Q3 2019 Earnings Call

Company Participants

- Alex Maloney, Group Chief Executive Officer
- Darren Redhead, Chief Executive Officer, Kinesis Capital Management
- Elaine Whelan, Group Chief Financial Officer and Chief Executive Officer, Lancashire Insurance Company Limited
- Paul Gregory, Group Chief Underwriting Officer

Other Participants

- Ben Cohen, Analyst
- Joanna Parsons, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Kevin Ryan, Analyst
- Oliver Troop, Analyst
- Paris Hadjiantonis, Analyst
- Thomas Fossard, Analyst

Presentation

Operator

Hello and welcome to the Lancashire Holdings Limited Third Quarter 2019 Results. Throughout this call, all participants will be in listen-only mode and afterwards there will be a question-and-answer session. And please note, the call is being recorded.

I will now hand the call over to speaker, Alex Maloney, Group CEO. Please begin.

Alex Maloney {BIO 16314494 <GO>}

Thank you. Good afternoon, everyone. I'm pleased with the progress our group has made during the third quarter of 2019. We continue to witness an underwriting environment that is transitioning to the harder stage of the pricing cycle. As this year has progressed, we are seeing continued hardening in virtually all the classes of business which we underwrite. We would still categorize the current market as a hardening one but not a hard market.

The key point to consider is where the absolute rating levels and margins offer any class of business, as it is very easy just to focus on the headline rate increase. Therefore, our current premium growth is very much weighted towards our view of the current underwriting opportunity. We continue to see more opportunities to write new business as others retrench. This allows us to offer our own pricing at levels which we believe are more sustainable.

We have seen a lot of loss activity in the third and fourth quarter, with Hurricane Dorian, typhoon Faxai and Hagibis having a catastrophic impact for our clients. We are also monitoring the current wildfires in California. For us, this is business as usual. We are there when our clients need us most. Although we believe it's too early to comment on typhoon Hagibis or the current California wildfires, our loss estimates for Dorian and Faxai are well within our expectation for such events.

We are not experts to have tasked with predicting climate patterns, but it's clear to us following the recent 36-month period of cat losses, our industry needs to reassess it's appetite for cat exposure and ask the question, are we getting paid the right margin for the risks we're assuming. We see each cat loss as an opportunity to test our assumptions and models, and the increase in recent frequency will be factored into our pricing assumptions as we consider the 2020 renewals.

Another emerging trend appears to be the strengthening of reserves in the casualty market. We are not a casualty writer, but we are monitoring this trend with interest. We believe, if recent public disclosures by carriers become a broader market issue, the need to improved pricing levels across all classes of business becomes more pressing. With much change and increased underwriting opportunity, we believe that our model of flexibility and simplicity will enable us to maximize immediate opportunity.

We will stay fluid with our capital needs, as you look ahead to the important 1st of January renewals and assess our own appetite when purchasing reinsurance. In summary, I feel that Lancashire is perfectly positioned at this stage of the underwriting cycle. We have no legacy issues and are therefore able to focus our attention on an improving underwriting climate.

Lastly, I'd like to thank my colleagues for their continued hard work and our shareholders for their continued support.

I'll now hand over to Paul Gregory.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. While Q3 is not particularly indicative quarter for renewals, it's been encouraging to see the right momentum across the majority of our product lines continue. This rate improvement, further build out of our new classes, plus new business in existing classes have seen us grow headline premiums and also deliver underlying growth of approximately 17% through the first nine months of the year.

It's always worth remembering that this premium growth does take time to earn through and that some of the new team income has more quota share protection than our traditional lines of business. The rating across our portfolio has now been moving in a positive direction since Q1 2018, and in line with our underwriting philosophy, thus scaling the business to the opportunity, so have our premiums.

