Q4 2014 Earnings Call

Company Participants

- David Andrew Horton
- Martin Lindsay Bride
- Neil Patrick Maidment

Other Participants

- Anthony Araujo Da-Costa
- Barrie Cornes
- Ben Cohen
- Joanna T. Parsons
- John A. Borgars
- Kamran Hossain
- Nick H. Johnson
- Sarah Lewandowski
- Thomas Seidl

MANAGEMENT DISCUSSION SECTION

David Andrew Horton {BIO 5697110 <GO>}

So, welcome, ladies and gentlemen, to our Annual Results Presentation. We have the disclaimer. If I go on to the contents, I'm going to give you an overview of some of the highlights of 2014. Then, Martin is going to take us through the financials, including our new capital disclosure. Neil is going to give an overview of how the underwriting has actually gone in 2014, a view of what 2015 is going to look like. And then, I will come back at the end to give you a view of our vision and strategy and overall outlook for 2015.

So, overview for 2014. Some high-level numbers, which you would have seen, which we published first thing this morning. So profit is down to $262 million from $313 million, mainly driven by the prior-year reserve releases which Martin will go through later. We're in line with our long-term average of an 89% combined ratio, and it's our second best profit ever. So it's not too bad, the result.

And return on equity reflects that low-interest rate environment with this – with the 17% return on equity. We're also pleased about the growth. It's been a very competitive market in 2014, but growing the top line 3% is excellent, and Neil will talk about one or two of the initiatives that have contributed to that growth.

Rates have reduced by 2% across the whole portfolio. There's a bit of spread of rate reductions in the cap classes to non-cap classes. Neil will go through that in a slide in a few minutes. As I mentioned, the prior-year reserve releases are down over the exceptional year of 2013.

Investments almost doubled. We achieved a close to 2% return. We had 1% in 2013, a generally quiet time where interest rates were edging down across the world. And capital action, base dividend, up 6% year-on-year. And because we have excess capital that funds our growth going forward, we are doing a special dividend – giving a special dividend of £0.118.

I'm slightly concerned that the term special is being overused, because we've now done special dividends in four of the five years. I do want to flag, it doesn't mean they're going to continue forever. It's a combination of good profits in 2014 and what we can actually use that capital for. We are expecting growth of around 5% in 2015, which we'll obviously use some of the capital. And we're also expecting rates to come down a bit, and therefore the margin of our portfolio is a bit lower, and that also uses some of the capital. So it's a combination of those three elements, which means we feel we have enough capital to deliver another special dividend in 2014.

If I just look at some of the initiatives very briefly, this year is our 10th anniversary of being in the U.S. Adrian's been out there for two years, celebrating those 10 years constantly over that two-year period. He's got six months left before he comes back. Done a great job at giving us focus, and it's fantastic in our 10th year to go over the $0.5 billion premium for the first time.

Not surprisingly, that's also helped drive the Specialty Lines growth, in our view, the better-rated business in 2014, up 8%, because about 80% of our U.S. business is Specialty Lines.

Continue to invest in the four areas. So, we remain an attractive place for people. So, we've brought people in on both London and in the U.S., across all areas, underwriting claims and everything else to do with the business, which had been great.

Continue to invest in new products; they can be core products where people have joined us such as cargo and property, or it could be the new, more innovative products, such as cyber and satellite.

Infrastructure, we've got to continue to invest. As we've grown our U.S. business, it becomes a larger part of us. It tends to be smaller business, higher volume, and it means we need to continue to invest in our platforms as that business is expected to continue to grow.

And from a geographic point of view, I think we've touched on – Adrian touched on at the half year how we're growing in the U.S. and getting closer to our clients in the U.S., opening a Dallas office, which we have now opened, and we'll be opening a Los Angeles office shortly. We've also put a couple of people in Dubai to look at the political risk market in the Middle East.

Active capital management continues, and we will look at the new disclosures I mentioned that Martin has come up with later on.

And we continue to strengthen the investment team. It's really important part of our profitability. So, we have insourced a part of Falcon. Falcon are now on a fully arm's length contract as far as we are concerned. And we've also taken on Stuart Simpson, who was the CIO of Lloyd's, to strengthen that team, which has been excellent for us.

So briefly looking at charts, you can see the top left where we show growth over the past five periods despite quite a competitive environment, which had been excellent. A lot of rebalancing the portfolio over those five years, looking for the ones with the widest margins and holding back on ones with low margins.

Combined ratio, some volatility in it, but averaging at around 90%, which is our target.

The dividends, the pink block, you can see the base dividend growing over our target range of 5% to 10% and special dividends where we have excess capital. And on the right-hand side, good return on equity over the five-year period.

