Q2 2018 Earnings Call

Company Participants

- Alexander Maloney, Group Chief Executive Officer & Executive Director
- Elaine Whelan, Group Chief Financial Officer and Chief Executive Officer, Lancashire Insurance Company Limited
- Paul Gregory, Group Chief Underwriting Officer and Chief Executive Officer, Lancashire Insurance Company (UK) Limited

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Lancashire Second Quarter 2018 Results Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Group CEO, Alex Maloney. Please go ahead, sir.

Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you. Thanks, everyone, for dialing in. The Lancashire Group has produced another solid set of results for the second quarter. Our underwriting portfolio continues to produce excellent results with little loss activity in the quarter, coupled with strong reserve releases. We have underlined top line growth masked by a busy quarter for premium movements, mainly from long-term policies.

Investment markets have been volatile, and as interest rates have increased in the U.S., we have seen the value of our fixed income bond portfolio reduce. But we're happy with our hedging strategy and the short duration of our portfolio.

Our combined ratio for the quarter of 69.2% and 67.1% for the year-to-date is a fine reward for underwriter skill and patience in a marketplace which is changing slowly after years of ill-disciplined underwriting driven by growth strategies which made no sense.

The second quarter developed as we expected with rate increases slowing versus the (00:01:25) first quarter, but we are still showing positive renewal pricing for the quarter and the year to date. New business in the quarter is up when compared to the same quarter last year, and we continue to service our longtime core clients. We purchased the same reinsurance program for 2018 versus 2017 and if not a little more, which was the correct strategy when compared to the underwriting opportunity we witnessed in the first half of 2018.

Our risk-adjusted underwriting return has increased year-on-year.

In the first six months of the year, we have for the first time been able to execute on two new product lines in onshore energy and power, and have very recently continued this trend with another underwriting hire that adds to our niche and complementary aviation product line to the group's existing aviation offering. All these hires fit our strategy of focusing on bespoke and specialist underwriting portfolios which we believe are insulated from third-party capital inflows and online underwriting platforms. Income from these teams will be modest for 2018 and will always match the available underwriting opportunity but will gain traction throughout 2019.

There is a lot of distress in our marketplace at the moment driven by the realization that no hard market has materialized to mask years of poor underwriting results which were previously hidden by benign cat years. We have seen numerous closures of underwriting portfolios and there are numerous syndicates and companies currently out for sale. This market will consolidate whether we witness any cat losses over the coming months or not. All of this is the inevitable consequence of consistent poor underwriting results. Although this will be socially (00:03:23) difficult for the insurance industry, this will ultimately lead to a smaller, more efficient marketplace for the future.

In summary, I'm delighted with our first half year performance. And although the current market didn't reach the levels we were expecting, we are still experiencing positive growth and have been able to execute on new product lines. Nothing changes for us. Our core strategy remains unchanged. We will continue to demonstrate the underwriting and capital discipline that we've always demonstrated. I'm confident that we are finally seeing sanity return into a marketplace that needs to go back to basics and concentrate on profitable underwriting.

I'll now hand over to Paul Gregory, Group CUO.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. In keeping with the first quarter, the second quarter writings (00:04:16) continued to be relatively benign particularly with regard to natural catastrophe losses. This benign loss environment and some favorable prior year development has helped the group achieve another solid quarter of underwriting performance.

We continue to see positive write (00:04:30) movement across the majority of our product lines and relative stability in the others. There's no question that there remains a high degree of capacity in competition particularly in the catastrophe reinsurance lines which undoubtedly dampened further forward momentum through Q2.

However, where we find ourselves at mid-year, with mid-single-digit rate increases across the entire portfolio, is broadly where we expected to be when we shared our views at the start of this year. We also believe that this vindicates our decision to not add materially more risk to the group's balance sheet.

As Alex has mentioned, we've seen more new business in Q2 than we did this time last year, and there have been some select opportunities in certain classes to grow both existing relationships and start new ones at more acceptable writing (00:05:17) levels.

We've seen year-on-year premium growth in property catastrophe, property risk, terrorism, aviation, property D&F and marine cargo. Some of this growth is write, some is new business and some is positive impact of renewal timing. Counterbalancing this growth is the negative impact of multiyear and non-annual premium specifically in the marine and energy classes which Elaine will provide more detail on. But ultimately, the underlying portfolio has grown in line with the market opportunity, which is pleasing.