In some classes, we're seeing some real momentum in ratings, particularly in the specialty lines with classes such as property D&F, cargo, power, downstream energy and our Lloyd's aviation portfolio all seeing double-digit rate rises. Our expectation at the start of the year was that in those specialty lines that have seen some capacity retraction, whether that be through prudent actions of Lloyd's or some of the larger carriers amending their risk appetite, we would see right momentum as the demand and supply balance shifted in underwriter's favor. This is exactly what has played out. Once again, Q3 has seen devastating hurricanes and typhoons tragically impacting the lives and livelihoods of the people in the Caribbean, US and Japan. From the insurance claims perspective, our exposure to those losses is well within our expectations and these events help to ensure that rating momentum continues.

Additionally, these latest natural catastrophe events are most likely going to create further dislocation in the retro market at 01/01. During 2019, we've already seen a gradually hardening retro market as tracked funds, loss creep and increased demands have all intertwined to push rates up. Our expectation is that retro rates continue to move upwards again at 01/01.

In purchasing our own retro cover, we have the flexibility to manage our purchase and premium spend if needed, although we will not be immune from the rating environment. Likewise, our focus on long-term reinsurer relationships with rating carriers will most likely help us through our retro purchasing at 01/01. And off course, this is supportive for Kinesis, where there will be an opportunity to our better priced and structured business. It's also our belief that this could help move property cat rates as we move through 2020.

Much like 2019, we do expect there to be a lag in property cat rates at the start of the year. Loss free territories renewing at 01/01, where some carriers are less willing to give up market share, are likely to see a more muted rate in response than loss impacted and more capital-intensive territories that renew later in the year. So overall, our outlook remains constructive. We are likely to see most of our classes continue to benefit from rating improvement as we move into 2020. This will allow us to continue to build out the new classes of business as well as grow in our existing books of business.

As market conditions continue to improve, there are certain areas of our traditional product lines from which we've retracted in recent years that we can grow back into without the need for additional teams or resource. We will always have our [ph] positivity with the recognition of where rates are coming from on a relative basis. And therefore, you can expect any growth to be underpinned with our usual underwriting discipline.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. As we're only publishing our trading statement again this quarter, as for Q1, my comments on our results will only cover a few things, our top line, losses and investment returns for the year-to-date. Our gross premiums written were up in the prior year, mostly due to the new teams we've added to the business, in addition to some rate improvements, plus some adjustments coming through on prior underwriting new contracts, and also some growth in our property cat book.

While our top line is up 13.8%, as Paul has noted, our underlying growth number is slightly higher than that. We recorded a net loss estimate for hurricane Dorian and typhoon Faxai of $33.2 million, with those events contributing 10.7% to our loss ratio for the year-to-date. Otherwise, as I mentioned, our half-year reporting, we haven't had much of note reported in relation to the current accident year, although we have seen a slight increase in the attritional claims being reported. However, there is nothing in the uptick that's indicative of any change in how we think about reserves or our attritional loss ratio.

Investments produced a return of 4.1% for the year to date, with most of our asset classes having a positive contribution to the return. While most of the return comes from our fixed maturity portfolio, we have some nice support from our bank loan, hedge funds and equity exposures. With the recent additional rate cut by the Fed, we expect to be in a lower yielding environment, certainly for the immediate future. Also given where spreads are, we don't expect to see any benefits in further spread compression in the near term.

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

Questions And Answers

Operator

(Operator Instructions) And the first question is from the line of Kamran Hossain from RBC. Please go ahead, your line is now open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, everyone. Two questions. The first one is just on the -- I guess the intention around capital and not giving back the share -- you know to me, it makes perfect sense, but just, if we get an idea of whether that's simply buying less rates and therefore you need more capital, or is this taking on exposures in other ways?

And the second question is just around 01/01. I guess for the last couple of years, we've been a little bit disappointed around 01/01, but then I guess, half the exposure there plus is European, where we haven't seen the losses. So looking out to 01/01, do you think we'll be disappointed again or what we -- kind of what are your expectations around that at the moment, especially with the backdrop of you deciding to retain all the capital for now?