This chart we show every year just to give a brief explanation. Our long-term incentive plan rewards based on growth in net asset value. The premise is that companies that grow their net asset value per share, the share price follows that. So, the gray bar is showing how the long-term incentive plan kicks in and tops out every five-year period, because it came in five years ago.

So if we achieved a 10% positive risk-free rate of return compound growth in net asset value per share – that is the bottom of the gray triangle – and the 15% is the positive risk-free rate at the top of the gray triangle. So, that's where our long-term incentive plan tops out. And you can see over the five years, we saw they started, in the gray, then went to the bottom of it in 2011, where the cap 2011, middle, just get the top in 2013, and now we'd outperformed it.

So, we've grown the net asset value per share by just about at 120% over the five-year period. The logic being, so that's a major driver of the share price, which was flowing nicely, in line with it up to the midway of 2012. And then, the share price has taken off beyond then with great results we've had over a long period of time.

On that note, I am going to hand over to Martin.

Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you very much, Andrew. Good morning, everyone. I'm Martin Bride, Finance Director of Beazley. And as is normal, during this presentation I'm just going to take you very briefly through a couple of the key figures, talk about investments, reserves and capital.

So, a few more figures. Our net written premiums, our net earned premiums, the growth there is very much in line with the gross written growth. That's, broadly speaking, what we would expect. And the use of Reinsurance has been very stable in Beazley, and that's why you see a consistent picture across those three metrics.

The other thing perhaps to pull out on this chart, net assets per share, net tangible assets per share, measured in sterling, therefore, quite a lot. There is an FX effect helping us there, because we actually carry our net assets in dollars. So measured in dollars, they're about flat. But why is that? That's because we distributed an excessive $220 million in dividends last year. So we have been exercising very disciplined capital management, which is why those per share figures are also in flat.

So on the investment portfolio, the middle of 2013, following some mark-to-market losses as interest rates went up, we indicated that we expected to make a 2% investment return over the next period. And we've done that. So over the 18-month period from 30th of June 2013, we pretty much achieved that. The unrealized losses have now actually unwound. So going forward, whilst interest rates remain at their very low levels, we're expecting slightly lower investment yields. But we are very happy to have delivered very much in line with our expectations over the most recent period.

In terms of the portfolio itself, it's broadly unchanged. There'd be one or two minor movements. We retain a core portfolio very cautiously invested. It's about 85% of our assets. And then, we have about 15% allocated into capital growth assets. Historically, that had been purely hedge funds targeting on correlated returns. And as you can see from the chart, we've expanded out the universe of assets that we will contemplate in that portfolio a little, with some equity-linked funds and some funds looking to invest in slightly more liquid areas. The overall investment risk that we're taking is unchanged. So there's not been an increase in investment risk implicit in those moderate changes.

If we look at the reserve picture, key to how Beazley approaches reserving is we set reserves prudently initially as we underwrite business and, therefore, on average, one expects reserve releases to emerge as we actually settle off claims. That has been the case in 2014. The level of 2014 releases is pretty much bang on the average that we've seen over the last five years. It is down on 2013, and that reduction compared to 2013 is the principle reason for the reduction in our overall result and the increase in the combined ratio.

So, two or three areas. First of all, Reinsurance. Both years very comparable in terms of loss activity. The difference in 2013, we had improvements in back-year (10:02) losses such as Chile and Thailand. In 2014, we actually increased our reserves for the New Zealand earthquakes.

So that's why while the Reinsurance outcome is slightly different, Specialty Lines portfolio at the bottom, the large dark purple chunk, we are coming perhaps towards the end of the reserve releases from the exceptional period 2003-2006, and that is the primary driver of why releases in that business are lower in 2014 over 2013.

So the next and most important thing to think about is, well, what about the future? This chart shows you how much margin we believe the reserves on our balance sheet are holding, which is a lead indicator of whether or not reserve releases will continue. And our perspective is that the reserve margin at year-end is very much in the middle of the corridor we target. Pretty consistent with recent history, slightly down on the previous year-end. But as I've said previously, minor movements in this line are to be expected.

So, our perspective is that we have the same reserve strength resulting from a consistent reserving process that we've always had. And therefore, all other things being equal, we would expect to see reserve releases continuing at broadly similar levels in the future.

So, now on to capital and capital management. We like to show this chart. It captures a history of the capital management discipline that we've been exercising over the last five-or-so years. And we've now cumulatively passed $700 million of capital returns to shareholders since our rights issue in 2009, and that is actually more than the market cap of the company post rights issue at the time. So, that's been a very successful period for our shareholders.

