Q4 2015 Earnings Call

Company Participants

- Alexander Maloney
- Elaine Whelan
- Paul Gregory

Other Participants

- Andreas van Embden
- Andy D. Broadfield
- Ben Cohen
- Jonny Urwin
- Kamran Hossain
- Philip Kett
- Thomas Seidl
- Xin Mei Wang

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Fourth Quarter 2015 Results Conference Call. Today's call is being recorded.

At this time, I would now like to turn the conference over to Alex Maloney, Group Chief Executive Officer; Elaine Whelan, Group Chief Financial Officer and CEO; and Paul Gregory, Group Chief Underwriting Officer and CEO. Please go ahead.

Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you, everyone. Thanks for dialing in today. I'm pleased to report that we grew fully converted book value per share by 3.5% for the fourth quarter, with an excellent combined ratio of 67.1%. This brings our 2015 year growth and fully converted book value per share to 13.5% and that's excluding any impact of the warrant exercises. Our full year combined ratio is 72.1%, and we believe this demonstrates the quality of our underlying book.

Every line of business we underwrite at Lancashire or Cathedral made an underwriting profit in 2015. We therefore wave goodbye to 2015, absolutely delighted with the result which we believe is more than exceptional in this challenging time in insurance industry, and the current new zero-yield investment environment.

We had a positive start to the year, with both Lancashire and Cathedral receiving excellent support from our brokers and clients. The rating environment is where we thought it would be, so there's no surprises and the group has purchased excellent reinsurance protections. So I think we're in good shape for 2016, although again, this will be very challenging.

Kinesis, our third-party capital manager run by Darren Redhead, continues to attract new investors who want to partner with someone who underwrites them, not just deploys capital. We run a small fund matched to the current market opportunities and believe our returns demonstrate the focus on quality underwriting and offering bespoke products of their investments and better opportunity for yield. This is very much in line with the group's strategy of quality returns not just capital deployment for the sake of it.

In terms of investor returns for 2014, we have generated a return in excess of 15% on the capital deployed for Kinesis. We expect the same for the 2015 (02:39) and all of these numbers are net of fees and losses. It should also be noted that these returns are not enhanced by any leverage. It's a fact now in time in our (02:47) industry, everyday seems to bring news of poor results and reserve strengthening for some of our larger competitors. We have said many times there are distinct advantages of having a short-tail business where you control your underwriting and expenses. We also believe a conservative investment strategy is exactly where we want to be.

We do not believe that big is always beautiful. I wouldn't try to call the bottom of the market as no one really knows where the floor is until it starts to harder (03:20) but there are signs that not all is well. Particularly if you look at the industry results for a year where not much has happened, you have to wonder what results would look like with any kind of normal loss experience.

Maybe I'm in the minority, but I believe that once capital is impaired, things will change quicker than people think. You have to be in good shape once the opportunity comes, in order to take advantage of it. And our strategy at the moment is about capital preservation and patience. So we continue to trade on, our strategy is clear and we continue to focus on areas where we feel we can add genuine value and stay away from the speculative opportunities. Again, I would like to thank our shareholders for their long-term support and also all the people that work for our group as we continue to navigate these choppy waters.

I'll now hand over to Paul.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. 2015 has been a relatively benign loss year for the industry. Other than the exception of energy, loss activity across classes has been low which has helped the market produce respectable underwriting returns. We have also been able to produce a more than respectable combined ratios 72.1% to 2015 which in any year should be viewed as a success.

Pleasingly for us, the underwriting profitability has been delivered from all our platforms and all classes underwritten by the group have contributed to profit. In what has been a challenging market environment, I would like to thank all the teams across the group for delivering yet another year of market-leading underwriting results and successfully defending our core portfolio of business in the face of fierce competition.

As a benign loss environment continues and we know obvious or significant retrenchment of industry capacity, the soft market endures. In some areas, the pace is slowing, but rates continue to fall. In such an environment, our is focus is on underwriting profitability, defending our core portfolio and then managing the volatility as underlying earnings are less in this weakened environment.

We've been really pleased of our trading at the 1st of January renewals across all our lines of business. Whilst the rate in the environment remains challenging, it was broadly in line with our expectations. And importantly, we've been able to maintain those current relationships and positions that we aim to.