Any thoughts would be much appreciated. Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

I think -- I think on capital, Kamaran, I mean clearly, if you think about what we've always said about capital, we always said, if we believe there is a good underwriting opportunity, we would use that to underwrite, and if we don't believe there is, we would give that back to shareholders. So I think that's entirely consistent with what we've always said. Clearly, we believe that there is an opportunity to use that capital going into 2020, that might be 1st of January, as you said, 01/01 is quite predominantly European reinsurance. And as you said, there haven't been losses there. So it's quite hard to call. There is a lot of -- there is a lot of noise about 01/01 and buying reinsurance. So I think in simple terms, we just want ultimate flexibility and we clearly believe that the underwriting opportunity is better than it was this time last year. And clearly, we don't have a crystal ball, but for us it's about having that capital flexibility going into '20.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's great. Thanks, Alex.

Operator

And next question is from the line of Jonny Urwin from UBS. Please go ahead, your line is now open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi guys, thanks. Just two for me, please. So firstly, I'm just trying to gauge how bullish you are on the outlook. I mean it kind of feels like this is what you've been waiting for. And then we've got pockets of rate dislocation, the potential casualty event, which is probably more disciplined from your peers. If you could try and help us gauge the size of the opportunity, that would be great.

And then is there any change at all in the view that the current capital base can support your growth plans? I mean, does -- is retro growth is going to consume more capital or anything? So, any color there would be great. Thanks.

A - Alex Maloney {BIO 16314494 <GO>}

So, basically we don't really like the word bullish, I suppose, we're just more -- we do see more opportunity, but the absolute key for everything that you look at the moment is, it's very easy to look at the headline on any particular class of business and I could give you some great headlines, but the key for the whole market is what does that mean in absolute terms and where are you coming from. So, yes, there are some big headline rate increases in certain classes of business. Quite frankly, we're still declining more new business than we're writing because even with some of those big headline rate increases, you're still on at levels that are technical or above. And that is a real symptom of a number of years of soft market, but the market is moving on. Clearly, we think the opportunity is better than what we did 12 months ago.

And when it comes to growth, remember for us, cat business is what really drives most of our capital needs. And if the cat market starts to move clearly, we want to write more cat business. The 1st of January is when we buy a lot of reinsurance and we can make the call if we want to buy less reinsurance. So I think for the immediate opportunity, and clearly we haven't done the special, so we believe we have adequate capital for the immediate opportunity. And if we don't, that means the market is better than what we think and that's a nice problem to have.

Q - Jonny Urwin {BIO 17445508 <GO>}

Sure. Thank you.

Operator

Next question is from Kevin Ryan from Bloomberg Intelligence. Please go ahead, your line is open.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thanks very much. I was very interested, Alex, in what you were saying about the casualty market and the reserve strengthening. Is that hint that you might wish to move into that market? Or are you really flagging that this is going to suck a lot of capital out of the market, which could have a knock-on effect for the area that you're currently playing in? Thanks.

A - Alex Maloney {BIO 16314494 <GO>}

Yeah, I mean look, we wouldn't describe ourselves as casualty experts, because it's not -- not an area that we're currently involved in. And clearly we're quite interested in a lots of public disclosures that's happened recently. I suppose what we're trying to say is, if that's a trend and that becomes an issue for our industry, that's going to take a lot of capital out the system. And I think as rating goes up and people try to improve the profitabilities of their businesses, this is a further thing that's going to drag people back. So I think that's why we are quite interested in it. Look for us, we're always interested in opportunities, and you know, it's obviously too early at the moment, but would be right casualty at some point, I think that's the question we're asking ourselves. But yeah, I think the next 12 months is going to be fascinating.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thanks.

Operator

Next question is from Oliver Troop from Autonomous. Please go ahead, your line is now open.

Q - Oliver Troop {BIO 20944194 <GO>}

Hi, good afternoon, everyone. A couple of questions from me. Firstly, I guess a follow-on question from Jonny's. You got the ability to issue 15% of shares on non-preemptive basis. I just wonder what the world would have to look like for you to use that power, and I guess how far are we away from that world right now?

And then second question, you previously talked about $60 million headwind to GWP this year for multi-year contracts, (inaudible). I just wondered how much of that headwind would remain for Q4, have we had posted already? Thanks.