In terms of our balance sheet, capital strength, we're in a good position. We have been signaling that we would change our disclosure slightly this year-end, and we have. So we're now presenting to you, as you can see on this chart, our capital requirements between our Lloyd's underwriting platform and our U.S. business. So, that shows you how much capital we are asked to post. So we've never shared those numbers with the market before, so those are new numbers, and we will continue to disclose those. And in principle, those numbers only grow if we grow our business and we grow the risk that we are taking.

Against that, what funds do we have available? We have our IFRS capital. We have our debt. And we also have what we call the Solvency II adjustment, because capital is now set on a Solvency II basis. When you add all of that up, we have a 30% surplus at year-end.

Now, the board has discussed in the Solvency II world what we should target and we've agreed that a 15% to 20% corridor is the sort of corridor of excess capital we should target, because that gives us the flexibility to take advantage of any short-term growth opportunities that come up and also recognizes the fact that our business is a volatile business and profits won't always be exactly as we expect in the business plan.

Because we are above that target corridor, we've declared a special dividend. And post that special dividend, our capital position is right in the middle of our target range of 20%.

Neil Patrick Maidment {BIO 5232207 <GO>}

Well, thank you, Martin, and good morning, ladies and gentlemen. In the next part of the presentation, I'm going to be looking at underwriting performance, which remains the key driver for the results which we're announcing today.

So if I start with 2014, particularly pleased to be able to report our combined ratio of 89%, in line with the guidance that we provided at Q3 and a little ahead of our five-year average of 90%.

Also pleased to be able to report growth; 3% in gross written premiums. That growth came across a range of products such as the first year of operation of our satellite business within Marine, the continued development of our cyber business within Specialty Lines, and also from a range of geographies. And in particular, as Andrew has spoken about, the continued positive development of our business onshore in the U.S. in its 10th year of operation growing 19% to over $500 million.

Now, we benefited there from a more focused distribution strategy. So, we're concentrating on nine key broker partners in six key cities. And also from a continued investment in people. We're putting more of our products in more of our offices across the nation.

Now, the results have been achieved despite an increasingly competitive market. Rates' easing overall by 2%. But our ability to reach the more stable SME and middle market business, particularly onshore in the U.S., has offset in our portfolio the more competitive market conditions here in London. And I think this underscores once again the benefits of a diversified portfolio.

We've also benefited from favorable claims environment and, in particular, that lower-than-normal instance of natural catastrophes. And as Martin has just described, in addition to that, reserves for prior liabilities continued to develop positively and, in particular, our consistent approach to reserving has maintained that surplus within the target range.

Turning to the numbers. So gross written premium, plus 3%. Net earned premium after the cost of reinsurance, growing slightly faster at 4%. And it's worth noting that we continue to buy more Reinsurance than we sell. And therefore, in that sense, at least we are a net beneficiary of a more competitive reinsurance market.

(16:22) the combined ratio. Expenses grew 1 point with our continued investment in the infrastructure, people and products; the opening of the Dubai office and the office in Dallas, for example. And claims ratio grew 4%, which as Martin described is (16:41) the exceptional year of 2013, which benefited not only from a low instance of claims during the calendar year, but also exceptional releases from the catastrophes which had occurred in 2010, 2011 and 2012.

Turing to pricing, that eased by 2%, led by the short-tail catastrophe exposed lines of business and the reinsurance market, in particular.

And if we turn to look at market conditions, this chart shows the cumulative risk adjusted. A great change across the portfolio going back to 2008. We measure pricing on a risk-adjusted basis to take account the changes in terms and conditions and exposures, as well as pure premium.

What I would note about this chart is that that line have remained relatively consistent across this period despite the ups and downs of individual business lines. And again, I think that underscores the benefits of a diversified portfolio.

If I turn to 2014 and look at the individual divisions, Life, Accidents & Health achieved 9% rate increases following the loss activity, in particular, in its Australian portfolio which we talked about last year.

Four other divisions: Property group, which is the pink line; Reinsurance, the dark blue line; Marine, the light blue line; and PCG, Political Contingency Group, which is the grey line, all experienced more competitive market conditions to a greater or lesser degree, led, as I say, by those large-risk short-tail catastrophe exposed lines of business such as property catastrophe reinsurance, energy insurance and terrorism.

Balancing this, Specialty Lines, which is our largest division, has been increasing rates since 2014. And although we saw the pace of those increases moderate during this year – sorry, it's been increasing since 2012 – although we saw the pace of those increases moderate during 2014, we, nonetheless, finished the year with Specialty Lines rates flat overall. And it's this more stable rating environment in Specialty Lines which is offsetting in our portfolio competitive pressures elsewhere.

