Q2 2018 Earnings Call

Company Participants

- Adrian Peter Cox, Executive Director & Head-Specialty Lines
- David Andrew Horton, Chief Executive Officer & Executive Director (Chair)
- Ian Fantozzi, Chief Operating Officer
- Martin Lindsay Bride, Executive Director & Group Finance Director

Other Participants

- Andrew J. Ritchie, Analyst
- Barrie Cornes, Analyst
- Joanna Tamar Parsons, Analyst
- Jonny Urwin, Analyst
- Nick Johnson, Analyst
- Oliver Troop, Analyst

MANAGEMENT DISCUSSION SECTION

David Andrew Horton {BIO 5697110 <GO>}

Good morning, everybody, and welcome to our Half Year Results Presentation. Looking at the agenda contents, we're going to go through the same normal process we go through. So, I'm going to give you an overview of the numbers and then a short business update. I'm going to hand over to Martin to go through the financials.

This year's, special guest star, as you know, at the half year, we always have a special guest star, is Ian Fantozzi, our Chief Operating Officer, who's going to give you an overview of what we're thinking from a digital point of view, and then I'm going to come back, roll out the crystal ball and have a go at looking at what's going to happen into 2019.

So, if I give you an overview, I think the first thing would be to bridge the profit movement year-on-year from $158 million to $58 million, $70 million as you can see is from an investment income. As we've seen yields rise over the first half of this year as we're bearing mark-to-market losses, despite the fact I think we've previously said we went as short as we could in our bond portfolio. We still bear those losses. The running yield on investments is now 3%. So the outlook for investment returns is now greater than it was at the beginning of the year.

The second element, which shouldn't be a surprise, is we were expecting fewer reserve releases in 2018. Why is that? Because we've used our catastrophe reserves in 2017 against the losses we had. And the third element, which I suppose is the surprising element, is we have seen above average claims mainly in our property portfolio and, to a limited extent, within marine.

And on the back of that, not surprisingly, we've seen property rates rise and you can see the rate increase in our property division is 10% but within our open market property, which has been impacted more by the catastrophes and, to some extent, the attritional claims, the rate increase in open market property is 20% year-on-year. And those rate increases have driven the 3% rate increase across the total portfolio, which is probably slightly higher than we thought it was going to be for 2018.

Growth has been good. So, we forecast we would have double-digit growth into 2018 at the end of the final results, and we've actually achieved 15% with growth across all five divisions, led in percentage terms by property, which is up 25% year-on-year; and followed by specialty lines, which is up 16%; and then the other three divisions are showing around 10% growth year-on-year so, showing good growth. Return on equity is 6%. And then, in normal fashion, the dividend is up around 5% year-on-year to £0.039.

Business update, briefly a business update. So I mentioned top line growth across all divisions. Our U.S. has grown 23% year-on-year. If you remember, for those people who've been tracking us, it grew 20% for three years prior to last year. We ended at about 13% growth last year and now we're up to 23% so, good growth in the U.S. as we continue to put more underwriters in our offices out there.

Good growth in specialty lines, obviously, seeing the rate increases in terms of property. Within specialty lines, cyber, of course, is a key line of business for us with environmental, miscellaneous, medical and management liability all growing in the U.S.

We started a new syndicate at the beginning of this year, 5623 to write facilities. And the good news is that it's actually written half of what we planned at the half year. So, we had a plan to write $25 million of premium and it's at $13 million. 50% of this business is being written on our own capital and the other 50% of capital comes from third parties.

This is not going to be a fundamental driver to Beazley's profit growth going forward until the syndicate is much larger than $25 million, which is the aim because we think this is a good way of reducing expense in the London market.

We announced at the first quarter's numbers that Neil will be retiring at the end of the year and then at the half year we've announced that Martin is going to retire in about a year's time in Q2 next year. I'd just like to confirm the retirement window is now shut for anybody else to retire in the near future. So you're not going to be seeing another retirement announcement every quarter from now on. But we do think about succession a lot within the company and it was relatively easy for Adrian.

Hopefully, it's going to be relatively easy for Adrian to pick up Neil's role because Adrian's obviously with us since 2001 running our largest division. Adrian will pick up the CUO role at the end of the year and then on the back of that we have decided to break specialty lines down into two.

So, Mike Donovan who was running our cyber business is going to pick up management liability, he has picked up management liability, I think it was in place in the 1st of July; and James Eaton who has been running our smaller professional negligence specialty lines business is going to pick up the rest of specialty lines. So that is good. So we're going to have two new divisions. We still haven't decided on a title for management liability and TMB yet. James has the advantage of running the division called specialty lines. So he has an easy job of what he's going to call himself.