Kinesis deployed marginally lower limits at 1/1, but is expanded by the decline and investor base and Kinesis continues to contribute nicely to group RoE and remains ready to deploy more limits when the opportunities arise in the future.

The group also renews a significant number of reinsurance protections at 1/1 and we're able to continue longstanding relationships with reinsurers whilst improving the balance sheet protection with broader and more comprehensive coverage, helping us to manage our portfolio volatility. Our outlook for 2016 is a continuous softening across most lines of business albeit at a somewhat slower pace. But we remain confident in our disciplined underwriting approach. Combined with our strong client and broker relationships, we'll continue to deliver outperforming and market leading underwriting returns.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. Our results are on our website as usual. It was another relatively quiet quarter for losses and some further favorable development on our prior accident year reserves with a strong performance in the fourth quarter. With a loss ratio of 18.3% and accident year ratio of 30.6% and a combined ratio of 67.1%.

We predict an RoE for the quarter of 3.5%, bringing up to 13.5% for the year after adjusting for the impact of warrants. Cathedral contributed 1% to the RoE for the quarter and 3.4% for the year and Kinesis contributed 0.8% to the RoE for the year. There's a reduction again in our gross premiums written this quarter compared to last year. That reduction comes mostly from our energy book and our Lloyd's platform.

In our energy book, reduction is driven primarily by multi-year deals that we wrote in 2014. While the fourth quarter isn't typically a major renewal period for our energy book. The $7.6 million of offshore energy multi-year deals were written in Q4 2014 and aren't up for renewal yet. The remaining reduction in that line of business is mostly due to rate exposure reductions, reflecting the impact of oil prices. There's also a reduction in the energy book and our Lloyd's platform for the same reasons.

Overall, in 2014, we (07:53) $180 million worth of non-annual deals, which were not due for renewal in 2015. We earned just over $100 million from those contracts over 2014 and 2015, out of which (08:04) $40 million of earnings coming through from them in 2016.

In the property cat and energy offshore lines of business, (08:09) $35 million of 2014 multi-year deals that are due to renew in 2016. With only about $35 million of multi-year deals written in those lines in 2015, I therefore expect the 2016 top lines to be much more stable compared to 2015. I will advise you there'll still be pricing pressure, particularly in the energy group, where clients will continue to rationalize their insurance budgets, but there are always some new business opportunities around.

Acquisition costs for the quarter and year are in line with our previously communicated expectations of 25% to 26%. There's an increase in the ratio year-on-year given the changes in our reinsurance program on business mix 2015 in addition to the impact of profit collections received in 2014.

On losses, we had a few smaller losses. So as we said, it was a very light quarter for losses and we had more favorable development on prior accident years with most of that again coming from the 2014 accident year.

As in previous quarters, there were no specific drivers of stability, just general IBNR releases due to lack of anything reported coming through. The LIBOR reserve releases this year is not indicative of a change in trend or expectations or methodology. We've therefore the best estimate for large losses in demand and have lost (09:33) for attrition. We just didn't have much reported coming through in 2014.

We had a small loss on our investment portfolio this quarter, as you'd expect given the (09:43) interest rate, we've been prepared for that for a long time though for a short duration positioning, and interest rate hedging strategies, mainly the impact of increasing yields was minimum.

Our loss for the quarter was 0.2%, bringing us to an overall positive return of 0.7% for the year. So far in 2016, with volatility seemingly ever present, our portfolio is essentially flat. For the immediate future, we will continue to focus on interest rate risk that may hold a little more cash to provide extra liquidity, and also to take advantage of any opportunities that may arise. Otherwise, our duration positioning and risk asset allocations are unlikely to change significantly in the near-term.

On KCM, we had $5.46 million of underwriting fees for the year, with $1.5 million of that falling in the fourth quarter. The loss from associates of $0.2 million in the fourth quarter of 2015 was a result of some mid-sized claims in the property risk, (10:43) offshore energy groups in relation to the January 2015 underwriting cycle. We've received $1.8 million in the first quarter of 2016 in relation to the 1/1/15 underwriting cycle with further PC expected later in the year.

KCM's expenses are reflected within Lancashire's other operating expenses and the fees are included in other income. In terms of actual returns for investors, we currently expect around 15% return in the 2015 underwriting year draws. The remaining other income as managing agency fees and profit commissions from Cathedral, these tend to be high in the fourth quarter as underwriting years close out, obviously depending on underlying performance. $3.4 million was received from the fourth quarter and $7 million for the year.