And if I turn to look at 2015, essentially we expect very similar rating trends to continue this year, with continued pressure on the short-tail catastrophe exposed lines of business after this favorable and benign claims experience that that market enjoyed for the last couple of years, and fueled by a significant amount of capacity.

Indeed, the 1st of January renewals in the treaty reinsurance market, we saw pricing continue to ease by a further 8%.

Offsetting that, we have the positive effect of real economy growth in the UK and most particularly in the U.S., where we sell most of our products. So against that background, we have a 2015 business plan that looks for continued moderate growth in the mid-single digit range.

Now every year, our planning process focuses on cycle management. That's the process that Andrew described, where we identify the areas with most opportunity and push forward there whilst exercising discipline in other products.

So in 2015, we plan to write less property catastrophe reinsurance, less energy insurance, and overall we will deploy a smaller natural catastrophe risk budget.

Balancing that, we have a number of areas of growth opportunity; four that I would highlight. The first is SME products, both in Property Group and Specialty Lines and both in the U.S. and in Europe. In Property Group under Mark in the U.S., the more stable rating environment in the small- to mid-sized risk there provides an opportunity for our Beazley E&S division to continue to build. And in Europe, during 2014 we have launched myBeazley, which is an online trading platform to sell small technology E&O business to brokers in France and the UK, and by the end of 2015 in Germany

Second area of opportunity remains the U.S. We will have the first full year of operation of our new Dallas office. As Andrew mentioned, we're also opening an office in Los Angeles. And we have the impact of that initiative to deploy more of our products across more of our offices across the nation.

The third area of opportunity is what I would describe as the green shoots in our business. These are products that we've started over the last five or six years, some of which have been held back by economic conditions and, now in a more positive economic environment, particularly in the U.S., we're seeing increased demand. These are products such as environmental pollution liability and transaction liability, which is the insurance of reps and warranties in M&A.

And lastly, as Andrew mentioned, people, the ability to attract experienced underwriters to some of our businesses enables us to grow. These underwriters bring their own relationships, and that enables Beazley to grow in maturing markets. Two examples of that would be Simon Jackson, who's joining to succeed Jonathan Gray in the leadership of our largest property team; and Ed Barker, who's joined cargo earlier this year.

With those thoughts, I'll hand you back to Andrew.

David Andrew Horton {BIO 5697110 <GO>}

Thanks, Neil. The key part of our presentation is not bumping into each other as we walk back from our desk, which is great. Three potential winners strictly next, they're (23:15) coming up.

So, vision and strategy. No real change to our vision and strategy. We still have our vision to become and be recognized as the highest-performing specialist insurer.

Four key elements, which I think we've talked about several times during the presentation, the three of those, the first being diversification and use of capital; the second being all about people; the third about service as we grow, and I'm sure we can manage our infrastructure and service as we grow; and the fourth is innovation.

I think we've talked about the diversification of the portfolio. What we have got better out over the years is balancing that portfolio, going for the higher-margin business at the right time. Neil does an excellent job running the business planning process to ensure we look at that on a one-year and five-year view, investing in businesses where there is growth and holding back where we have intellectual capital and businesses where margins are under more pressure. And then using capital, as Martin outlined, when we have excess capital, handing it back when we can't deploy it. Our aim is to deploy as much capital as we can in the lines we are in.

The people is the most important thing to us. The aim is to create this environment which will attract and retain good people. And we've been fortunate over the past few years in continuing to attract very good people and retaining the majority of people which have been excellent.

The scale and investment is key as we grow that U.S. business. We go back to 2004, for those of us who are around, writing our business on a back of a relatively large envelope. The envelope has been slightly automated since then, which is excellent.

And then the innovation. We're a specialist insurer. We need to continue to look for new risks that we can jump into and underwrite as we have done over the past few years, and some of our lines may become more commoditized.

The key thing I'd like to say is we're not complacent because the world is changing around us. Although we have our nice vision and we have the four key things we do, we need to keep an eye on what is going on in the world as brokers change and the carrier competition changes. So, we need to be mindful of that and adjust our strategy accordingly.

Most of the outlook, we've covered. We've talked about the diversified portfolio, reducing the markets, going to be a bit more competitive in 2015 than 2014 from a rating environment point of view.

We are hoping to grow the U.S. business. That was one of the reasons we went in to it 10 years ago, is to balance the large-risk business at Lloyd's with the mid- and small-sized business in the U.S. And our aim is to grow that 15% to 20%, again, in 2015.

Further invest in people and products, we will not stop in investments for this year despite the market being slightly tougher.