But we do focus a lot on people and a lot on succession. Martin is giving us plenty of advance notice. He is going to be doing – I'm not setting his objectives for the next year, actually Martin at this (00:05:17) point in time but he's going to be taking us through the year-end process of 2018 and we can look for a successor both externally and internally between now and then.

Exciting things ahead of us, the organization is quite good at focusing on a few key strategic initiatives and putting a reasonable amount of effort into those. And earlier on the year the management team got together and decided we wanted to focus on some new strategic initiatives. We then have a board strategy today that reviews those with all of the non-executive directors which is great and what we come up with are, these are the four initiatives we are going to focus on going forward in addition to one or two others that we've been working on for a number of years.

Ian is going to talk about a couple of these in a bit more depth. But in overview, Beazley Digital is all about using technology to write smaller business, better, the faster, smarter underwriting is looking at data and analytics and technology to write larger more complex business more efficiently and effectively than we currently do.

Closer to client is something we've been talking about for a number of years now. We do a lot better on cross-selling to clients and understanding our clients' needs than we used to. We think we can put more effort into that. Of course, we are a 100% brokered market. So that's with the support of our brokers.

And then, the London market finally, there's been a lot of talk in London, that London needs to be more efficient and effective and cost-effective. And we want to be at the forefront of that. And of course I am now chairing the London market group and overseeing to ensure that London remains an incredibly strong insurance market going forward.

The beauty about these initiatives is they're all interlinked. So, they're not as though they're standalone and this idea of using technology which, in my view, the insurance industry historically has not been very good at, is an exciting opportunity for us.

On that note, I'm going to hand over to Martin, who's going to take us through the financials.

Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you, Andrew. Good morning, everyone. I'm Martin Bride, the CFO of Beazley. So, I'm going to talk to you about my usual trilogy of subjects: investments, reserve strength and capital. So, first of all, a couple of headline KPIs. In terms, of premium growth, net written premiums actually growing slightly more strongly, even the very strong top line and that's just to do with where the growth falls, falling in divisions that proportionately buy a little bit less reinsurance. Earned premiums takes a little bit of time to catch up. So the growth in earned premiums will come through but it lags written premiums. As far as the per share metrics are concerned, So, NTA, et cetera per share in sterling are down a little. There are two reasons for that. Over the last 12 months property is down. We had PBT of $10 million in the second half last year because of the nat cat events. And then for the reasons that Andrew has already talked about by our standards, a relatively low profit in the first half of this year and we distributed the full-year dividends. So, that's the principal reason and then there has been a little bit of FX headwind when one is looking at things in sterling because we carry our capital in dollars.

So the investment performance significantly down on previous periods. The primary driver of that rising U.S. interest rates and that is a sort of double-edged. It's bad for us, double-edged sword; it's bad for us in the period in which it happens it's good for the business going forward. So we believe that our underlying investment performance has been quite good given the quite difficult market conditions which is to be frank, what we focus on internally is making a good, having a good outcome compared to the external conditions that we don't control, but we find ourselves faced with.

The portfolio itself is very unchanged. So, we have 85% of the assets in a relatively conservative core portfolio. Governments and investment grade are fixed income. And then 15% or so in other types of capital growth asset that do bring a little bit more yield into the portfolio. And there've been one or two minor tactical changes going on across the portfolio allocation, which is why we have a relatively good outcome compared to the actual macroeconomic factors we've faced. But the strategy remains unchanged and will continue on that basis.

So, on to reserve release picture. So, Beazley reserves prudently; continues to be the case, and so on average, you should expect reserve releases to come because we believe the reserves we set up are greater than the amounts we will pay out. So, compared to the very smooth picture that you've become used to over the last five years, we do have in one of our divisions, reserves strengthening this half year. This will happen occasionally, but when you reserve prudently, more often than not, you do get releases. So, $34 million of strengthening in the property group. About two-thirds of that relates to increasing reserves for the cost of the natural catastrophe claims last year. And then about a third of it from strengthening reserves for other claims on – for 2017 in particular underwriting year (00:10:56) in property group was the most notable area.

In aggregate, across our group, the total cost of the nat cat events from 2017 is fixed. So we've seen some increased costs in the property group, and that's being compensated in marine and reinsurance where the cost of those events is slightly lesser than we envisaged. So that's the current period view.

What's going to happen in the future? So, this chart shows you our view of how much margin is in the reserves on our balance sheet compared to the internal actuarial view which in itself has some prudence in it. So, we are in our corridor. We are at the bottom of the corridor as we were at the year-end, and so therefore, all other things being equal, the picture of reserve releases being the normal outcome in any one trading period will remain.

