Q2 2017 Earnings Call

Company Participants

- Alexander Maloney, Group Chief Executive Officer & Executive Director
- Elaine Whelan, Group Chief Financial Officer & Executive Director
- Paul Gregory, Group Chief Underwriting Officer

Other Participants

- Andreas Evert Cornelis van Embden, Analyst
- Faizan Lakhani, Analyst
- Joanna T. Parsons, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Olivia Brindle, Analyst
- Thomas Fossard, Analyst

MANAGEMENT DISCUSSION SECTION

Alexander Maloney {BIO 16314494 <GO>}

Okay. Thank you. Thanks for dialing in everyone. We have Paul Gregory on the phone in London, Elaine Whelan here with me in Bermuda, Denise O'Donoghue here in Bermuda as well.

I'm pleased to report a strong set of results for our second quarter, where our underwriting investment strategies have continued to add value for our shareholders. Our return on equity of 3.2% and a combined ratio of 69.8% are excellent results in the current underwriting and investment climate.

When looking at where we are for the half year, we have now generated return on equity of 5.9% and a combined ratio of 78.4%. So we are happy with our progress as we enter the hurricane season.

Our results have benefited from the low level of cat loss activity in the quarter and the year-to-date, but we do believe these results clearly demonstrate that our disciplined approach to underwriting is allowing us to continue to produce excellent underwriting margins. Our investment return reflects the same disciplined approach in the face of rising rates.

We are only at half-time, and history suggests that the second half is generally more challenging than the first half, so we won't get ahead of ourselves, but we do enter hurricane season with a nice buffer of profit, more cat reinsurance than last year, and excess capital to deploy if any underwriting opportunities arise.

There is little change in the underwriting climate, but we are finally seeing the slowing of rate reductions and some sanity returning in pockets of specialty classes. This is by no measure a hardening market, but we do believe it's a realization that there is little margin in most classes of business.

We continue to focus on our book of core clients at Lancashire and Cathedral and continue to develop and nurture those relationships. The rating environment is where we thought it would be, and we continue to maintain our presence and relevance in our niche classes. There are no surprises, and we expect the outlook to remain the same until capital is impaired, when we believe the action will be more apparent.

We have said this many times, but you have to remember the industry's results are rather anemic, even there has been little major loss or cat activity. Results will go red quickly when normal loss activity returns. We have adopted a different strategy to most in tackling this stage of the cycle, and we believe you have to reduce your underwriting footprint when the risk versus return balance is against you.

Our work at Cathedral continues as we have welcomed Andrew McKee to our business. Andrew will lead the Cathedral business and has joined our group executive. Andrew will continue the process of aligning our Lloyd's business with our group values and the continuation of Cathedral's excellent underwriting results.

Darren and Matthew at Kinesis completed their mid-year draw and renewed a contract for one of their core clients. We have more investors in Kinesis this year as we continue to build out our investor club, with many partners who can deploy multiples of their current stakes when the opportunity arises. But as usual, and very much aligned to group strategy, we remain disciplined until then.

So our story is consistent as we see no immediate change in the underwriting environment. We will wait to see if Mother Nature brings us anything that could change the underwriting environment, but if not, we are prepared to maintain our current course. We believe we have enough yield to satisfy our shareholders and the correct underwriting investment strategy for the current climate, but we are equally prepared to move quickly and aggressively when the opportunity arises.

I will now hand over to Paul.

Paul Gregory {BIO 16314515 <GO>}

Thanks, Alex. I'm pleased to report that all underwriting platforms across the group have contributed to a very respectable combined ratio of 69.8% for the second quarter and 78.4% for the year-to-date. We have of course been helped by a benign loss quarter. However, given the current market conditions, we're extremely satisfied with these combined ratios and they are testament to our disciplined underwriting philosophy that focuses on bottom line rather than top.

We have firmly stuck to these beliefs and see no good reason to change our approach, as this strategy continues to serve us well in this challenging part of the cycle.

As can be seen from our RPIs, most lines of businesses are still experiencing rate reductions, albeit the rate of reduction continues to slow. We remain of the belief that until capital retracts or is unwilling to be deployed, then there will not be a meaningful improvement in market conditions.