And something I think we'll be practicing out for about 30 years now is growing organically and modestly, I would say. I think we're getting reasonably good at it. So, our aim is to continue to grow organically in 2015.

After that, I'm over. We are open to questions.

Q&A

A - David Andrew Horton {BIO 5697110 <GO>}

Nick.

Q - Nick H. Johnson {BIO 1774629 <GO>}

Yeah, here we go. Good morning, Nick Johnson from Numis. I have two questions, please. Firstly, on Specialty reserves. So with reserves releases going forward, probably more dependent on the poorer years in Specialty, could you just give us a feel for how confident you are in the ULR projections for those years in terms of the visibility you've got on the claims coming through from those years? You said that claims spiked during recession. So, just a question around confidence in potential reserve releases in the Specialty division going forward?

And secondly on the U.S. business, can you give us a feel for the potential ambition for this business? I mean how big can it get with new product launches coming through? Are there potential barriers above a certain scale in the U.S. market? Thanks.

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Should I start on the first one...

A - David Andrew Horton {BIO 5697110 <GO>}

Yeah, go and get started with that. Then, I'll go with U.S. (27:29)

A - Neil Patrick Maidment {BIO 5232207 <GO>}

So I think in summary, the recession-prone years in Specialty Lines, we've seen the development in this year relatively stable. So years 2007 through 2008, 2009, 2010, relatively stable development. The forward-looking releases are not entirely dependent on that period, of course, because we then have the years 2012, 2013, and we have an increasing amount of the data breach insurance business within Specialty Lines, which is shorter-tail and where positive development from reserves will come through more quickly.

A - David Andrew Horton {BIO 5697110 <GO>}

The U.S. is a real challenge. I don't want to commit necessarily to a number, and I don't want to see Adrian sweating even more as I start setting targets for the next six months. He's not allowed to leave the U.S. until he achieves this targeted number.

If we have to look at specialty carriers in the U.S., when we first went in, we looked at specialty carriers in the U.S. and a lot of them was sort of (28:30) $1 billion-plus market. And therefore, we've set our sights on achieving that.

Now, what we've done as we've gone into the U.S. is we've added more product as we've been – as we started with a limited Specialty Lines product set in limited geographies. And in 2014, as we added more depth of (28:48) underwriting to more of the offices we currently had, plus opening up more offices, I suppose we have been pleasantly surprised by how much more premium we can grow by.

So I still think if we continue to add a product to some geography, $1 billion should be an achievable number. Don't have a deadline of when, what date that will be. But as I say, our expectation is to try and grow 15%, 20% initially, which will add another about $100 million of premium to the number we've got.

Q - Nick H. Johnson {BIO 1774629 <GO>}

Thank you.

Q - David Andrew Horton {BIO 5697110 <GO>}

Thank you. (29:28) JPMorgan. You mentioned you were going to reduce your cap budget further in 2015. If I look at your economic capital requirement on your new model, is that risk appetite reduction, is that already factored into that requirement, or could that requirement come down further?

(29:46)

A - Martin Lindsay Bride {BIO 15458196 <GO>}

So the capital requirement shown at 31/12/2014 is for the 2015 business plan, because the way the Lloyd's capital setting process works is in November 2014, we would post capital for next year. So, that capital reflects our risk appetite for the 2015 period of underwriting.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. Ben Cohen at Canaccord. I had two questions, I guess, related on the competitive environment in two areas. And specifically, in Marine, in the context of the very good margins that you continue to make there, I think there was a comment that you'd see more competition in energy. Just the extent to which you can continue to make those very good margins in Marine as a whole in that environment.

And secondly, on the Specialty Lines, maybe you could say a bit more about the competitive environment in the U.S. in particular. And do you feel, as the cyber risk market grows, that you will be able to hold on to the very strong margins that you make in your cyber products? Thank you.

A - Neil Patrick Maidment {BIO 5232207 <GO>}

So starting with Marine, I think the first thing to say, Ben, is it got quite a number of products within that segment. So just to recall, we obviously have the traditional Marine businesses: hull, cargo, liabilities. Then, we'll have our energy business and finally aviation. Each of those operate in slightly different market segments. It's a relatively diversified business. Marine hull and cargo, that has been a competitive market, but then it being a competitive market for a very long time imply it's our excellent job (31:32) segmenting that market to achieve the results that we have started (31:39).

Energy has fallen partly. That's in response to benign claims activity from a natural catastrophe point of view. Also, it suffers as an insurance market from a weak oil price, because that suppresses demand. So we have seen significant rate reductions in energy, and that's why we plan to write those business this year.