As we have emphasized for 2018, reserve releases will be below long term levels because we came into the year at the bottom of that range.

So finally onto capital. So there are one or two moving parts in relation to this. So our overall position remains strong. We target, as you know, having a buffer of between 15% and 25% of our Lloyd's economic capital requirement. We are slightly above that currently and we expect to be slightly above that at the end of the year when our capital requirements would have evolved to the figures that I'm showing you here, which are our projected year-end figures.

We have or we will be increasing the capital in our admitted carrier in the U.S. As a consequence of some of the changes that have been pushed through in the U.S. in relation to intergroup transactions and which types of intergroup transactions make economic sense, we're going to be carrying more risk in our U.S. carrier and less risk in the syndicate. So we have injected or we will be injecting some capital in the U.S., $80 million, to support that. And as a consequence of that, we get some reduction in the capital we need to carry in the syndicate. But there is a net effect on the group of about $30 million as a consequence of that, which is not too significant. It's 2% of our capital.

As far as our strategy is concerned, it remains unchanged. We will grow the regular dividend 5% to 10% and return any excess capital to shareholders. You're going to hear from Andrew in the outlook about our thoughts about growth and to be clear with - if we can maintain a double-digit growth environment then - it has always been our priority to reinvest capital in the business if we can and that's probably going to be the outlook certainly in the short term that we're going to have plenty of opportunity to reinvest capital. So, we will be growing the regular dividend 5% to 10%, but I would expect most of the capital that the business generates beyond that is going to get reinvested in the business.

Ian?

Ian Fantozzi {BIO 17550035 <GO>}

Thank you, Martin. So, good morning, I'm Ian Fantozzi I'm the Group COO and I've been in this role for seven years at Beazley in the exec team and I have no immediate plans to retire. You'll be pleased to hear. So I'm going to give you an overview of operations at Beazley and our digital strategy. Before I begin, you might wonder what these photos are. Well, this is our new Birmingham office which we opened in February this year, and it's a new high-tech activity-based working environment and I'm going to talk to you a little bit about how we're doing a bit more of that at Beazley as we go.

So what does the COO role cover at Beazley, because it does cover different things in different organizations. Well, technology and data, so I'm responsible for all of our technology infrastructure, software development, IT projects, all of our data management, data analytics, projects and change. So anything that requires transformation at Beazley I will have a hand in.

Underwriting and claims operations, so I manage all of the underwriting assistance and claims assistance to support our traders on a daily basis. I also manage our processing centers. So, we have a center in Farmington, Connecticut, where we do admin support on policy production. And also, of course, we now have Birmingham in the UK.

Commercial management. So, all of our outsourcing and procurements is centralized unto me. And real estate, I look after all of our offices globally. And very importantly, I look after all of our information security. So, as you know, we are a cyber-insurer. It's absolutely critical that we look after our own house, and I'm responsible for that.

The names in pink next to that, that's my operations management team. We've worked together for a number of years and you can see quite a few at Beazley. They're very experienced. I think that sets us apart from many operations management teams. We know what works, what doesn't ,and we've worked on a lot of projects together.

So, another thing that I cover is the digital strategy for Beazley, which we formalized and agreed at the board last year. And the sort of three trends that I really wanted to talk about that that strategy covers, one, the significant opportunity for technology and data. Now that might sound pretty obvious, but we are - I'd say, we're bombarded with opportunities for technology and data, insurtech opportunities. I think in the last year we've looked at 200 insurtech opportunities in total. And we have to make sense of all of that and apply it to our business effectively. So we created two new strategic initiatives to do that and I'll talk you through that shortly.

We're seeing changing patterns in the way our customers buy from us. So, brokers are increasingly wanting to place business electronically through different channels, and we need to respond to that. Also, our customers, the insurers, there is a huge amount of data now available on our customers that we need to be using and helping to support our underwriting. So we're building and digitizing our transactions around the customer.

And finally, it isn't really necessary to be fixed to any particular location now. The advances in mobile technology and software to support that have taken us to a point where you could really be based anywhere. So we're adjusting our physical environments to suit that and make the best of it.

So on to our two new digital strategic initiatives, we took a step back and looked at the way our business operates and the volumes that go through it, and it really fits into two areas. We have complex risks, lower volume, higher premiums, and we think that we can use technology and data to support the expert judgment of our underwriters and claims managers. So it's something we're calling bionic processes and under the initiative smarter, faster underwriting, we're investing in technologies to assist in the expert judgment. So that's one initiative.