Our G&A ratio was higher than normal this quarter due to the combination of yearend bonus to adjustment, additional compensation expense for the Cathedral execs who are leaving the group and lower earned premium. In 2014, we had $8.4 million of amortization expenses in relation to the Cathedral acquisition. If you adjust for that, an additional compensation expense in 2015, the year-on-year dollar spend is broadly the same. I'd expect our run rate on G&A to continue on those levels for the coming year. The movement in our stock compensation expense is due to vesting and performance assumptions, and it can move around a bit quarter-on-quarter.

Our financing expenses were favorably impacted by the mark-to-market on our interest rate swap. Ignoring the swap, our financing costs tend to be around $4 million a quarter. We have a tax credit this quarter and for the year, which is a bit of a one-off benefit due to the group release recovery on profits on pre-acquisition on duration years at Cathedral. The acquisition completed in November 2013, and since then, the group has been restructured a bit. So I'd expect tax impact to be smaller going forward. For those looking for guidance for models, our tax charge or credit will obviously be driven by underlying performance, but I would expect it to be immaterial to the results going forward.

Finally on capital, we're declaring a final order dividend of $0.10 per share. That's about $20 million in total. With the 2015 interim and special dividend, total capital return for the 2015 financial year is $218.3 million, which is 128.6% of compressive income and a dividend yield of 11.9%.

As we said last quarter, we're targeting around $1.35 billion to $1.4 billion of capital for 2016, but we'll continue to monitor that closely as the year develops.

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

Q&A

Operator

Thank you. Our first question today comes from Xin Mei Wang of Morgan Stanley. Please go ahead. Your line is open.

Q - Xin Mei Wang {BIO 20796577 <GO>}

Hi. Good afternoon. I have got two questions. My first is on capital management. You've taken down your net exposure by buying more reinsurance, new PMLs, hassles are reduced. Could you link that with respect to how you think about – thought about capital management in 4Q 2015, and also to that $1.35 billion, $1.4 billion number you gave for 2016? That's my first question. Secondly, my question is on the loss ratio. You've guided towards 34% attritional losses. Would you be able to update us on how to think about that given the increased reinsurance cover at Cathedral and Lancashire, please? Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi. Sure. I'll start with the loss ratio first. 34% is what we're guiding to, and we have had a few more midsized losses coming through this year. There would be no reason to think of changing that guidance for attrition. We've had a few losses that are around about the kind of 3% impact on the loss ratio, but nothing really that significant.

As we move back, although, we still end up kind of thinking about 34% as about the right level. And you might want to place it just that going into 2016 a little bit, but as you heard, the rate of price change declined going a little bit, so I wouldn't adjust that too much.

And on capital management, our primary capital driver is (15:22), so maybe a bit different than from some of the other UK companies that you've been following. So we work at how much capital we need to keep (15:31), and then we stress that, and then we put a buffer on top of our stress test as well.

If we have anything left after that, then we'll see if there's other opportunities. If there aren't any, then we return that. And we do have a bit of a buffer in there coming into this year, just given the market environment. And hopefully, that gives us some opportunities probably this year.

Q - Xin Mei Wang {BIO 20796577 <GO>}

Okay. Thank you. And just – would you be able to link that through capitals around 4Q and dividends around that as well?

A - Elaine Whelan {BIO 17002364 <GO>}

In what regard?

Q - Xin Mei Wang {BIO 20796577 <GO>}

In terms of how you thought about the capital returns in 4Q?

A - Elaine Whelan {BIO 17002364 <GO>}

Well, we did do a big capital return at our November board meetings, and our outlook for 2016 has been pretty much bang on this year. So that's why there's no additional special there. We have bought more reinsurance. We have brought P&L's down. So, there might be a little bit more of a buffer in there where we are at this time, but we're quite comfortable just to play in our orders, and then wait to see how the rest of this year goes.

Q - Xin Mei Wang {BIO 20796577 <GO>}

Okay. Fair enough. Thank you.