For the group, the second quarter is significant for most product lines but is dominated by energy and property reinsurance. In the energy market, the pace of reduction has certainly slowed, albeit rates remain under pressure. It's worth pointing out that the energy offshore worldwide RPI of 104% for the quarter is unfortunately not indicative of a market change. This quarterly RPI has been driven by one significant loss-impacted renewal which has created a spike in the RPI. Absent this renewal, the RPI would be closer to what was seen in Q1.

Once again we've experienced stable demand for our Gulf of Mexico wind product, and have maintained the majority of our longstanding clients, which is pleasing given the stresses within the energy industry itself.

With property reinsurance, once again the group was supported very well by our Japanese clients at 1/4 where renewals were very orderly and in line with expectations. In the U.S., renewals became slightly more challenging as the quarter progressed, albeit the market was still in the single-digit range of reductions. The Lancashire platform RPI for this class improved versus Q1, which is representative of a portfolio that is like Florida and that sits at a level where rating pressure is less pronounced. The Cathedral RPI is more indicative of the broader market conditions, given the shape and make-up of that portfolio.

Across our other lines of business, we've also been successful in maintaining our core clients. As always with our portfolio, premiums are impacted by non-annual multi-year policies, particularly within the political risk class, which is usually lumpy given the non-renewable nature of this book. Given the current global political climate, we've been navigating this class very carefully to ensure the standard of risks within the portfolio is upheld, and as with all other classes, our underwriting decisions will be driven by a focus on risk quality as opposed to premium volume.

The combination of our underwriting discipline and reinsurance strategy means that our risk levels across all our major exposures remains at historically low levels, meaning we are currently retaining capital headroom, which gives us plenty of options to deploy underwriting capital in the event of a loss and flexibility for capital returns absent a loss.

I'll now pass over to Elaine.

Elaine Whelan {BIO 17002364 <GO>}

Thanks, Paul. Hi, everyone. Our results are on our webpage as usual. Our ROE of 3.2% for the quarter and 5.9% for the year-to-date are great results given the current market conditions. With a very quiet quarter on the loss front and more favorable development on our prior accident year reserves, we had a loss ratio of 12.1% for the quarter. While we had a slight uptick in our expense ratios, our combined ratio for the quarter was only 69.8%. Our investment portfolio performed well through another rate hike, producing a return of 0.8%.

Contributions to ROE through the half year are 4.2% from the traditional Lancashire platform, 1.2% from Cathedral, and 0.5% from Kinesis. So all aspects of our business are performing in line with expectations.

Our gross premiums written have reduced a little more this quarter. On the Lancashire book, that was driven mostly by the timing of multi-year and non-annual deals offset to a degree by new business and some premiums coming through on prior year risk-attachment business. On the Cathedral side, reductions were mostly in the reinsurance book and largely due to market pricing.

Our ceded premium is lower this quarter compared to last year, largely due to timing. As I said in the last earnings call, we renewed our group umbrella cover earlier in the year. In the second quarter, we have also extended some covers, so they won't renew until next quarter now. I still expect our full year spend to be relatively in line with last year's.

The impact of both the reduction in our gross written premiums and the timing of our reinsurance renewals has led to reduction in our net earned premium for the quarter.

We expect to maintain our core book for the rest of the year. There will undoubtedly be some business we can no longer support, but there are always bits and pieces of new business that we pick up. With around 70% of our book written in the first half of the year, the second half renewals outside of the books that are naturally a bit lumpier and harder to predict should mainly be a reflection of market pricing.

Our acquisition cost ratio was higher this quarter, in part due to business mix and the timing of our reinsurance program.

The majority of the energy book renews in the second quarter and tends to have higher acquisition costs than other lines of business. In addition, there was some premium coming through on prior year risk-attachment business in the marine class this quarter and that book also tends to have higher acquisition cost ratios. I'd expect the ratio to normalize for the full year to 27% to 28%.

On losses, as I mentioned, we have had very little reported in the quarter. There haven't been any major events or risk losses, and our prior year reserves continue to develop favorably with a release of $27.2 million for the quarter.

We had one longstanding claim close in our favor, and the rest of the development was due to a lack of reported coming through, no specific drivers in there.

Our loss ratio is 12.1% and our accident year ratio is 39.5%. Our attrition is therefore running slightly higher than our usual mid-30s guidance, partially driven by Cathedral, but that doesn't change our view in where we think our attrition typically sits.