The second, we've also got a whole tranche of business which is a specialty business but its simpler risk, higher volume and we think that that should be fully automated. We should have zero touch if we can get to that, so that we're making as efficient and as quick as possible. What does that mean in practice? Well, how do you digitize our business? Well, at the middle of all of that in the middle of those two initiatives and you see in this pink circle, we've got something called the Beazley single customer view. And what that means is over the last two years, we've taken all of our insured data from all of our systems and put it into one database and then integrated that to our systems.

Now that we've done that, we cleaned that data and removed all the duplication, we can start to augment that with external data sources. So we use simple sources like Dun & Bradstreet, Companies House. There are many other sources out there that are publicly available to get a better picture of our customers so that we can assess their risk in a more accurate way.

We can then perform predictive analytics on that. An example of that recently from med mal book. We've been able to look at U.S. hospital data, look through very high volumes of loss-run data and then correlate that with our claims activity to try and predict. When the next U.S. hospital comes in, we can assist the underwriter with data to help them make that underwriting decision and support the pricing.

And also, although we do quite a bit of cross-sell at Beazley, we've often relied on humans to do that cross-selling for us. Well, actually, we can use data sources to suggest cross-sell opportunity. And that's exactly what we're doing. So we may have a liability risk come in and we may end up finding that they may be exposed to some property risks or property perils and offer one of our products accordingly.

On the other side, more towards Beazley digital, it's all about automating the transactions. So we've got brokers out there that may not have a high level of automation. And for them, we give them our e-trading solution, myBeazley.com that gives them an end-to-end policy production pricing solution.

We also have a lot of brokers just send us e-mails. And I think that's probably the most common form of e-trading actually. And for them, we've been able to start scraping data out of those e-mails, structuring it, attaching it to customer record and then pricing it automatically. And I think there's a great deal of opportunity in our volume business with that.

And finally, we have brokers that don't want to do any keying at all even into e-mail. And they want to type it into their own system and have us interface to that. So we've been starting to do that, where we hook up pricing tools directly to their solutions.

Underpinning all of that, we've built also a robotics team based out of Birmingham that's been helping us to automate a lot of our mining processes. And ultimately, we'd like to get away from having any kind of data keying going on in a duplicative way at Beazley.

Why are we doing all of this? Hopefully, it's relatively obvious that it will make us more productive. But we want to change the way we underwrite. We want to have more informed decision-making, better pricing, price on different rating factors, increase our cross-sell potential.

We want to change the way we communicate with our brokers through those different channels and speeding up our response times as best we can. I think that will be a competitive differentiator going forward and of course increasing our staff productivity, having our talent focus on the right things.

And finally, as I talk about staff productivity, we need to have the working environment to make the best of this technology. So we've been turning our environment or we plan to turn our environment into something called activity-based working solutions, which is where we map all the activities that go on in each office and then tailor the physical environment to those.

Technology plays a significant part in that. So in Birmingham, where we've trialed this, nobody has a phone on their desk. There are no computers on any desks. Everyone is given a mobile device. They do all their telephony through that, all their e-mail, all their interaction with their systems. And importantly, they do their interaction with their brokers through those devices.

So we're really trying to make the best of our physical environment. We also think that will help to attract a new talented workforce, a more tech-savvy workforce over the years. So we started with Birmingham. But we're doing New York next year, Toronto next year and then the year after, 2020, we will also convert London to an activity-based working environment as well.

And with that, I'll hand back to Andrew.

David Andrew Horton {BIO 5697110 <GO>}

Great. Thank you, Ian. That's excellent. I just wanted to confirm my personal outlook before going to the outlook does not involve the word retirement. And the good news, I guess, is my wife has confirmed that personal outlook is correct.

So jumping into the rate changes, the outlook for the company. Cumulative rate changes, not surprisingly, we're seeing rates adjust on the back of the losses in 2017 as we forecast. I think one of the things we've done well over the past, and this is in our 10-year chart, is keeping that dotted line as close to 100% as possible.

And that was the business planning process overseen by Neil to ensure we mixed the lines of business depending on what the rating environment is in any one year. And now we can see the dotted line ticking up. What's driving that? Well, the pink line on there is property which is showing the largest increase, not surprisingly, on the back of the losses, the claims we were talking about earlier on. The dark blue line, which is property reinsurance, also kicking up quite considerably.

