn't include one-off costs associated with your efficiency program?

A - Inder Singh {BIO 20594382 <GO>}

No.

Q - James Coghill {BIO 14006200 <GO>}

Those are coming down below the line...

A - Inder Singh {BIO 20594382 <GO>}

That's right.

Q - James Coghill {BIO 14006200 <GO>}

-- outside insurance products. So where will those be reflected next year?

A - Inder Singh {BIO 20594382 <GO>}

We'll report those as restructuring charges, yeah.

Q - James Coghill {BIO 14006200 <GO>}

And perhaps just a -- perhaps a question on growth again. I don't think you're going to give us a lot here, but I mean you referred to it as a tiny amount of growth outside of rate into '19. Perhaps just extending beyond that to get your expense ratio down to your 14% target, I mean in the past in the topline that has negated QBE's ability to deliver on expense ratio targets, not the actual dollar value of costs. So, I mean surely there must be something more than a tiny bit of growth that you are thinking about over the next three years.

A - Patrick Regan {BIO 15131018 <GO>}

Look, all good questions, James. So we haven't built our expense plans or expense ratio plans of a whole heap of growth. To your point, that doesn't feel like a smart thing to do. It's built off a whole heap of expense dollar reduction, for a couple of reasons, our own history and then just normal sensible behavior. If we can eke out a little bit more growth, then all well and good. Well for us, particularly in the second half. It is very much based around strong retention to good accounts and a very targeted new business and keeping the rate. And that worked well in '18 and we'll try and repeat that as we go into...

Q - Matt Dunger {BIO 16939207 <GO>}

Thanks. It's Matt Dunger from Bank of America Merrill Lynch. If I could just ask a question on capital. You know, the reduction in the capital requirements here, to what extent are reinsurance recoveries versus the de-risking activity versus divestments driving lower capital requirements?

A - Patrick Regan {BIO 15131018 <GO>}

Bit of have all of those, Matt, really, isn't it? The reinsurance structure did help for sure, that's definitely a component of it, but also the -- some of the disposals helped, as Inder ran through. A number of those carried some cat exposure for us. But then just the portfolio actions has helped as well, because we've reduced both the insurance concentration charge and the general insurance structure. It's a bit of all three. Anything you want to...

A - Inder Singh {BIO 20594382 <GO>}

Yeah, just on the reinsurance structure, I mean it's -- as we said in December, it's a lot more efficient with the traditional reinsurance structure to get better capital credits. So rather than -- the aggregate structure we had was a little bit harder to translate into regulatory capital credit. So, that's definitely helped in terms of contributing to that improvement.

Q - Matt Dunger {BIO 16939207 <GO>}

Okay, thanks. And just on the cash remittances, do you have any targets around cash remittances and what's the outlook there?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. Look, that is a good question. So what we've been doing obviously for 2018 and we're trying to do again for 2019 is, we've got a dividend payout policy of up to 65%, so we paid that. We're capital-strong at the moment, so -- and we're not really consuming capital for new business growth, so that allows us to pay out to shareholders by way of a buyback with the other third, if you like. And we did that in 2018 and we'll try and repeat that in 2017 -- sorry, in 2019.

Obviously, therefore, to make that to work, you want to remit up something similar to those two amounts. The kind of thing that is kind of the rule of thumb is you've got to remit up at least your external outgoing, so your financing costs and your external dividends. So that's what Inder and the team do. It's tough to remit up a 100% of divisional profits, but you want it to be 80% or so, is only a reasonable rule of thumb.

Q - Matt Dunger {BIO 16939207 <GO>}

Thank you.

Q - Ross Curran {BIO 17605313 <GO>}

Hi. It's Ross Curran here from Deutsche Bank. Just wondering if you could give us a little bit more color around your risk appetite and your investment book, and how you're thinking about that has evolved over the past year or so?

A - Inder Singh {BIO 20594382 <GO>}

Look, the main thing we've done really is -- as we've sort of flagged during 2018, is extend duration, right. So, we've been very short historically on the asset side and we've had probably carried a bit of interest rate risk as we've done that. So, what we've now done is really move to a more neutral position to have duration where we think is a better reflection of our book of business that we have.

So, I think that's the main issue -- that's the main thing we've done on growth assets. We're saying we're going to have exposure of between 10% to 15%. We've sort of been at the lower end of that. And we'll see if there's opportunities to modestly take that up a bit, but 10% to 15% has been our appetite for some period of time.

Q - Ross Curran {BIO 17605313 <GO>}

I guess as you've exited those higher-yielding LatAm assets, have -- has your thinking around what you've done with the core portfolio shifted?