Operator

Thank you. Our next question now comes from Kamran Hossain of RBC. Please go ahead. Your line is open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Actually I have three questions. The first one is, I guess it's a three-part question, but it's on Cathedral. The assessment that (16:49) you have $5.6 million of expenses in Q4 related to, I guess, payments to the old CEO and CFO of Cathedral. Is that $5.6 million personally for paying them off? That's kind of a part one. And the second part, in terms of staff number (17:08) at Cathedral, are you needing to pay any kind of retention bonuses in order to keep people happy, people at Cathedral? And if so, how much do you think that might cost this year? And the second question, it just comes back to some comments that Alex made about being at the bottom of the market and things might move quite quickly. It sounds like you have a scenario in mind, would it be possible to kind of share your thoughts on what will change the market from here, because it seems like you've kind of taken an awful lot? Thanks very much.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Kamran, so I'll start on two of the three, I think on the Cathedral morale thing, it's – personally, obviously more like an industry morale. So I think most of you who been in the industry at the moment, there are pressures everywhere and everyone's looking around the market and everyone understands it's a difficult environment, so that is just a general industry thing.

We have retention things in place for everyone within the group. It's not just a Cathedral thing and there's various things that we have to do to keep our best people all the time and sometimes we can do that and sometimes we can't. And obviously, the (18:23) is one part of keeping people happy. I still believe we have a very good group of companies with good books of business, and if people leave here to go somewhere else, the environment doesn't really change.

So I think, it's about having a blend of money, happiness, but whether you like it or not, the market environment doesn't change wherever you are. So, I think that I don't believe we have a massive problem. Obviously, it's bonus time here, so if we were to lose anyone like we do every single year, you probably would expect to lose people now, just because everyone's about to get their bonuses, but that's kind of normal business for us and we've got (19:06) demonstrating that. This business is not built on one person. So, we have a number of things in place, I'm totally (19:13) about that.

I think on the general market comment, I mean it's incredibly hard to call the bottom of any market. I'm definitely not saying this is the bottom of the market. I suppose my comments are really based around, if you look at people's results for 2015, including as of to the point in a world where on the underwriting side not much has happened at all. I don't feel that I look at that spot for the industry. And then, if you just see some of the behavior that's happening now, it does appear that people are really thinking quite cautiously about can they give another reduction. We are seeing some kind of push back. And that kind of feels like to me – at the end of the late 1990s, that's what happened, people did slow down a bit and people did question things a bit more. That's not to say the market is going to go up, but I'm still in the minority that thinks that the second you get some meaningful losses and you overlay them on the industry's results, there's just not much margin for error.

So, people could be in the red quite quickly. And then, (20:24) which you probably will, you've got a number of events quite quickly and then you just look at the investment markets. There's just so much going on. I think if you go from – I think the industry could go from looking vaguely okay to pretty awful quite quickly. And then you just overlay this human element of any market.

So, our strategy, as we said earlier, at the moment is all about trying to be there for that market whatever that may be. And I think we all agree it won't last very long when it comes. And you have to be in your best shape you can to take advantage of it. And that at the moment where rich investment or underwriting means capital preservation. You've got to have the capital. You've got to be ready to go, you've got to be in the best shape. That doesn't mean we wouldn't lose money and that we're part of the market, we would fully expect to lose money in a very large event. But if we're in good shape, we think we can take advantage post loss.

So, you have to be patient. It's quite boring. We've been saying it for a long period of time. But I'm more interested in trying to make more money in the future than what I am today, because it's incredibly hard to trying to do anything today, and reaching for any kind of yield now. There's huge risks associated with that.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's fantastic. I really appreciate the really detailed response. Thanks very much.

A - Elaine Whelan {BIO 17002364 <GO>}

On the G&A question, the number that you're quoting, I think, is the overall increase in employee salaries and benefits. So there's a few things going on in there. One of which is the packages for people leaving. The rest of it is an increase in head count. And just Q4, bonus adjustments on both Lancashire and Cathedral sites as the results start coming through.

So there's a bit more lumpiness around our G&A quarter-on-quarter now because of the way that the bonus tools work. If you go back to kind of the guidance on the overall number and if you look at where we've been last year and this year and adjust both the amortization and the one-offs, you get kind of about $100 million to $103 million. And I think that's about the right kind of level for us.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Thanks very much.

Operator

Thank you. Our next question now comes from Thomas Seidl of Bernstein. Please go ahead. Your line is open.