We've also seen specialty lines not move that much. It's relatively flat in the specialty lines market, which is good. And the bottom line which is marine, where we have seen a lot of rate reductions in energy and other lines, aviation and so on over the years, put a floor on the rates and now seeing some rate increases in energy and aviation. The line that continues to trend down is PAC which has terrorism in it. And generally, it's being driven down again by terrorism. But even that is not going down at the same rate that it historically has. So, again, I think we forecast at the end of the year, we thought the losses would put a floor on the rate decreases across a number of lines. And that is what we have actually have seen.

So on to the overall outlook. We touched on most of these. We're not seeing - we don't believe there's going to be a major change to the economic environment. So we're not forecasting a recession into 2019. Of course, we mentioned the recession of 2007-2008. We did have a recession plan as we are contemplating what would we do if we went into a slowdown in terms of economic growth. But our expectation is similar growth into 2019. And on the back of that, we think we can achieve double-digit growth in our top line. We still have opportunities, as I mentioned, in a number of specialty lines business. We have opportunities in the U.S. in general. And as we grow specialty lines internationally, we have opportunities outside the U.S.

We think rates are going to hold from where they are at this point in time. Of course, that's uncertain until we see the renewals on January 1, 2019. But expectation is that not - our expectation is that rates are not going to go down into 2019 across the total portfolio. Aiming for this low to mid-90s combined ratio for this year, we came to give a good indication of where we think we're going to be. Investment yield, we're now running at about a 3% investment yield. So theoretically, if nothing happens in the second half of the year, we should earn 1.5% in the second half of 2018, depending on where the expectation of interest rates are going.

Technology is quite key to us as Ian has just outlined. As I mentioned, the insurance industry historically has not been that great at investing in technology. We have some exciting initiatives underway. They're really struggling whether they should plan the $1 billion party in the U.S. or not because we're going to go through the $1 billion if we're going to go through it in the month of December. And it's quite difficult to plan for 550 people having a party on a certain day without any advance notice. But the expectation is we're going to hit the $1 billion premium mark. Not all of that comes to our account because some of that goes on to Syndicate 623. So the number you see in the group numbers is just a share of that $1 billion. It'd be great to hit $1 billion this year. Growing at 20% per annum, that's just been fantastic over the past few years.

London gets a lot of coverage in the press about how we need to become more cost-effective and efficient. As I touched on earlier on, there are plenty of initiatives that are market-wide and specific to us that can ensure that London remains a very thriving insurance market going forward. So the combination, I think, of premium growth, the outlook for higher interest rates and therefore investment returns and some of the new initiatives will make 2019 a very exciting year.

And we have got time for questions. We got a microphone coming.

Q&A

Q - Jonny Urwin {BIO 17445508 <GO>}

Hello, there, morning. Jonny Urwin from UBS. Two quick ones. So can you give us a bit more detail on what drove the attritional strengthening in property firstly? And secondly, you mentioned the press around the London market, Lloyd's of London. Do you guys feel a bit vulnerable given you don't have a multi-platform business like some of your peers? Is that a worry? Thanks.

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

You want to pick up the first?

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

Yeah. So the total strengthening is $34 million. So a third of it is attritional. It's just slightly over $10 million. It's a couple of claims, I think, in various parts of the portfolio. But I don't wish to belittle it, but at the same time it's not a significant number.

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

But talking about platforms, obviously, the company started with only one platform which was Lloyd's. And then in 2004-2005, we went onshore in the U.S. and it has two elements to it. It has the admitted platform which is domestic business. It has the MGA where we're bringing business that historically would not come across the Atlantic into Lloyd's naturally. But the great beauty about using MGA is we're getting the capital benefit of sitting in Lloyd's. So about a third of our premiums are now coming from that U.S. business which is business that would have not made it to Lloyd's. So I think that's a reasonable sized number. And then, of course, we've just kicked off our European insurance company which at this point in time doesn't actually write that much on it but can continue to grow with European business.

The fundamental issue though is that we've got to ensure that London remains a strong insurance center. And although I think its costs are on the high side at this point in time, I don't see any weakening of customer desire to place business in the London market. So we're not losing business despite the fact that we're probably a bit more expensive than we should be. And the initiatives under the Target Operating Model that Ian has been chairing on PPL to how do we actually place business more efficiently. In my view, if that works successfully and there is a massive market appetite to ensure it does; it can open a pipeline to almost everywhere in the planet to get a good quote from London because the opportunity is to get more business into London rather than less. Now, time is of the essence and we need to be successful with the initiatives. But I think there is a desire and a consistent desire between the broking and underwriting community to deliver this stuff relatively rapidly, which is different from any other position I've seen in my 15 years and I've heard others see in longer periods of time.