Aviation, slightly different story. As is widely reported, there's been significant loss activity both in the airline business and aviation war, and both are seeing a degree of rate increases although perhaps not what the market would hope for. So, I think it's an overall mixed picture.

Specialty Lines, we expect and plan this year for overall flat rating picture to continue. Of course, there's variability, again, within such diverse portfolio and businesses where loss activity occurred, such as employment practices liability, which not surprisingly saw a significant increase in claims through the recession years, it' still at a heightened rating level. Whereas other businesses such as healthcare, which weren't prone to recession losses, have seen some pricing pressure. So, it's a mixed picture overall.

Pricing, I think, remains relatively stable within the data breach world. And demand in the U.S., which is the most mature market for that product, I believe doesn't grow in a linear fashion. But we've seen particularly strong uptick in the last several months following some very high profile breaches. And we're also beginning to see nice growth and demand in other territories, including Europe. So, I think, overall positive prospects remained in cyber world.

Q - Sarah Lewandowski {BIO 16389455 <GO>}

Good morning. Sarah Lewandowski, Espirito. Two questions, one of the investment portfolio. I think you mentioned that, obviously, we're expecting low yields going forward. Do you have numerical guidance for 2015? And for the underwriting portfolio as a whole, are you guiding towards a kind of 2% reduction in rates again this year, or did you indicate you expect more competition in that?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Perhaps, I'll tackle the investment question. Our business plan is to make 1.25%, which is, essentially, if you look at our duration and our U.S. preponderance, it is a sort of mechanical calculation of what you would make with our portfolio.

A - David Andrew Horton {BIO 5697110 <GO>}

I think we're guiding to 3%...

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Minus 3%, yeah. Very similar, just replace the mix.

A - David Andrew Horton {BIO 5697110 <GO>}

Yeah, that's right.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Westhouse. Two questions, if I may, please. Firstly, in terms of the growth that you're looking for in the SME world, you mentioned yourselves that it's obviously more volume-based. Do you see that having an impact on your expense ratio or, indeed, your claims ratio in that area of the market? And if so, do you think that growth in the premium roughly will offset or are we actually going to see a small deterioration in the overall combined ratio in that class?

And the second question is, you're obviously – you've grown the business well, very good organic growth, and you say in your release that you prefer to grow organically. But do you think there are opportunities out there to make acquisitions for the U.S. book or not?

A - David Andrew Horton {BIO 5697110 <GO>}

(35:48)

A - Neil Patrick Maidment {BIO 5232207 <GO>}

(35:50)

A - David Andrew Horton {BIO 5697110 <GO>}

...on the expense run is, we think we can put more volume through the infrastructure we've invested in. So, we will expect expenses – expense ratio to sort of peak and then come down. I think it has the advantage. But generally, the acquisition costs are lower. So, you may incur a higher internal expense ratio and a lower acquisition cost because it's more technologically advanced rather than having to be broke (36:16). So, it complements that. And we aim just the same return on capital and the same loss ratio as we would for the (36:22) business.

On the M&A front, I think we're always – although we have done one or two acquisitions or three or four acquisitions over the years and we do continue to look for them, the challenge with them is just getting businesses that actually complement what we want to do, are culturally-aligned and have the same returns and the price isn't ridiculously high. So, it's quite difficult getting the stars aligned around those.

And we've shown with the ones we've done. I mean (36:48) market was fantastic for us, but it's always challenging with the culturally-aligned element. It's worked well. The Australian business was tough for us, so we incurred a loss in acquiring the Australian business. They're not easy things to do even when we thought they were. They fit all those categories in the first place.

So, we prefer the idea of doing rapid organic growth. I mean, some companies have a view that organic growth gets harder. When we're 100 people, acquiring 10 people was adding 10%. Now we're 1,000. Adding 10 people only means 1%. But I think we're better at it, so we do organic growth even better than we did, and that's why I flagged it at the last point. I think there's a lot of room still in the organic growth wherever we are.

And Adrian has shown that extensively in the U.S. He's been able to attract more people to the offices. When we decided in Atlanta to complement what was mainly a property business there, we had no problems finding people to write liability there. Opening up in Dallas and L.A., although we want to get to good people, we have been able to find people to do that. And we continue to attract people in London as well.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you.

Q - Barrie Cornes {BIO 2389115 <GO>}

Hello. It's Barrie Cornes from Panmure Gordon. A couple of questions for me. First of all, can you just comment on your relationships with the insurance brokers and whether or not you're under any pressure to increase commission in respect to brokers?

And second question, going back to your comments, Andrew, about special dividend, how we shouldn't assume that it's a yearly thing. Now that you're sort of in the 15% to 20% range of surplus capital, all things being equal, and if there were 20% this time next year you announce, should we anticipate no dividend? Is that (38:26) special dividends?