Q - Thomas Seidl {BIO 17755912 <GO>}

Hello, good afternoon. Three questions, one on the top line. Excluding multi-year deals, I think I understand you have been shrinking 12.5% now, given the rate reduction is in line with your expectation. And also excluding the multi-years that are renewing this year, is basically what we should think in terms of top line reduction is in the order of 10%, 15% again this year? First question.

Second question, attrition loss ratio. I hear your comment on the guidance, 34, but with the rate pressure being 10% and already attritional rising last year, of course, I appreciate there were some large losses, but still, why should we not think that the falling rates should bring up the underlying loss ratio?

And the third question is, I noticed your share of IBNR reserves have gone up, a question, is this an indication for being more conservative on the reserves and what is the driver for this?

A - Alexander Maloney {BIO 16314494 <GO>}

Right. Okay. Thomas, I'll take the first one, and then the other two, I'll pass over to Elaine. I think on top line, we're pretty confident, albeit we think that the rating (23:49) environment will still soften this year. The fact that it's slowing down, and the fact that we're pretty much back to our call book, whether that's Cathedral or Lancashire, we're pretty confident that we can keep it relatively flat year-on-year. I think 2015, particularly for the Lancashire book, was probably the most challenging year we've ever had mainly due to the oil price and all the effects that you had there.

So, 2015 was brutal. We are much more confident that 2016 will be much flatter, and obviously the impact of the multi-year is coming out in that. So, we're reasonably confident. There will be some new business around, not a huge amount. But as I said, we just don't think the market is going to be as aggressive as the way it was in 2015, and we've taken most of the pain from our energy account where clients just don't actually have the money to buy as much insurance as they used to, or they don't need as much because their values have reduced.

A - Elaine Whelan {BIO 17002364 <GO>}

I'll just add to that. I think the impact of multi-years is more normalized as compared to kind of moving into 2015 or 2014. But it seems to be renewing and as to non-renewing, so it's much more stable. And on the loss ratio, as I said, still pretty comfortable with the

34%, with maybe a little bit of price adjustment on that. As Alex has said, we're pretty much down to corporate plan. We've done a lot of work around reinsurance, and we've done a lot of work adjusting our book, so I'm pretty comfortable with our attritional guidance.

Could you repeat your third question for me, I didn't catch it?

Q - Thomas Seidl {BIO 17755912 <GO>}

The third question was on the reserves. I noted in your commentary that you have a higher share of IBNR as part of your reserve (25:33). And the question is, is this an indication of being more conservative now or what is driving the higher share of IBNR reserves?

A - Elaine Whelan {BIO 17002364 <GO>}

Some of that is just tightening really. The change is going to be in the 30% to 35% range, so I don't think there is anything necessarily to be done to that, is what happened towards the end of the year, we might have a higher percentage of IBNR.

Q - Thomas Seidl {BIO 17755912 <GO>}

Maybe one follow-up on the top line, if I may. Could you – do you have a flavor for how much of this underlying 12.5% is driven, as you say, by lower exposure as opposed to giving up market share because of price? Can you give us a sense – is it 50/50 or is it mainly lower exposure or mainly market share?

A - Alexander Maloney {BIO 16314494 <GO>}

So, sorry, on that one, did you say – I didn't quite get what you said there, sorry.

Q - Thomas Seidl {BIO 17755912 <GO>}

Sorry. When I heard your comment that a big – it seems to be that a big driver of the lower top line in energy is simply the lower exposure driven by the oil price, and my question was could you give us an indication. Is that basically 50/50 off of the top line shrinking or is it the main course? Or is the top line shrinking mainly because of market share reduction due to the price pressure?

A - Paul Gregory {BIO 16314515 <GO>}

Yeah. Hi, Thomas. I'll take that. So, excluding the impact to multi-year which obviously did have an effect on energy, the reduction in premium is affectively – you're right, it's 50/50. There's about 50% of its driven by the softening market and the rates that have come off. And then, about the other half is reduction in exposure/demand with clients buying less insurance because they've got lower values at risk or just trying to save money.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Thank you. Very helpful.

Operator

Thank you. Our next question today now comes from Andreas van Embden of Peel Hunt. Please go ahead. Your line is open.