Hi. It's Cameron Hussein (00:30:47) from RBC. Just touching back on the property reserve additions. When you think about the two-thirds piece, which one of the big losses last year led to the increase? And do you think this is a market issue or was this Beazley-specific? And when you think about the one-third addition on (00:31:07) site, was there anything exceptional in terms of distribution channel? So is this kind of delegate your authority business?

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

I think the one particular claim I have in mind is a homeowner's claim which I think was £4 million, Neil was telling me. So, no, I don't think there were any – in the context of a portfolio of $350 million of premium, $10 million or $11 million really isn't a large number. And it was a few claims in our open market portfolio, in our homeowner's portfolio. So there was no particular distribution channel.

As far as the HI and M (00:31:44) are concerned, Irma is certainly the largest loss for the property group. And so probably proportionately, I'm sure more of that strengthening came from there. As far as the broader market is concerned, I don't have a sort of good insight into how they reserved initially and what they're subsequently doing. As I say, our overall number was correct. I think sometimes you guys have very tough expectations of how accurately you believe we can estimate events 24 hours after they've happened. I think I actually got the first call on Harvey before it had landfall. So we believe in aggregate. We do it pretty accurately and with the prudence that we talk about. But sort of event by event and class of business by class of business, that's the moving around of the numbers afterwards.

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

I'd say, look, I don't think it's specific to us. I think it's generic. But chances are you're not going to see it because it's not going to – public companies like us are going to be sitting in some of the private markets or very large companies where it's not that material to them.

Can you tell us who that was that called in the next day?

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

They're in the room. It was a Friday afternoon I remember because Harvey had landfall on Saturday. It wasn't you then.

Q - Joanna Tamar Parsons {BIO 1558226 <GO>}

And it wasn't me. Joanna Parsons from Canaccord. A couple of questions if I may. Firstly, on the digitizing aspect, could you give us a bit of a feel as to how much you're spending on it and therefore what impact this is having on the expense ratio, has had, will have? And what sort of reward you expect to get from it again? Will we see that reflected in the expense ratio and the sort of timing we're talking about because obviously you've got an ongoing program here? And then, separately, I just wanted to ask about the marine market. Obviously, a lot of talk about underperforming syndicates and lines in the marine market and what you're seeing because it looks like on your chart that the movement on the rates on the marine side has still not been that massive.

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

You want to pick up the digitizing?

A - Ian Fantozzi {BIO 17550035 <GO>}

Yeah, well, I'll kick off. And I think Martin -

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

Because how much are you spending?

A - Ian Fantozzi {BIO 17550035 <GO>}

So, well, in terms of our technology budget, we set that top down in our business planning process. So, first of all, we look at how much we can afford based on our expected growth in the year. So that whole process ensures that we stick to our investment target in terms of infrastructure. In terms of expense ratio, yes, the objective is absolutely to reduce it based on the extra productivity that we'd get. Again, we set head count targets each year that we have to meet. And one of the benefits of that is that it forces team leaders to go to the technology teams and look for solutions to be able to automate manual process. So that's the process we go through. In terms of absolute numbers -

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

They're not large. Our IT development budget is going to be $25 million next year, Joanna, which is slightly higher than it is normally. That having been said, I think if we identified some changes that we needed to invest heavily in as a business and that we're going to have big benefits, we wouldn't drip-feed them through slowly. We would spend the money. But then clearly we'd be presenting that that's what we were about to do if there was a business case for doing it. So at this stage, there's not going to be an adverse expense ratio impact from what Ian is doing in terms of investment. And as Ian has pointed out, hopefully, we will start to extract some benefit from it.

Q - Joanna Tamar Parsons {BIO 1558226 <GO>}

(00:36:00)?

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

No, I think my overall view of the expense ratio in the company is if we can keep our costs growing at low single digits, that's pretty good. There is a lot of upward pressure on it. And, therefore, if you can grow the top line at double digit, you can get the expense ratio down. So we're actually down 2 points, half year on half year. And we're hoping that will translate into a full year picture as well. I think at this stage, it would be incorrect to present to you there's some silver bullet on expenses being loaded in the gun that is going to completely revolutionize our industry. But it's possible that we could get some quite exciting – there is a lot of data keying and re-keying and scrutinizing submissions manually. And it does appear as though that some technology of today makes it realistic to automate quite a lot of that without losing the quality of the output.

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

I got to thank Martin for how professional he is because he could have set it at 5-point reduction and then just left in a year's time. And then every year, you'd be coming back and saying how are you getting on with the 5-point reduction that Martin said was going to be relatively easy for you. So thank you for that, Martin.