A - Alex Maloney {BIO 16314494 <GO>}

Yeah, I think, I think the follow-on question about how good does the market have to get, I mean for us, I think the cat market has to move on. I mean there is a lot of -- there's a lot of conversations around retro the 1st of January, and the variability of reinsurance and we are in that period now where everything sort of starting to happen. So I think we believe that cat reinsurance will have to pay more next year or people will have to cut back. And to me the key, which we've seen in other classes of businesses, if people start cutting back cat write-ins, that will move the market. So for that, for us, that will start to move our capital if we write more cat business. As you said the preemption is one of the levers we can pull, but as we did say earlier, I think at the moment, unless the market really, really sort of surprises us on the upside, I think we've got enough capital for the immediate opportunity, but clearly, as I said before, as well, If we get to the point where we're using more capital, we see that as a nice problem to address. Elaine, can you just talk to the multi-year one, please?

A - Elaine Whelan {BIO 17002364 <GO>}

Yes. Sure, so, I think for 2018, we said we had about $60 million multi-year impact. And we said you could expect a little bit less than that for this year. We're probably running a little bit behind expectations at the moment. So I would expect to see some and multi-year impact in Q4. We do have multi-year impact every quarter, but the impact has been coming down over the last few years, so it's a much smaller impact now.

Q - Oliver Troop {BIO 20944194 <GO>}

Okay, great, thanks very much.

Operator

Next question is from the line of Thomas Fossard from HSBC. Please go ahead, your line is open.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Two questions from me. One would be on the -- coming back to you, Paul, initial comment on potential your interest to go back into lines where you've been retrenching in the past years. Could you be maybe a bit more precise? Does that mean that you may enter back again into property D&F? That's the first question.

Second question would be related to net premium and if Elaine could help us to better understand what we should expect in terms of growth in terms of net premium earned for '19 and 2020. I know that you don't like to comment to much on premium guidance, but any color would be interested.

And also on Kinesis, due to the potential large losses in '19, how this is going to impact the profit commissions that we should expect for 2020? Thank you.

A - Paul Gregory {BIO 16314515 <GO>}

Hi Thomas, I'll answer the first question. Yeah, what I described in there is if you look at certain classes of business that we're still being writing over the past few years such as aviation and marine, there are niches within those classes that we've really cut back on. But half the team is in the ability to grow back into them and have started to do that this year as the rating environment improved. And I suppose the point I'm making there is, obviously we bought in -- we did bring in three new teams. But there are also areas in existing lines of business where we can naturally grow back into.

On your property D&F point, I would highlight of course we do write a substantial property D&F portfolio already through our Lloyd's platform. And obviously as that market improves, we have the ability to grow that out as conditions get better.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, on the net earn premium question, we would be expecting growth in that for 2019 and 2020 versus last year, but just bear in mind that there's a fair bit of growth in our top line as we're building out the new book to business, but there is a little bit of a lag in the earnings of that as they develop and also we buy the reinsurance upfront. So there's a little bit we're taking impact on that. So while you see an increase in 2019, it might not be as high as you might otherwise expect. It will be higher in dollars, but probably slightly lower earned to written ratio than the last year.

A - Paul Gregory {BIO 16314515 <GO>}

Me and Darren can take Kinesis. I mean, I suppose the first thing to say on Kinesis and I'll let Darren talk about how it was structured this year in terms of what was sold, obviously there's cat exposure in Kinesis. There have been a number of cat losses this year, some of which remain ongoing. So I think it's a little bit early to talk about potential impacts to profit commissions coming through, etc., but obviously we can give you better guidance on that at the end of the year.

And Darren, do you want to talk a bit -- a little bit about how Kinesis was structured for the year in terms of what you were selling?

A - Darren Redhead {BIO 17995744 <GO>}

Sure. Thank you. So one thing you've heard from us before is, and Alex touched on in his opening statements, is we have seen increased loss frequency through '17 and '18, and during the '19 we re-engineered, if you like, Kinesis portfolio to be at higher attachment points and that has been through '17 and '18.

Q - Thomas Fossard {BIO 1941215 <GO>}

All right, thank you.