As we've said before, our business can be a little lumpy and it can therefore be misleading to focus on individual quarters. To put that in some context, the traditional Lancashire platform does not write an attritional book, whereas the Cathedral book is more traditional but much more heavily reinsured. That means Lancashire tends to avoid attrition and Cathedral is well protected from it, so unless there is a significant change in market conditions or our book, our expectation stays fairly stable.

Investments returned, 0.8% for the quarter, with all of our asset classes having a positive contribution to the return again. Most of the return continues to come from our fixed maturity portfolio, but we had some nice support from our hedge funds and equity exposures. Our hedge fund portfolio repositioning is almost complete.

The reduction in other income this quarter is due to the timing of recognition from both Kinesis and Cathedral and is driven by the underlying performance of the underwriting cycles or years.

Our G&A ratio has increased this quarter, primarily due to the reduction in net premiums earned. The dollar spend is broadly in line with previous quarters. There was a continued benefit from the reduction in sterling relative to the prior year. There was also a reduction in variable compensation accruals, driven by underlying performance. These reductions were offset by some increased software costs and timing of other expenses.

Lastly on capital, there's no change in our view there. We said last quarter that we were targeting around $1.3 billion to $1.35 billion of capital and we would reassess after one season. That continues to be the case. Currently, if nothing changes, I would anticipate returning earnings to shareholders later in the year. We will determine the amount of the buffer we want to carry once we have a better idea how the market is shaping up for 2018.

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

Q&A

Operator

Certainly. Thank you. We will now take our first question, which comes from Kamran Hossain of RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good afternoon, everyone. Two questions. First one just coming back to Elaine's comments about capital and the buffer and where you end up after wind season. Just thinking about this kind of philosophically, do you need to maintain as high a buffer as you might have done in the past given that my understanding is that you would probably deploy capital via Kinesis if there was a large loss? So that's the first question, do you need another bigger buffer?

The second question is just on energy pricing. Do you think we do need the oil price to go up materially to see prices - or see energy rates go up there? Any kind of comments on clarity, really, really helpful. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi there. On the capital side, I would view Kinesis as just one part of our operation. Our shareholders have invested in the entire platform. So we are still quite happy to keep an extra capital buffer there so that we can use that to make - to have as much opportunities we possibly can across the entire operation.

A - Alexander Maloney {BIO 16314494 <GO>}

I think as well, Kamran, it depends where the loss comes in. If the loss was Gulf of Mexico, energy specific, that may not be one for Kinesis investors, that may be more Lancashire. So it just kind of depends where the loss comes in as well.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. That makes sense.

A - Paul Gregory {BIO 16314515 <GO>}

Kamran, hi. It's Paul. On the energy question, to be honest, the oil price really is more of the driver of demand in the market. So if the oil price started to go up, I think you would see clients buy more as values went up, whether that would be physical damage or business interruption, and more projects coming to market. So I think it would bring more premium to the market. My genuine view on rates, however, is that that's driven by the dynamics within our industry around supply of capital. I don't think in the energy market until you see people retracting or not willing to deploy the capital they are currently deploying, there will be a material change in rates. If the oil price drove demand enough to create imbalance between demand and the supply, then that's when you could see some adjustments of rating, but primarily, I think it's going to be to do with the dynamics of the insurance industry itself.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. That's great. Thanks very much for the color, Paul.

Operator

Thank you. We will now take our next question, which comes from Olivia Brindle of Bank of America. Please go ahead.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. My first question is around the premiums. So I take the point around the timing, but just to Elaine's comment around you expecting to maintain the core book from here on. I mean, if we take into account what you said I guess last year and that premiums in 2017 should be more stable and that you should be down to your core book already, it's quite hard to see how you've shrunk gross written by about 12% year-to-date. So just wondering if you could give a view on what exactly that core book is and where that goes from here on.

And then the second question around expense ratio. So you mentioned a normalization on the acquisition front, but it sounds like on the admin costs, it is just going to be structurally a lot higher than even what we assumed given the premium trend. So, if you're taking a 28% plus a 25%, 26% ratio, you're getting to well above 50% on your total expense ratio. Do you think that kind of level is sustainable going forward? Thank you.