The marine market, Joanna, as you know, is one of the most bizarre markets in the London market because it's remarkable how long it can survive without making money for many people. And I can't remember whether it's down to three or four or five who've actually made money over the past four or five years. And of course, we are one of those. And it's remarkable to us that we don't see the rate change on marine including aviation. And we don't see the rate change on the back of it. And I think we have a group of people who are very good at segmenting their accounts under Clive and have been for many years and we continue to do that. But you can see the impact on us; it's the marine market not moving. We can't really grow it that much. We've seen a bit of growth this year on a bit of rate increase but nowhere near as much as we think it needs to do. So our aim is just to continue to form those deep relationships and look for opportunities wherever we can. But if the market stays like this, it's unlikely to show much top-line growth in the foreseeable future. But our main focus is on maintaining profitability in that division, which they've done a fantastic job of.

Q - Oliver Troop {BIO 20035307 <GO>}

Hi, Oliver Troop from Bernstein. So I've got another couple of questions just on the reserve strengthening. Firstly, it's obviously an imprecise science and you mentioned that from time to time this kind of thing will happen. I can see from the chart on page 11, I think it was, that you haven't had to do it since 2003. When was the last time that you have had to do this kind of thing at divisional level and how often might you expect it to happen in a well-reserved company such as yourself? Yeah, thanks.

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

So, yeah – no, it is quite rare. I think we have enjoyed, in our view though, 10 years of pretty benign claims experience, which helps. So, we do reserve prudently but not having any claims is also helpful. So, those of you who have followed us for longer will remember, I think in H2 2009, we've strengthened reserves in the political risks division at the time, off the back of seeing a big uptick in claims frequency from the credit crunch. So I guess that would be there for two events in that period but not that I'm predicting lots of events. But, yeah, we'd probably have had a tailwind, as an industry, claims-wise over that period. But so...

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

Martin, you've also seen within specialty lines, I think with Adrian? We've seen some reserve strengthening in specialty lines. But because the portfolio is so relatively large and was always offsetting things, but if you track the specialty lines reserve releases through recession, they shrank to a pretty low number compared with where they are now. You remember that, Adrian?

A - Adrian Peter Cox {BIO 16257010 <GO>}

That's right. So, it fell quite a lot. So, it's just it's been more marked, sitting in a division by itself and it's happened across a number of classes within that division.

Q - Oliver Troop {BIO 20035307 <GO>}

Just to follow up, sorry, so just to clarify. So, in the two-thirds part, the reserve strengthening, am I right in thinking you basically got the overall number about right but it was just that the mix...

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

Yeah. That's right.

A - Adrian Peter Cox {BIO 16257010 <GO>}

Yeah.

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

Yeah.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi. Nick Johnson from Numis. Just two questions, one on actuarial assumptions. I'm just wondering how the actuaries view the recent loss experience. Has there been any adjustment to lost picks as a result? Not stressing it should have been, but anyway, that's the question. And is the long term average combined ratio of 90% still achievable in the current environment?

The second question on GDPR, just wondering whether, obviously early days, whether or not the demand for breach cover has played out as you would have expected.it?

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

Yeah. So, as far as the actuarial view of the world is concerned, that they will react so if the underlying experience changes then yes they do react to that. It's an expert process rather than a mechanical process. And so, that's baked into the – yes, the X axis of that chart is the actuarial estimates. And it will have reacted to the fact that it seems some above average claims experience in property and will therefore have moved the actuarial view upwards and one of the challenges is to avoid them overreacting as experts can sometimes.

But as far as 90%, yeah, I mean absolutely. We're reserving in the same way that we've always reserved and you've seen the overall rate change graph has actually just gone back through the 100 Index which I think is set in 2008. So that's good. Long term, we'll have to – if we're going to have higher U.S. interest rates at some point maybe, there might be some price reaction to that but – and it's sort of new territory for us all having higher interest rates. So I'm not expecting that to be an overnight impact. So, yeah, I think we can maintain our combined ratios.

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

And Nick, on the GDPR, I think it's in line with what we expected. We didn't expect immediate tick up on 26th of May because it was only implemented on 25th of May. We also thought it'll be more competitive potentially in the U.S. where we almost (00:43:04) with our Beazley Breach Response product. We are seeing more opportunities than we used to. So, that's sort of in line with where we thought it was going to be at this point. It is too early to see how quickly they will end up buying it - (00:43:14) that ultimately everyone will buy (00:43:16) policy.