Q - Andreas van Embden {BIO 1795530 <GO>}

Hello. Good afternoon. I've got a few questions around Cathedral, the premium volume has declined quite materially in 2015. I think you mentioned around 13% year-on-year. How much of that was pricing? Because it seems to me that pricing pressure at Cathedral was much higher than I would have expected for the type of book at Cathedral rates instead of small, medium-sized enterprises in the U.S. U.S. is very property-focused, but it's property insurance, not reinsurance, and it's all very much Midwest. I'm just surprised about the high level of rate declines. Could you just comment around that, please?

And the second question around Cathedral is now that there has been sort of a change in management within Cathedral, is it an opportunity to integrate Cathedral more within Lancashire? Could you just maybe discuss what your plans are going forward? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay, Andreas. So just a general point on premium, and I think Paul has got a few more details as well. I think – we would expect prudent underwriters in this environment in the classes of business that we underwrite, coupled with the commodity issues, to reduce their top line.

I mean, I would probably question any business that was increasing their top line or – it's very difficult to even keep your top line flat in 2015 because so much happened. And yes, parts of that book are less immune to the rate decreases, but other parts are very much like in this sort of standard lines of business that we write as well. So Cathedral was much as Lancashire are in the same market.

And so, of course, with the right pricing pressures, and those guys are good underwriters. They're not going to just write business to maintain their top line, so that doesn't surprise me. So I think – on the kind of integration thing, I mean, look, we've made some changes. I'm sure, going forward, if there's things where we believe as a company that we can change things that make sense, we will do that. There is no grand plan to do anything dramatic because quite honestly, we think we're in great shape for 2016 already. We've got good businesses at Cathedral, good business at Lancashire, good business at Kinesis. So I don't feel the need to dramatically change things.

If you think about some of the big companies and then their integration plans or the reason they're doing an M&A is generally because they've got too many people in the first place. There's never been so many people at Cathedral. There's not too many people at Lancashire. There's no kind of expense synergies on a big enough scale that we would consider doing that and these things are incredibly unsettling. So, there's no way we would do that when we got two great businesses at the moment. So, we want people focused on their day jobs and making money for our shareholders not worrying about their jobs and there's far too much of that going on in our industry at the moment.

But look, if there's things where we can work closer together, I was quite fascinated by the industry at the moment. It is when the brokers come through the door, I've never seen the brokers as joined up as what they are and I think as a group we're incredibly joined up already. If we can get more joined on areas that make sense, if we can drive more value of that group reinsurance purchasing or things about that. Of course, we would look at that, but we're definitely not going to do things for the sake of it, because that would illogical and too unsettling.

A - Paul Gregory {BIO 16314515 <GO>}

Andreas, just to give you a little bit more flavor on the Cathedral numbers. I think if you look at it in the class of business, they're written there, if you take the reinsurance book reduction there is broadly in line with rate reductions in the market that's primarily driven by rate. If you look at something like marine cargo, that's come off a bit, but as you'd expect with the commodity driven book that to an extent driven by price but also demand. There's also got the energy part in it that sits in 30/10 (31:29) which plays out the same story that we've seen at Lancashire.

On the other line, it's pretty much driven by price other than proxy DNS, and you'll recall that the portfolio that's written in 2010 is approximately half-binded (31:45). That's been very stable both on demand and price. But the other half is open market DNS that has quite frankly been very, very competitive. So that's driven by price, but also some proven underwriting by the team where things have just become a little bit too cheap.

So overall, the 13% is primarily driven by price, but there are a few other small moving parts within that.

Q - Andreas van Embden {BIO 1795530 <GO>}

All right. Perfect. Thank you very much.

Operator

Thank you. Our next question now comes from Ben Cohen of Canaccord. Please go ahead. Your line is open.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi there. Thanks very much. I wanted to ask two things I guess related to premium. The first was, could you maybe just say a bit more about your experience in the January renewals maybe in the context of the rating index that you provide? I guess that was for Q4. When we see that for Q1, would you expect an improvement on the sort of the last number that you gave?

And the second question was in terms of the outlook for net earned premium. Obviously, earned premium declined, lagged. The gross written premium declined in 2015. Would you expect that to reverse in 2016, and can you give us some indication as to how big that effect might be, given all the different multi-year deals and everything else going on? Thank you.