We've made no secret of the fact if we're able to add good underwriting talent to the group in the niche short house (00:05:54) specialty lines, then we'll do so. As Alex commented, we've recently added the third new product line to the group's underwriting portfolio by entering a niche aviation subclass that complements the group's current aviation offering. That makes three new product lines in the last nine months. There's currently a fair amount of disruption in the London market. A number of companies are up to sale, others are to be merged or consolidated and others are being forced to review the viability of various product lines.

We are fortunate as a group that we are not in a position where we have to review any of our product lines. This is because historically we've made decisions early and exited classes that we do not feel are profitable over the longer term, or as importantly not entered new classes where the only obvious benefit is the top line. This means that now we can look to take advantage of such disruption and employ new underwriters to the group if we believe they can add value to the bottom line.

So from an underwriting perspective, we're perfectly comfortable with where we found ourselves at mid-year. Underwriting results have been good. The write (00:07:02) environment, whilst not spectacular, has improved. There have been some discrete pockets of new business to access. Our risk levels remain appropriate for the current levels of return and we've been able to take advantage of market disruption and add new underwriting talent to the group within complementary product lines.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. The second quarter was fairly quiet in the loss front for us. We also had some decent net favorable development for the quarter which resulted in a net loss ratio of 18.5% and a combined ratio of 69.2%. Our investment portfolio performed well through another rate hike positioned (00:07:37) return of 0.5%. Our ROE for the quarter was 2.9%, bringing us to 5.9% for the year to date. Our gross premiums written have reduced this quarter due to a much larger impact of multiyear and non-annual deal renewal timing than last quarter.

Those impacts can be most clearly seen in our energy and marine classes, and most notably in the Gulf of Mexico energy and marine hull books. In the Gulf of Mexico book, there's around just $17 million impact and the marine hull there's a bridge of $4 million impact of multiyear deals that aren't up for renewal yet.

Q2 2017 also had some adjustments on prior underwriting year risk-attaching contracts across a few lines of business that booked the (00:08:19) premiums. The multiyear deal and prior underwriting adjustments last year (00:08:24) the top line comparison a bit. However, on other lines of business, we continue to see rate increases in new business, in particular, across our property book on both the Lancashire and casino platforms.

And as Paul has mentioned, our new underwriters are also up to a good start, and we're seeing new business in the energy onshore and power books. Part of the increase in our reinsured spend this quarter is as a result of buying cover for those new lines of business. The rest is mainly due to stations under the new quota share agreements we put in place at 1/1/2018 (00:08:54). We had a slight uptick in our attritional losses this quarter, but nothing was indicative of any change in how we think about our attrition. It's just timing and the lumpy nature of our book.

We didn't have any major event or risk losses and our prior-year reserves continue to develop favorably with the release of $26.6 million. We had some largely offsetting movement and a couple of prior-year claims. Otherwise, we just had general IBNR releases due to a lack of reported claims coming (00:09:20) through. Our own (00:09:21) reserves were relatively stable. Our loss ratio again is 18.5% and our accident year ratio is 43.6%.

As I mentioned, investments produced a return of 0.5% for the quarter. We're getting some benefit of the rates hikes in our fixed maturity portfolio coupon, which help to more than offset the losses from the slight increase in yields and spreads in the quarter. Our risk assets continue to perform well and hedge against the interest rate increases. We expect volatility to continue plus further rate increases this year. But we're well-positioned for both of those.

G&A is relatively in line with Q2 2017 although there was an increase in employment cost that was offset by reduction in non-employment cost. As I've mentioned in previous quarters, we're currently slightly long sterling as we're hedging some of the future sterling expenses from our UK operations. But the depreciation of sterling and other currencies to the dollar this quarter, we booked an FX loss.

Lastly, on capital, we continue to be comfortable with our current level of capital is more than adequate for the book we expect to write this year. With almost 70% of our book written in the first half of the year, we expect the second half renewals to be fairly straightforward. As ever, we will monitor underwriting opportunities and adjust our cap accordingly, and we will reassess our capital needs after one season.

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

Q&A

Operator

Thank you. It appears there are no further questions at this time. Let's turn the conference back to yourself.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. So there's definitely no questions. That's definitely right, yeah.

Operator

There are no questions from the phone. No.

A - Alexander Maloney {BIO 16314494 <GO>}

And that's not an error?

Operator

No, not at all.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. Thanks for your time.