Operator

And next question is from the line of Ben Cohen from Investec. Please go ahead, your line is open.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi, thanks very much. I just have two questions. The first question was just for a bit more detail in terms of rate adequacy, particularly in the reinsurance. Look Hiscox, yes, they were saying that they thought large parts of the market has materially sort of under-priced. I just wondered how much growth you might see if there was -- if there was a bigger upturn where those sort of opportunities might be.

And the second question was, just in terms of the outlook for the attritional loss ratio. Given the increase in price that you see in this year, is it reasonable to assume that your attritional loss ratio would show material improvement in 2020? Thank you.

A - Alex Maloney {BIO 16314494 <GO>}

I think, (inaudible) but I think one thing that people need to consider and it's in line with what Darren said about his portfolio. I think we're at the stage of the market where it's not just about price. So particularly, if you look at some of -- some of the events in Japan, I mean, I think in the soft market, people probably didn't move attachment points. So I think as an industry, people need to consider what -- effectively what cat events I want to cover and what the impact of those risks. So I think it's a combination of level and price. And I think that's what you're going to see into '20. And clearly, I mean that there parts of any portfolio that are more under-priced than others and maybe that's just more apparent when you have losses, but I think as we've said and as Darren said, I think with the increased level of frequency, that will all be factored into people's models and appetite, and clearly the availability or the lack of availability of reinsurance going into next year will focus people's attention a bit more as well.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay.

A - Paul Gregory {BIO 16314515 <GO>}

And one thing, when we look at opportunities going into the year, Ben, to be honest, we are pretty agnostic as to where we deploy. We'll just look at the market as it is and if there is areas to grow, whether that be in cat and non-cat, quite frankly, because we're getting better rate and then we'll obviously do that. And I think you saw that this year with us, developing a small footprint from our Bermuda platform in Florida. There was an opportunity to provide some more risk and we took that and there could be opportunities like that as we move into '20. Trying to predict exactly where they're going to be at this point is obviously difficult, but obviously they're there, and then we will look to take advantage.

A - Elaine Whelan {BIO 17002364 <GO>}

Hey Ben, on the attritional loss ratio, I think it's too early to consider any changes to guidance on that. I think basically our current RPIs are (inaudible) by a point or two anyway. I think (inaudible) this year in general, and you do have some new lines of business that are a bit more attritional in nature and they're quite new books and they still need to develop a little bit. So kind of comfortable with where we've been guiding so far. And also may not change as well, but we'll let you know.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thanks very much.

Operator

Next question is from Joanna Parsons from Canaccord. Please go ahead, your line is now open.

Q - Joanna Parsons {BIO 1558226 <GO>}

Thank you. Well, Ben sort of asked part of my question, but to follow on a little bit on that. Do you see -- notwithstanding the losses that have come through in the second half, do you still see the rate rises in the reinsurance market as still being very much loss-driven? Because obviously there has been the talk about the Europeans not wanting to pay for others' losses. And on that, do you think that the European prices are appropriate? Technically, are they adequately priced and how much of that do you write?

And then secondly, talk as well about more retrenchment in either capacity. Are you seeing evidence of that? Do you believe that we'll get a further flight to quality in 2020?

A - Alex Maloney {BIO 16314494 <GO>}

I'll take the first part, Joanna. I think you definitely see it go through '20 in the cat reinsurance space. There will be a difference, in my opinion, between loss impacted and non-loss impacted territories. Also you judicially say I talked about, and this will feed into the second part of your question on ILS, so I definitely think there will be more dislocation in retro at 01/01. Historically, that does take some time to filter through. Sometimes there is an element of head in the sand as you got to come up to 01/01 renewals, and then people realize the cost of their retro and that takes that time to feed through, and you saw a little bit of that this year. And I think you'll see a bit of that in 2020 as well. So some of it will be that retro lag and some of it will be loss impacted territories being skewed to Q2.

Darren, do you want to talk about ILS?