A - Alexander Maloney {BIO 16314494 <GO>}

So, I think, Olivia, I'm going to say a couple of things and Elaine can jump in. So I think on core book and premiums that they're slightly different in that we are down to core book, we hold our core book, we don't lose any business, they're core customers to the group, but clearly, no company is insulated from what rate and pressures there are out there. So, we have kept our core book sometimes at the rating level. Rating reductions have slowed down, but we're still giving reductions, the market is still giving reductions, so I don't think we've said anything – we didn't say anything last year that we haven't delivered, and that just is what it is.

And I know probably you don't agree with it and lots of people don't agree with it, but we have taken a different stance in managing this stage of the cycle, and I'm just not obsessed about premium. People are obsessed about premium, we're obsessed about returns and profit, and lots of people that have grown their premiums have got a worse return. So I'm just not that worried about that.

I think on expenses, you have to accept if you run our kind of model that your ratios are going to spike up in this kind of stage of the cycle. So we always look at the dollars. If you look at the dollars that we have spent on expenses in the last four years, excluding any changes to FX, we're flat, which I think is a pretty good achievement. It's very hard to keep your expenses down, regulation costs more money, you have to add more people all the time, Solvency II, lots of things that we have to spend money on. So to keep our expenses flat for four years we think is an achievement. And as I said, if you run our model and you cut our top line from nearly $1 billion to where it is today, your ratios are going to look high. So we don't really think about ratios, we think about dollars.

Q - Olivia Brindle {BIO 17273762 <GO>}

That makes sense. Can I just follow up on that in that case? So if you take an expense ratio of 50%, 55%, a combined ratio which is I guess reasonably normal looking at history; without any particular loss activity is probably more like 30% than the 12% you had in this quarter. So you're getting to a normalized combined ratio of something between 80% and 85%. Does that sound about right in this current environment?

A - Elaine Whelan {BIO 17002364 <GO>}

And it's a lot better than a lot of people out there.

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah. I mean, look, again, obviously our combined ratios have stepped out. But if you look at where the industry is at, most people are at 100% or close to 100%. So even if we step out to 85%, we're still – we're maintaining the gap. And my general view is, and why I still think this business is cyclical is, the market will probably continue to give up rate and people will continue to do really stupid things until the whole thing blows up and then we'll all go back to basics. And as long as we maintain our gap on the competition, it's a bit of a relative game. And we are not insulated from the market like anyone else. But we have maintained our discipline, we've been incredibly explicit about we just won't chase premiums.

And as I said, I mean, you would know this better than me, but if you analyze everyone's results apart from probably Hiscox and Beazley, in my opinion, everyone who's grown has got worse results. So we've taken a certain stance and we think our numbers are still great in a really tough environment. And that's all we really care about, we just care about returns for our shareholders, we're not expecting (19:55) anything else.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. That's very clear. Thank you.

Operator

Thank you. We'll now move to our next question, which comes from Andreas van Embden of Peel Hunt. Please go ahead.

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

Hello. Good afternoon. Two questions, please. Just coming back to the energy market and in terms of protecting your core book, are your core clients more active at drilling and exploration in the Gulf of Mexico or is it more or less the same as last year? So just to get a sense of activity rather than pricing.

And the second question is really on large losses. Were there any sort of significant large losses either on your Lancashire book or within Cathedral in the second quarter? Thanks.

A - Paul Gregory {BIO 16314515 <GO>}

Hi, Andreas. This is PG. I'll take the energy question. I think in terms of activity, it's been broadly flat if you look at it this year versus last. There has been a few new projects come back to market, so a bit more construction activity. I wouldn't exactly call it a flurry of demand, there's a few little signs there. But broadly it's pretty stable.

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

All right. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Andreas. So on the loss one, it's been very light this quarter. We've had virtually nothing coming through. We've had a little bit of attrition and then prior year releases plus one old 2011 year claim settling in our favor this quarter. So it's been pretty light. I think we've talked about that off and on over the last number of years. So if nothing much happens, we've got light – low loss ratio, and if stuff comes through, then it will be a bit higher, but that's the nature of the book.

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

So the volatility in your attritional loss ratio quarter-on-quarter, is that mainly pricing or just frequency?