A - David Andrew Horton {BIO 5697110 <GO>}

So first, (38:33)

Q - Barrie Cornes {BIO 2389115 <GO>}

(38:33)

A - David Andrew Horton {BIO 5697110 <GO>}

(38:34) carried away by the second one, that I got lost on the other. Yeah, I think in markets like this, Barrie, it's not surprising that we're under pressure from insurance brokers to increase commissions as they are seeing their commissions go down as the rates go down. We've obviously got some brokers which are more fee-orientated and potentially don't see their income go down as much; and a lot of brokers are commissioned-orientated and, therefore, they see that clear, big proportion (38:55) at the premiums.

So, we are under pressure from brokers. I think we've done a good job at resisting that pressure and building with brokers we've had good, long-term relationships with. And I think we offer in return something innovative. So, there are several brokers who are very keen to take on cyber product and grow with it and many have done, and that alleviates the pressure because if they're selling a new product to a new market, they're getting extra commission that they haven't had before. So, we're trying to balance everything. But of course, we're under pressure, no question, as is for every carriers.

Special dividend, I suppose if we did end up with a position that was 20%, we went through this year, took profits into account and we ended up back to where we started;

we would have no special dividend in 2016.

Q - Barrie Cornes {BIO 2389115 <GO>}

Okay, thank you.

Q - Thomas Seidl {BIO 17755912 <GO>}

Thank you. Thomas Seidl, Bernstein. First question on capital, you have a tight buffer (39:53) to 15% to 25% when you calibrated it for the B level. So, what sort of events can you withstand at this capital buffer given the underwriting and investment risks you're taking? So, what have you figured into those target capital buffer?

Secondly, you mentioned you are net buyer of reinsurance. So given the front headwind of 2%, how much should be that of – see a mitigation from the back-end side of the business?

And thirdly, growth, you mentioned target 5%. You're giving up in some in property reinsurance, meaning you should grow in other areas 7%, 8%. What are those areas where you can gain market share?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

All right. So, I lead off with the capital event question. I mean if the balance of Beazley's portfolio would require quite extreme events to cause us to have zero profit in any one year – but the board's thinking around what capital buffer to carry is to think about the fact we've committed to 5% to 10% dividend growth, that we want to have sufficient capital in the company to take advantage of growth opportunities.

So, we haven't come to our thoughts around what that capital buffer should be via sort of scientific model that's backed out a conclusion that there's a 48.72% probability of X happening. But what we believe if we carry that capital buffer, we can support the businesses' growth; we can support these businesses' regular dividend growth in most reasonable outcomes.

Clearly, if the 1-in-200 San Francisco earthquake occurs next year, there's going to be a different course of action taken to this sort of normal annual event of paying the regular dividend, paying the special dividend and financing business plan growth all organically. But we certainly expect with those buffers in most years that don't have extreme outcomes, to be able to do certainly the first two – finance business growth, finance dividends. And then, if we have exceptionally good profitability, obviously pay special dividends as well.

A - Neil Patrick Maidment {BIO 5232207 <GO>}

If I pick up Reinsurance, I think you mentioned that minus 2%, that's the overall rate change in the portfolio. As I mentioned in the presentation, the rate change we saw in our own inwards reinsurance portfolio. The 1st of January renewals was minus 8%, and we anticipate that that will be - we're going to experience that type regularly from the reinsurance that we purchase.

In terms of growth opportunities, as we mentioned in the presentation, most of the growth opportunity I would see is coming in Specialty Lines, and in particular in our U.S. platform, so in the SME to mid-market in the U.S. platform within Specialty Lines. Outside of that, we also see opportunities in Life, Accident & Health in the U.S. After several years of development, we're seeing increased demand for our specialist healthcare product there as well. So, that would be the focus of the growth.

Q - Kamran Hossain {BIO 17666412 <GO>}

Good morning. It's Kamran Hossain from RBC. Quick questions on the capital side, and probably one for Martin. Could you just run us through what the differences are between your own equity, equity in the Solvency II basis, and what the sensitivities are between - on that kind of Solvency II basis?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. So there are - in reality, there are a lot of movements. The largest movement is when you calculate equity on a Solvency II basis, you set your technical reserves at true best estimate and you discount them, but then you add back in an explicit risk margin. There are a lot of other minor movements on the Solvency II balance sheet, but those are the major ones.

A - David Andrew Horton {BIO 5697110 <GO>}

This one here.