FINAL

Bloomberg Transcript

A - Paul Gregory {BIO 16314515 <GO>}

Hi, Ben. I'll take the first question, and, Elaine, second. So we, 1/1, pretty much all lines were broadly in line with expectation when it came to rating. Most classes were down, but pretty much where we expected. So if you look at the treaty portfolio and it's supported (33:39) by Lancashire and Cathedral platforms, U.S. was broadly in line with what you've seen in the press, which is 5% to 7.5% off. International was a bit more competitive, probably closer to 10% to 15% in some instances.

The energy book was around what we saw across the whole of last year, so kind of 10%, 12.5% off, absent a couple of loss affected deals, which obviously will help bring that up a little bit. There's no real government go business renewing at this time of the year. That's later in the year.

Terror book, again, broadly in line with what we saw last year, circa 10% off, and the same applies to aviation. So the trend is broadly similar. There's definitely a slowing of pace on the treaty side, particularly in the U.S., and it will be interesting to see as we come up to 1.4, 1.5 (34:29) how the market continues.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

And in terms of net earned premium, as you've heard, we think that our top-line is going to be more flat going into 2016. Our net premium earned to net premium written for 2015 was about 118%. That should come down a little bit, but not too drastically.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you very much.

Operator

Thank you. Our next question now comes from Philip Kett of Macquarie. Please go ahead. Your line is open.

Q - Philip Kett {BIO 19507232 <GO>}

Thanks very much. I just had a couple of questions. Firstly, in terms of credit risk, I note that the group's exposure to BBB rated cash in fixed income securities has risen from 9% of the total to 12%. I was wondering what the reason for this was. Is it a change in investment strategy or perhaps a downgrade of investments have already been held.

Secondly, on capital requirements, so you've mentioned a capital buffer a few times. I was wondering if you'd be able to quantify how much that buffer was, whether it's increased recently, just a bit more color on that, please. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Okay. On the first one, growth percentages driven by revenue (35:45) a little bit and sometimes, it's just driven by the dividends we're paying out and makes a big difference when we pay a big dividend to the percentage of the portfolio. Even in terms of just what we liquidate to pay the dividend, and then we rebalance afterwards. So I wouldn't read lot (36:01) into that. We don't disclose our capital buffer. We do have a little bit more than we would typically have by the end of this time of the year (36:08), but not enough to be able (36:10) to make us want to think about special dividend.

Q - Philip Kett {BIO 19507232 <GO>}

Okay. Thank you very much.

Operator

Thank you. Our next question comes from Andy Broadfield of Barclays. Please go ahead. Your line is open.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Yes. Hi. Just one question please just around your tax position (36:29) obviously lots of discussions – board discussions around tax and taxability. Some years ago, I think (36:36) UK which had a tax, you were given sort of special dispensation I think which, I think, has expired. Can you just give us an outline of where you are on your tax position and where you see the mid to longer-term future from your taxable position, please? Thanks.

A - Elaine Whelan {BIO 17002364 <GO>}

Yeah, in terms of future, I'd love to have the crystal ball that tells you where the tax rules are going and the changes all the time. We did monitor them, and they're just constantly moving. We did move over to the UK tax residency a number of years back with the CFC exemption which we then converted. And so, that's all quite stable.

In terms of the future, Alex, if you've got any insight, I'd love to hear it.

A - Alexander Maloney {BIO 16314494 <GO>}

(37:16)

Q - Andy D. Broadfield {BIO 7273415 <GO>}

(37:18) I just want to reiterate there's no discussions in place or anything that you had recently with HMRC.

A - Elaine Whelan {BIO 17002364 <GO>}

No. I mean we look at domicile quite regularly. So it's kind of in a rolling cycle with the board. We have those discussions, but there's nothing in the pipeline at the moment.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Thanks very much.

Operator

Thank you. Our next question today comes from Jonny Urwin of UBS. Please go ahead. Your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi. Thanks for taking my question. Just two quick ones for me today. Firstly, back to your capital buffer, I'm afraid. It's interesting to hear that you're holding a bit back for 2016. I mean I'm just wondering do you feel like you were just gearing up for big events to take advantage of it or are you thinking about other things potentially like small bolt-ons or any M&A?