A - Darren Redhead {BIO 17995744 <GO>}

Yes. Joanna, you saw some of investors being more picky through '19, and if you like, rationalizing some of the ILS managed they invested in and that's just been accelerated, in whether you're going through to 2020 and whether you have 30-odd managers, I think that will be rationalized down over the next couple of years (inaudible).

Q - Joanna Parsons {BIO 1558226 <GO>}

Thank you. Sorry, just to clarify on that. So you still think that's -- rate rises will be still reflecting more loss activity, rather than anything else? But did I misunderstand?

A - Alex Maloney {BIO 16314494 <GO>}

So, Joanna, I think, I'm in the same camp as Paul. So I think that loss effective business clearly will -- the market will see rate increases. But the thing that will move the cat market if it happens, will just be appetite, because I think more than anything, and maybe this is -- maybe it's an industry we're not very good anymore, putting prices up if everyone sort of stays. But I think in other classes of business, where we're seeing the biggest rate increases, people have retrenched substantially. So I think if carriers get to a point where they decide they don't want as much cat business or they decide that a certain zone to them is under-priced and they've retrench, that is where you will see the biggest rate increases. And so I think one of the questions from Kevin earlier about European business, at the moment -- who knows, at the moment, it appears unlikely that you'll get substantial rate increases on clean European business. That doesn't seem apparent at the moment, I'd love to be wrong. So for me it's about -- it's about appetite for cat business, it's people's view on frequency. And after 36 months of cat losses, people are asking themselves those questions. So that's what's going to move the cat market. It's a supply and demand game, at the end of the day.

Q - Joanna Parsons {BIO 1558226 <GO>}

Sure. Okay, thank you.

Operator

(Operator Instructions) And next question is from Paris Hadjiantonis from Exane BNP Paribas. Please go ahead, your line is open.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, hi guys. It's Paris from Exane. I have a couple of questions remaining. The first one will be on RPIs. So looking out what you have disclosed in Q3, it doesn't look like an acceleration from Q2, but obviously I know that Q3 is not a big renewal period. And not a lot of people -- not a lot of business actually renews during like this period. So maybe if you could give us your expectations going into the full-year numbers or maybe beyond that? What I know about some of the aviation classes see a big renewal in Q4 and a few other business as well. I mean if you can also talk maybe about the technical profitability on a like-for-like business because the RPI doesn't really include new business. It would be quite helpful.

And the second one is a quick one on the reserve releases. It looks like a healthy number in Q3. I just want to make sure that this is general IBNR, or whether there is some degree of large losses from 2017-2018 developing positively there.

A - Alex Maloney {BIO 16314494 <GO>}

Paul, are you going to take the RPI one?

A - Paul Gregory {BIO 16314515 <GO>}

Yeah, I'll take the RPI one. Yeah, to be honest, you're right, Q3 is a much lighter in terms of premium, but in general the trend is very similar to what we saw in Q2, so is the continuation of what we've seen in Q2. One point I would make is, there is some new business in the aviation clauses in Q3 that wouldn't have been there last year, because we didn't get the new aviation team until Q4. That's all new business, so it doesn't come with an RPI. And also some of that business is written -- some of our aviation business is written in our Lloyd's platform and we produce a combined RPI view for Lloyd's to say you necessarily -- you can't necessarily see the detail on that period. Our new business, if you were to -- RPI generally carries a higher RPI than renewing business because obviously we haven't written in the past. It hasn't met technical, so it needs to have a bigger rate rise to get where we want to be in terms of technical. So we can't RPI new business and obviously that doesn't come through.

A - Elaine Whelan {BIO 17002364 <GO>}

On the reserve releases, '17 and '18 reserves have been pretty stable. So there's a little bit of move on there, but it's mostly releases in general RPI. And so it's down to a lack of reported coming through and a few other bits and pieces of adjustments, but nothing really that significant an isolation in that number.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

That's good. Thank you.

Operator

And there are currently no further questions registered. So I will hand the call back to the speakers. Please go ahead.

A - Alex Maloney {BIO 16314494 <GO>}

Okay, thank you very much for your time. And we will talk to your at our full-year results.

Operator

And this now concludes the conference call. Thank you all for attending. You may now disconnect your lines.