A - Patrick Regan {BIO 15131018 <GO>}

No, just glad we haven't got the higher-yielding LatAm assets. Look, Inder said it well, we've got a more normal setup for the company now. We're trying to improve the underlying quality of the combined ratio, which I'll do that again -- we'll try and do that again in 2019. You match that with a more normal investment return that allows us to generate a much better ROE. That's sort of what we're trying to do. We're not trying to take a lot more risk for that (technical difficulty).

Q - Ross Curran {BIO 17605313 <GO>}

And then -- secondly then on Aussie LMI, can you just help us think about this quota share? Is that kind of how you're going to be thinking about this business going forward? Would you like to repeat? And if you're offered this same opportunity in FY20, would you look to continue rolling out a sort of 30%-plus quota share?

A - Patrick Regan {BIO 15131018 <GO>}

It's -- I think it's more of a -- less of a philosophical statement and more of a kind of -- to a certain extent, opportunistic. The -- it turned out there was actually quite a lot of capital interested in that kind of quota share that allowed us to get really quite good terms and in that context it sort of made sense to do it. Whether that's true in 2020 or '21...

Q - Ross Curran {BIO 17605313 <GO>}

Does it free up a lot of capital or a little bit of capital or...

A - Patrick Regan {BIO 15131018 <GO>}

A little bit.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. Kieren Chidgey, UBS. Pat, you mentioned a reasonably strong 1-1 renewal season in Europe. Just wondering if you can give us any granularity around that and how you're feeling about the outlook for rates as we move through the year?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, thanks for the question, Kieren. So we -- as you probably remember, we have more of our business in Europe that's reinsurance renew on 1-1. So, that's a bigger block of what we've got. You'll have seen from all the market commentary that reinsurance rates are flat to up a tiny amount.

On the insurance business, which -- less of which renews on 1-1, whether that be the London market type of business or the UK regional type of business, that was kind of reasonably encouraging. So, we saw rates kind of more consistent with our 4% to 5% that we saw in 2018. So, so far we're reasonably encouraged from that. It does look like that some of the actions that Lloyd's are taking, that often decile [ph] stuff, is making an impact to capacity in -- certainly in certain lines of that. More broadly, our rates are so far so good. I mean, we had a kind of an okay start here in Australia, rate increases at 1-1, again it's not a huge part of our business but were similar to what we saw over the 2018.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. And just secondly on claims inflation around the various regions, how you've seen that as we moved through the back half of '18?

A - Patrick Regan {BIO 15131018 <GO>}

Look, nothing kind of dramatic to call out on that. So you've still got spots where -- anything that's medical, inflation-related in the US. One of the reasons -- we talk about getting rate of plus 10% on Accident and Health. And you need some good rate because you're covering a higher level of medical inflation in that kind of thing.

But overall, I mean, you see the same data I look at, that inflation rates are generally low around the world. There's pockets of discussions as much as anything about wage inflation, whether it comes through. But we're not seeing a tremendous amount. You've seen 1 or 2 pockets that runs hotter, which are the traditional ones, sometimes motor, anything medical related.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks.

Q - David Ellis {BIO 18025447 <GO>}

Good morning, David Ellis from Morningstar. I've got a quick question on franking. My apologies if it's included in one of the releases today, but the final dividend, 60% franking. Is that a good indication of the franking rates going forward?

A - Inder Singh {BIO 20594382 <GO>}

No, look, I think what we've done is the franking credits that were sitting on our balance sheet of -- just valuable in the hands of shareholders. So what we've done is looked at what we can sustain going forward. Obviously, our Australian business and particularly when you look back historically, our LMI business, is now contributing less in terms of Australian taxable profits. So 60% I wouldn't take as an indication of what we can do going forward. We'll try and keep the franking rate as high as we sensibly can really, is kind of our objective given the mix of earnings that we have which is skewed less and less to Australian-sourced earnings.

Q - David Ellis {BIO 18025447 <GO>}

Thank you.

Q - Mark Hancock {BIO 18643095 <GO>}

Just a question on the investment return. Your guidance says 3% to 3.5%. Sorry, it's Mark Hancock from Precept. Your rate -- I believe your exit run rate was 2.2% and you just mentioned previously your risk margin strategy is about -- your high-risk assets is 10% to 15%. So I'm struggling to see how you get it up as high as 3% to 3.5%.

A - Patrick Regan {BIO 15131018 <GO>}

Broadly, the maths -- I do CEO maths now I'm the CEO, is that you take 2.2%, you add -- to your 10% to 15%, you add a premium of somewhere in the 5, 6, 7, depending on what class of business you're in and then you add a little bit of TAA to make the investment team work a bit harder. So -- and then you get somewhere in that range. So, the 2.2% is purely off the fixed income, it doesn't reflect the kind of what we call growth assets.