And then secondly, a bit more of a philosophical question. Where does the price of oil need to rebound to for things to look a bit more rosy for you guys? Clearly, 2015 has been a pretty tough year. But if I gave you one way actually (38:21) you could tell me what the price of oil you'd like, as a bare minimum, I suppose, what would that be?

A - Alexander Maloney {BIO 16314494 <GO>}

$2 (38:28) a barrel. So on the first one, when we think about capital, I mean obviously, there's the mechanics that come out of the machine. So we look at our exposures, we've got about – we buy our reinsurance program and align (38:45) numbers and then we start the debate. At that point, there's a huge amount of debate, particularly at the board, at the moment about the world in general, the insurance environment in general, and we just feel it's prudent to hold a little bit more capital than we would do.

I mean we're definitely not sitting on a huge special dividend that we can do tomorrow, but we just feel it's prudent to just have a little bit more capital. We haven't put all (39:11) that money away for some transaction. As we said before, we would always be very cautious so that any transaction that's not just say (39:19) we wouldn't do it if the opportunity came up. Equally, if there was a market moving event, the amount of capital we have here, additional, is not – hopefully, we would need a lot more capital than that to take advantage of the event.

But we just feel it's always a judgment call, but we just feel at the moment, there's quite a lot going on in the world, so we're just going to be a little bit more conservative. Look, the oil price has been brutal. If you look at the last 10 years, this company has made a huge amount of money as energy insurance, and our clients have made a huge amount of money out of the oil business, because the oil price has been so high, and that's changed rapidly.

And obviously, we've taken that pain along with our clients. I don't think anyone knows what will happen to the oil price, although I still believe it's a cyclical market. And if the oil price increases, our insured assets will increase in value and they will need more insurance, and obviously, we will ride that wave as well.

But until that happens, I think we've taken the majority of the pain already in 2015. Our clients are incredibly good at themselves managing the cycle, and they've taken some drastic action. And obviously, part of the action involves what they spend on insurance. So I don't believe it will get much worse from our point of view from this point, and any increase in oil price over time, we should benefit from that, because our customers will need more insurance. But until that moment comes, I can't see much changing.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks very much.

Operator

Thank you. We'll move to our next question. This is from Frank Cawood (41:11) of Frank Cawood & Associates. Please go ahead. Your line is open.

Hello. Congratulations, again. I think on a very good quarter in the midst of what would be potential turmoil for a lot of other insurers. And Elaine, particularly on the conservative portfolio and I just have the really remarking question. I think it's really gratifying as a shareholder to see reserve redundancies. There's a lot of talk about the industry in general, running out of any possible, I mean not necessarily actuarial redundancies, but just having a little more conservative nature of how your reserves. So I think that's encouraging that we're not seeing a declining slope in those things. So any comments on that?

A - Alexander Maloney {BIO 16314494 <GO>}

I think Frank (42:07), obviously, thanks to your comments. I think as we said many times, running a short-tail sort of uncomplicated business does help you and I think if you look at some of the reserving issues that some others have at the moment, that's – it's always very hard reserving the casualty book and I think you do have the one (42:27), let's be honest, if some of those people have been (42:29) right in the cookie jar and there's not much – it does not make cookies less.

So I think our reserves will always be easier you would think. We've always taken a conservative view on certain reserves. We definitely hope, not to have distant from (42:46) those reserves, but for me, I think it's quite an interesting time in the industry where there does appear to be a number of large companies propping out reserves, and again, as I said earlier that kind of fills out the past.

So we'd like to see what happens there, and I think particularly when you look at (43:05), fascinating what's happening now. There's a lot of big companies that they're going to have to do a lot of things to get their show back on the road. So we're quite happy being small Lancashire at the moment, nice and simple, hopefully, keep our head down, and hopefully, things improve.

Q - Operator

Well, great. Just from the (43:24) shareholders, keep up the good work.

A - Alexander Maloney {BIO 16314494 <GO>}

Thank you.

A - Paul Gregory {BIO 16314515 <GO>}

Thanks, Frank (43:27).

A - Elaine Whelan {BIO 17002364 <GO>}

Cheers, Frank (43:29).

Operator

Thank you. With no further questions in the queue, that will now conclude today's Q&A session. I would now like to hand the call back to our speakers today for any additional or closing remarks. Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you for your time and questions, and we'll talk to you next quarter. Thank you.

Operator

That will now conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.