A - Elaine Whelan {BIO 17002364 <GO>}

I wouldn't say that we had much volatility in the attritional loss ratio. I think you look at the large losses in the cats for – we can't predict the timing of when they come. Our attritional loss ratio we keep fairly stable. Rather get stuff reported coming through, or we don't, and if we don't get anything reported, then we release those reserves.

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

All right. So there is an element of buildup of reserve buffer in that attritional?

A - Elaine Whelan {BIO 17002364 <GO>}

We select our loss ratio picks on what we expect the book to do over time. It either comes through or it doesn't.

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

All right. Okay. Thank you.

Operator

Thank you. We will now move to our next question, which comes from Jonny Urwin of UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, guys. Thanks for taking my question. Just two. So firstly, I mean, you mentioned, Alex, that you've obviously addressed this soft market in a different way to others by continuing to retrench, which is very clear. At which point do you think this strategy changes, how long can you ride out the current cycle on this current strategy?

For example, if the market were to just keep coming off like even low single digits for another three to five years, would you be happy just shrinking, shrinking, shrinking, taking that capital base down, because I know you've got to keep certain amounts of capital in certain jurisdictions. I mean, would you consider a defensive acquisition to bring diversification at all? I'd be interested just to get your big picture thoughts there.

Secondly, on the attritional guidance, mid-30s. I get what you're saying, but just thinking conceptually about this, we've had four years of pricing pressure – five years of pricing pressure now, and I guess the guidance hasn't really changed. But if you look at all of your peers across various jurisdictions, everyone's underlying loss ratios have crept up. And I'd be interested to hear your thoughts on that. But also looking out from here, if it does get to the stage where we start to see premium level off because you're protecting your core book, does that mean you would then have to take more pricing pressure and that then your attritional guidance would creep up? That's it. Thanks.

A - Alexander Maloney {BIO 16314494 <GO>}

Okay. All right. Thanks, Jonny. So I think this is a $6 million question, isn't it? What happens if the market doesn't change, what happens if rate goes down for five years? The other question, will the market ever change? And our view is the market is still cyclical and once people lose enough money, things change and nothing will be changed until people lose enough money, which is quite frustrating in itself because I think if you look at the Lloyd's – the Lloyd's result is a good barometer for the kind of business we do, and the Lloyd's result at the end of 2016 is 98% combined ratio, and most of that driven by FX and investment gains, nothing driven by underwriting.

So, if you just look at that, in my opinion, the market's done already. If you overlay – everyone's having some reasonable results, but there just hasn't been a cat loss since 2012, there's been no loses at all. So the industry looks okay. But if you overlaid any kind of normal loss activity, you've just got no return really at all. So I think there will be some loss activity at some point and people's numbers will step out. We pretty much have a 15% to 20% gap on most people in the market and we believe that is driven from all the things that we've spoke about; discipline, underwriting, et cetera, et cetera. So if the market goes down for another three or four years and nothing really happens and our numbers step out to 100% combined ratio and in general the rest of the industry goes to 120% combined ratio, I just don't believe that the industry runs at 120% and nothing happens. So that's why I believe it's cyclical. I think if you get a cat loss, some of those numbers step out quicker. So I just don't believe that we just bleed to death forever.

In the late 1990s, I kind of believed that the market would never turn and we would bleed to death ever. And then something happens, the industry loses a lot of money and then we all go back to basics and say what idiots we were in a soft market. So, I just don't think there is anything different this time.

Will we change our course? No, you have to hold your nerve. I'm not saying I'm right, but I think I'm right. So I'm not going to change now, that would be a massive mistake. And I think a lot of the things we've said about the market are starting to appear now. Things are definitely creaking, underwriters are starting to get fired, all the small signs are there already and it will just be very interesting to see what happens this year if we get any kind of loss activity.