Q - Mark Hancock {BIO 18643095 <GO>}

If you had a 5% risk margin on 10% to 15% of assets you'd only get about another 0.5% to 0.6% above the 2.2%, which would get you to about 2.7% to 2.8%. So, the TAA must be quite a lot.

A - Patrick Regan {BIO 15131018 <GO>}

No. Normally we -- we estimate that normally in the 20 basis points kind of margin. Our maths comes out a tiny bit higher than you've got there.

Q - Mark Hancock {BIO 18643095 <GO>}

And that assumes no volatility or no adverse movement in equities obviously?

A - Patrick Regan {BIO 15131018 <GO>}

It doesn't assume any mark-to-markets, up or down.

Q - Mark Hancock {BIO 18643095 <GO>}

It's just running yield on equities?

A - Patrick Regan {BIO 15131018 <GO>}

It assumes (multiple speakers)...

A - Inder Singh {BIO 20594382 <GO>}

Yeah, it is -- on equities it's total return, on the -- the 2.2% obviously is running yield, so it excludes any mark-to-market impact on the fixed income book.

Q - Mark Hancock {BIO 18643095 <GO>}

One other minor point, I don't quite understand, your claims duration on your outstandings has increased from 3.1 to 3.3 over the year. Is that due to divestment of personal lines businesses or can you just further explain what's happening?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. Look, you're right. You'll see it's a little bit mix of business. We've talked about coming off some of the cat-exposed stuff, which is a little bit shorter tail. You'll see that part of the duration is increases in Europe, which is typically the place when we're writing a bit more business in Europe that has always been our longest-duration business. We write lots of specialist liability type insurance there as well. So, it's a combination of the two.

Q - Mark Hancock {BIO 18643095 <GO>}

Thanks very much.

A - Patrick Regan {BIO 15131018 <GO>}

I think we've got a couple of questions on the line. So, Brett Le Mesurier?

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

Thanks very much. The risk margins fell on the net outstanding claims, I believe, to AUD81 million, and you commented that in your underlying performance risk margins increased by AUD12 million. Do I conclude that AUD93 million went with the sale of the businesses during the period?

A - Inder Singh {BIO 20594382 <GO>}

Brett, a couple of points really, so yes, a component of it went with the sale and we also saw some FX movements impacting that. But as you said, I mean on an underlying basis, it was up AUD12 million. And also we look at risk margin as a percentage of the central estimate that we're holding going forward, and that's ticked up a little bit.

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

So in your adjusted performance, there was only a AUD12 million impact from the changes in risk margins, that's the comment means, is that right?

A - Patrick Regan {BIO 15131018 <GO>}

We didn't adjust the result for the change in risk margin. So we just absorbed the increase in risk margin in the results. It was only a small one, but yes, we absorbed it.

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

Yeah, what I meant was in the adjusted result the only impact from risk margin is a AUD12 million adverse impact.

A - Inder Singh {BIO 20594382 <GO>}

Correct. Yes, correct.

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

Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

I think we have Sid on the line?

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Hi guys. Quick question. Similar to Mark's question I suppose. It's a question just on your guidance for FY19. You're basically not guiding too much improvement at all in the combined ratio. And I was just curious why that is, given that you flagged base increase of 5.5% for the second half. There should be some incremental impacts coming from your -- all the cell optimization programs that you've been undertaking. Or what is the thing that you're worried about which would actually lead to a material drag on that 5.5%?

A - Patrick Regan {BIO 15131018 <GO>}

Well, nothing specific, Sid. So -- I mean, we've got a range of 94.5% to 96.5%, so we're not guiding you to any particular point in that range. Look, we've -- we're in the year one of our new reinsurance program. We've called out the fact that we've got our higher allowances in that. So we've got to overcome the higher allowances. And then we think we've got a good trend on the attritional loss ratios that will offset that and the net of those should be a positive for 2019 versus 2018. But nothing that we're specifically concerned about in 2019.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

So how much of a drag is that reinsurance program, Patrick?

A - Patrick Regan {BIO 15131018 <GO>}

I think what we said in December, we've got -- we saved on reinsurance costs and then we've assumed higher allowances in 2019 versus 2018. And the net of those two is AUD50 million to AUD100 million. So if I round up a bit, kind of close to a point.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay, great. Okay, thank you.

A - Patrick Regan {BIO 15131018 <GO>}

And we've got David Humphreys on the line.

Operator

My apologies, David Humphreys has removed his question.

A - Patrick Regan {BIO 15131018 <GO>}

Any other questions in the room? Right. Well, thank you for spending time with us today.

A - Inder Singh {BIO 20594382 <GO>}

Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you.