Q - Barrie Cornes {BIO 2389115 <GO>}

Hello. It's Barrie Cornes of Panmure Gordon. I've got three questions, if I may. Martin, I think you mentioned that at the moment that for 2017 nat cat loss was now fixed. At what level is it fixed at? Could you let us know that?

Second one, the NAV reduction, obviously partly due to the final of last year. Can you split out the sort of £0.17 or, sorry, £0.15 drop between dividend, FX and investment? And last or third question, just could you remind us what the average bond duration is so we can get a feel for how quick it's going to recover, please?

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

Yeah. Sure. Can I come back to you on the second one, Barrie? I think I need to just make sure my math is straight on that. So, the initial loss estimate we put out for that, it was a $200 million to $300 million range for the group. And I think we guided towards the midpoint and we're still there, is where we are on the nat cats as well.

As far as bond duration is concerned, we were as short as three quarters of a year, duration earlier this year. With rates slightly higher, I was now starting to add duration because you could see rates going down as well as up now. So it's a slightly more delicate balance for Stuart (00:44:45), who's standing over there to manage. So, I think, we're now at about one and a quarter years, Stuart (00:44:50).

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

1.5 years?

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

Yeah. 1.5 years. I guess the period where it was quite easy just to be short because it was kind of a one way bet. It's over now. So, we'll probably carry a bit more duration. Our neutral position would be to two, two-and-a-half years, which would match our liabilities. And, as I say, I'll drop you an email with the bridging of the NTA.

Q - Barrie Cornes {BIO 2389115 <GO>}

Okay. Thank you.

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

Maybe just pick up the next one. Did we confirm the 90% combined ratio or not or do we? I don't know whether Martin said that or not.

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

Yes.

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

You did. Okay. (00:45:18). I just wanted to make sure we had confirmed that.

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

Always thinking about (00:45:22)...

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

That's right.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

It's Andrew Ritchie from Autonomous. There hasn't been much focus it. but can I just focus on the specialty lines division maybe just give us an outline of market conditions pricing dropped slightly, I guess that's different because there's lots of different classes in there. Maybe just summarize what's going on in terms of the pricing? And also the loss environment because I think that's been more unstable in certain specialty lines.

The second question on cyber, there's been a proliferation of press releases from Beazley on new product initiatives in cyber and add ons to your core product range. Have you been able to get extra rate for those add ons or is that just you just following kind of the market pressure. And the final question is just a clarification. Martin, I think in the press release it says your running yield is 2.9% I don't think that's what it was the half year based on calculations is that 2.9%, what you're reinvesting at or is that kind of just observed today? What – were you're at?

(00:46:26)

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

Get a microphone for Mr. Cox.

A - Adrian Peter Cox {BIO 16257010 <GO>}

Yep.

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

So, that's what we are observing today.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

So that's current reinvestment.

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

Current - no, it's what we're making.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

(00:46:43)

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

So, I'm trying to answer this specialty lines which is obviously - because it's got a number of lines in there. It's not an easy one to answer. And Adrian's going to run over and kick me in the shins when I'm getting it wrong. But generally, I think we're seeing rates holding pretty steady across most lines and doing generalization. We are seeing cyber rates come under pressure because reacting to the lack of loss activity especially on the large cyber and there's plenty of capacity and plenty of people wanting to stay in and jump into that market. So, I get, I would guess, the small reduction is driven by cyber. Throwing in extra coverage, I think we're one of the most thoughtful companies in thinking about the impact of potential cyber losses to us. And we do a lot of modeling on how it could work for us and we think about our reinsurance buying on the back of it. And we would generally throw an extra cover at extra premium rather than throwing it in for free.

But you're picking up a valid point that perhaps some people in the market are willing to throw things in for free. And while the losses are low, it's okay. But I think you have to be very thoughtful about doing that. So, we try to restrict broadening coverage if we cannot get price increases on the back of it

Adrian can add anything if he wants to, to that. But...

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Curious as well on the claims environment and specialty. There's been some...

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

Claims environment and specialty. I don't think we see - I don't think we see - I mean, the claims environment, as you saw the reserve releases are virtually in line with track, with where we expect them to be so we haven't seen anything within the SL portfolio in total, it looks abnormal in the claims environment. So, no, I mean we could talk about individual things, whether it's in the healthcare or D&A. But generally, those are sort of individual claims as opposed to major trends at this point in time that are going to fundamentally impact the portfolio. The beauty of the portfolio is broad and deep.

Have we covered everything? So, nobody wants to know what Martin is going to do in a year's time. So, that's good news. Of course, hoping to find that out, I'll have to ask him myself later.

Thank you very much, indeed, for joining all of us.

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

Yeah. Thank you, everyone.