Q - John A. Borgars {BIO 15015364 <GO>}

John Borgars, Equity Development, what may seem a very minor question. On your liquid credits, what interest rate margin do you get on them compared to (44:39) bonds, and what's the sort of term for them? Because I could see an argument and I think (44:49) got a decent margin, up 25% of yours in those?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yup, right. So, I mean, I think our expectation is that we're thinking about investments that would have a five-year to seven-year term. Our hope is that we would make something up towards 8% to 10% from those investments. But obviously, we've only just made them and that needs to be proven. So, I think the next step is to establish the initial portfolio and to monitor its performance over time. But that's the thinking behind taking that step. With our large technical provision, we believe we can tolerate some illiquidity in our asset portfolio. I'm not sure that 25% of the portfolio in a liquids would fit within our investment risk appetite, which is really still quite low, our main risk appetite is for underwriting risk.

Q - John A. Borgars {BIO 15015364 <GO>}

Yes, if they would stay (45:44-45:52). The second question is, the decline in notes on political risk looks like modest compared to the profitability of that sector. And also, I see that you're only getting 67% retention. Would the decline in rate be a lot more on the market, taken that market rate, if you included (46:18) you lost that business because somebody's caught under-quoting you (46:21)?

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Good question, John. I think, actually, there are of couple of different things going on within that group. So, it's in different business – three, three elements really. Political risk itself, which tends to be one-off, non-renewable business. And so, that doesn't have a rate change, because it's a non-renewable business. And in that sector, obviously with heightened geopolitical risk in the world at the moment, the pressure to reduce rates is limited.

The part of Political Contingency Group where we are seeing rating pressure is for standalone terrorism business, which despite that heightened geopolitical risk, that market has not seen, fortunately, a recurrence of the large – any large losses, or going almost all the way back to WTC with the exception of the loss in Kenya last year. So it had a remarkably benign run and, consequently, is still seeing rating pressure.

A - David Andrew Horton {BIO 5697110 <GO>}

(47:38)

Q - Anthony Araujo Da-Costa

Hi. It's Anthony Da-Costa from Peel Hunt. Two questions, if I may. Given the growth in the U.S., what differentiates Beazley from the competition? The second question is, can you tell us a bit more about your cycle management approach and how it is enforced within the organization and how flexible this is? Thanks.

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Okay. Growth in the U.S, I think, our differentiator is our people and our products. We've been very fortunate to attract a very high quality of people in the space. And our entrepreneurial approach individual accountability is very distinctive and appealing to that population. We now have nearly 300 – or nearly 400 people onshore in the U.S. And our product set would be led by that specialist inside data breach portfolio. I think it's also a big part of the mix. So, I think those are the key differentiators.

The cycle management, it's just part of the planning process every year. So we have key underwriting strategies, have a diversified portfolio. That's what enables us to target a balance between profit growth and consistency every year. And of course, each year, we're assessing the prospective market conditions across that portfolio, and they're all running at different market conditions. And we push forward in the areas that have most opportunity, pulling back in areas where margin is under pressure.

We measure everything against our long-term rate of return target and the combined ratio target that we're aiming at. And then, we adjust the portfolio within that. So next year, we're going to write less in the business where margins are most under pressure, which essentially is Reinsurance and catastrophe-exposed lines of businesses, and push forward in the areas where we see most opportunity, which are these SME and mid-market businesses, particularly within Specialty Lines where rating has been stable.

Q - Anthony Araujo Da-Costa

Thank you very much.

Q - Nick H. Johnson {BIO 1774629 <GO>}

Hi. Nick Johnson from Numis. Just one further question, please. Just the U.S. capital requirement hasn't changed year-on-year despite the U.S. growth. Is this because U.S. growth and income has been Specialty Lines and written at Lloyd's, or will the admitted carrier in the U.S. require further investment at some stage? And perhaps if you could just give us a feel for what admitted income is within that carrier. Is it low? Is that capital being fully deployed?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Right. I'm going to say that our admitted business is about a third of the total U.S. business, so $160 million, $180 million, of which a quarter remains in the admitted carrier. So, the admitted carrier is capitalized to achieve an A.M. Best AA rating. And so, it won't require more capital in the short term to maintain that position. If the company becomes a lot bigger and has a lot more risk, then it would require more capital for that. That is achieving our target A.M. Best rating that is driving the capitalization of that company, and it will remain stable and might need to increase as we get towards $100 billion. But...

A - David Andrew Horton {BIO 5697110 <GO>}

That's true. So Nick, to pick on the point, we reinsured 75% of admitted carrier back on the Lloyd's syndicate. That's why we're leaving 25% in the capital spend here.

Any more questions? Great. Thank you for joining us this morning. Good to see you all.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you very much.