Defensive acquisitions. I know firsthand how difficult acquisitions can be. And if you buy a great business like Cathedral, that works out fine and we've brought great people into that business and we've got some great people that were at Cathedral that are still at Cathedral and everything looks great. But acquisitions are challenging. Lots of them go wrong, and you've just got to be careful who you buy. You definitely don't want to buy someone else's mistakes at this stage of the cycle, you don't want your whole management team on a huge clean-up job. But if the right business came along with the right characteristics, very much like a Cathedral purchase, we definitely would consider that, but we're not going to go out and buy something for the sake of it. Some people are probably going to buy things just for the sake of it, and that's probably going to be a wrong decision. So, we're not going to do that, but if the right business came along and we felt that was appropriate to add values for our shareholders over time, we wouldn't be averse to doing another acquisition, but it is not anything that we're desperate to do.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Jonny. On attritional guidance, I know we've been saying mid 30s for a while, but we have brought that from low 30s to mid 30s if you look back over the last number of years. When I look at what we've actually been producing, it's been in that kind of range. I think I've said to you guys before, if you want to price adjust what we're suggesting, then that's absolutely fine, but we haven't really seen that coming though and I think a lot of that's due to the way that we select our risks. And we have been buying more reinsurance as well and both Lancashire and Cathedral sides of the business have been improving their reinsurance programs over the last few years given the market that we're in. And Lancashire does write a fairly non-attritional book and Cathedral does write more attritional book, but it's pretty well protected and it's a fairly low level. So, I'm happy with the guidance that we're giving you. If you want to price adjust it, then feel free.

A - Alexander Maloney {BIO 16314494 <GO>}

And then lastly on that, Jonny, I can assure you, if we had pushed our underwriters for growth, all our ratios would be stepping out dramatically, that is guaranteed. And I think that's why, as I said that comment earlier, I just don't think there is many people that have grown to a better result. And I just don't believe you grow yourself out of a soft market and I think history will tell you that most people that have grown out of a soft market, their results get worse not better.

Q - Jonny Urwin {BIO 17445508 <GO>}

Fair enough. Thanks very much.

Operator

Thank you. We'll now move to our next question, which comes from Faizan Lakhani of Bernstein. Please go ahead.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Hi. In the current market, where you are seeing quite a lot of rate pressure and pressure on the your expense ratios, do you see yourselves pulling out of any lines of business currently? I can see maybe in particular something like aviation. If you could give some information about that, please.

A - Alexander Maloney {BIO 16314494 <GO>}

(30:19). I mean, there's nothing that we sit there at the moment and say we need to pull out of this line of business. We have done that in the past. We pulled out of contingency at Cathedral last year I think it was. That was a small book of business. We just couldn't make any money. And we're a small nichey company and we're only in product lines where we think we can outperform the index. So we don't really dabble, we don't go in business for the sake of it. So there's nothing that I can see at the moment where we're sitting there thinking oh my God, we need to pull out of this line of business. And as we said earlier in the call, if anything, we are seeing rate increases slowing down. Our results are still looking quite good. So from my point of view, there's nothing on the agenda that we are looking to pull out of at the moment.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Thank you.

A - Paul Gregory {BIO 16314515 <GO>}

Yeah. Just to add to that, I mean, we look at every line of business really regularly, about what's going on, how they're performing. We never make snap decisions. We have shown in the past on a number of occasions, and Alex mentioned there contingency, that we are prepared to pull out of classes if we don't think they can add value to shareholders over the longer term.

I mean, energy is a great example. We obviously made a lot of money from our energy portfolio in the early years and middle years at Lancashire. And that's been a lot tougher to operate in, in this part of the cycle, but it's certainly not a class that we'd look to come out of, because we think through time we will make good money from that class of business.

And you mentioned aviation, again that falls into that category. Aviation market is always tough, has always been tough, particularly tough at the moment, but again, we have managed to continue to make profits in that class, albeit they're smaller than they would be in a hard market. But as a general rule, we keep a close line, every line of business that we underwrite. But as Alex said, there's nothing at the moment that's sticking out as something that is an area that we'll look to shut down.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Great. Thank you very much.

Operator

Thank you. We'll now take our next question, which comes from Thomas Fossard of HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good afternoon, guys. Good afternoon, Elaine. Can I risk one question on the PYD (32:39) development? Obviously you're still getting some benefits from reserve policies in your Q2 results. I mean, are you internally surprised by the strength of PYD (32:57) still coming in or there is nothing specific and going forward, something around $60 million to $70 million a year should be considered as a recurring basis? I mean, as far as I am concerned, I am still surprised to see such a big number coming, so any granularity or any sense and direction will be helpful. Thank you.

A - Elaine Whelan {BIO 17002364 <GO>}

Hi, Thomas. We don't really give guidance on reserve releases. We do have a fairly lumpy book and stuff can come through from time to time. We reserve for what we think our book's going to do based on history and judgment. And if nothing comes through, we release those reserves, that that's really nice to have, which is how we kind of look at it.

Operator

Thank you. We'll now move to our next question, which comes from Joanna Parsons of Stockdale Securities. Please go ahead.

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

Thank you. Good afternoon. I just wanted to ask a little bit more about the third-party capital in Kinesis. I imagine that the third-party capital people are happy with what you've been doing, but as you yourself said, the big issue here is the amount of capital that there is in the industry and that capital needing to be eroded. Do you get any feeling that your Kinesis investors are actually starting to pull back or indeed do you get any feeling that elsewhere in the market people are beginning to look at, as you yourself said, trying to grow your way out of a problem and the losses therefore picking up if other entities are starting to pull back or seeing their third-party capital providers pull away?

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah. I think the capital providers in Kinesis are all people that we think are smart people that understand our industry and what can happen and how you can lose your capital, and most of those people, as I said in my script, have had multiples of their current allocation in Kinesis in cat bonds or all kinds of different things and they have pulled back their positions and are sort of waiting for an opportunity. No, we don't think those guys will reduce their positions in Kinesis. But as I said, they've definitely got deep pockets for the right opportunity.

And I think the whole third-party capital thing, I think the rated people or the traditional players kind of want to blame the third-party capital guys for spoiling the party. I don't think it's quite as simple as that. I think there's definitely smart third-party capital investors, and there's people that have drifted into insurance world because there is no yield on what they used to do and some of those people have never paid a loss, so they'll probably turn up in insurance-land, made a load of returns, think it's quite easy, never experienced a loss. And I think the proof for everyone will be when there are losses and how those people react and do they lose some of their capital in the kind of loss that they expect to. I think for any of these guys, if you lose your capital in Florida or California, that's what everyone expects. If you lose your capital in a Turkey quake or a flood loss in somewhere they've never heard of, I think that's more of an issue.

So, for me it's not about – lots of people say there's walls (36:51) of capital out there and they're never in of a (36:52) hard market and they will pile into the market. I think there's lots of capital in the world in general, but I think a lot of the smart people will come in at a certain level, and it's not inconceivable that the industry could have a really – a reasonable size loss and nothing happens. The industry could go flat, people might not pull out and that may surprise some people. So, we haven't seen people leaving the sector, but equally I don't think there's people rushing into insurance world at the moment. As we all know, returns are tight, everything is difficult, it's hard to make money. But I think you only really get the real picture once you get some loss activity, and particularly if that loss activity, like everything in life, is not how people expected to lose their money. And we would suggest there are some funds who are being rather economical with the truth, I suppose, and bending their modeled results and bended their expected returns to their capital providers. And as usual, we don't do that. We're very vanilla. There is no leverage in our fund. We take our investors through every deal. That sounds rather old fashioned, but our general principle is, if you take someone's money and you don't really tell them the truth and then you lose it, they tend to get upset. And they're going to get upset at a time when quite frankly all you want to be doing is underwriting because hopefully you're in a great market. You don't want to be getting sued by a bunch of third-party capital providers.

So I think you can only tell when the losses come in. There's definitely smart money there. There's definitely dumb money there. But we'll to have wait and see.

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

Okay. So bottom line, you're not seeing any sign of generally third-party capital starting to get a bit twitchy about some of the margins. You are seeing the same level as before and so you're saying we're going to have to wait for a specific loss which shocks people to get – to see any change in that capital outline (39:00).

A - Alexander Maloney {BIO 16314494 <GO>}

Yeah, I think so. And that's what's so frustrating about the whole industry, isn't it, that I think lots of the signs are there. It's quite obvious that there's not much margin, everyone has sort of forgot you can have cat losses and go from hero to zero overnight, but nothing sort of happens until everyone's bleeding to death. So it's rather frustrating, but I think I just don't – I don't think there will be like a technical hardening of the market. I don't think people would really pull their positions until it's too late really is my opinion.

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

Okay. Thank you.

Operator

Thank you. As we have no further questions, I would now like to turn the call back to your speakers for any additional or closing remarks they may have.

A - Alexander Maloney {BIO 16314494 <GO>}

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