S&P Global
Market Intelligence

AXIS Capital Holdings Limited NYSE:AXS

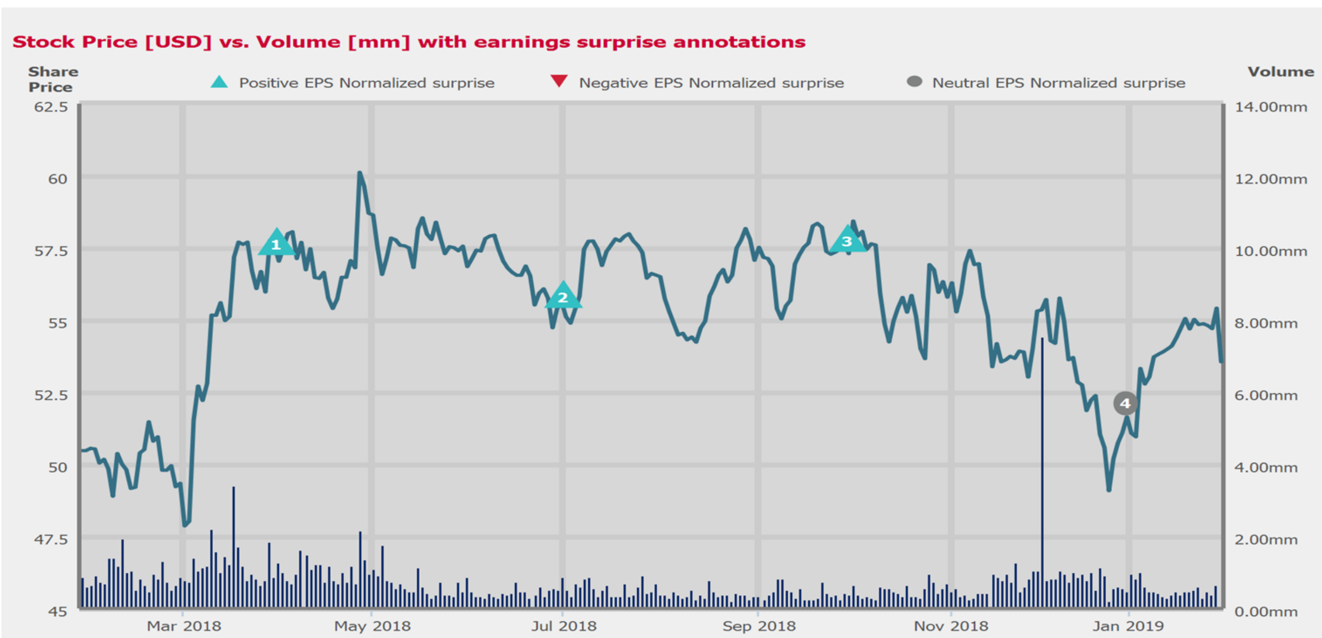
FQ4 2018 Earnings Call Transcripts

Thursday, January 31, 2019 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	(1.30)	(1.77)	NM	1.43	2.59	1.92
Revenue (mm)	737.02	752.70	▲2.13	2034.90	4643.28	4658.96

Currency: USD
Consensus as of Jan-31-2019 10:55 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	1.15	1.46	▲1 26.96 %
FQ2 2018	1.15	1.27	▲2 10.43 %
FQ3 2018	0.76	0.96	▲3 26.32 %
FQ4 2018	(1.30)	(1.77)	NM

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Call Participants

EXECUTIVES

Albert A. Benchimol
President, CEO & Director

Matthew Jay Rohrmann
Head of Investor Relations

Peter John Vogt
CFO & Executive VP

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Joshua David Shanker
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Morgan Stanley, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Good morning, and welcome to the Fourth Quarter 2018 AXIS Capital Earnings Conference Call and Webcast. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Matt Rohrmann, Investor Relations. Please go ahead.

Matthew Jay Rohrmann
Head of Investor Relations

Thank you, operator. Good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the Fourth Quarter and the period and year ended at December 31, 2018. Earnings press release and financial supplement were issued yesterday evening after the market closed. If you'd like copies, please visit the investor information section of our website at axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the investor section of our website. A replay of the teleconference will be available by dialing (877) 344-7529 in United States and international number, (412) 317-0088. The conference code for both replay dial-in numbers is 1012797.

With me on today's call are Albert Benchimol, our President and CEO; and Pete Vogt, our CFO. Before I turn the call over to Albert, I'll remind everyone that the statements made during this call, including the question-and-answer session, which are not historical facts, may be forward-looking statements. Forward-looking statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from those projected in the forward-looking statements due to a variety of factors, including the risk factors set forth in AXIS' most recent report on Form 10-K, as well as the additional risk identified in the cautionary note regarding forward-looking statements in our earnings press release issued yesterday evening. We undertake no obligation to update or revise publicly any forward-looking statements. In addition, this presentation may contain non-GAAP financial measures. Reconciliations are included in our earnings press release and financial supplement, which can be found on the investor information section of our website, which is located at axiscapital.com. With that, I'd like to turn the call over to Albert.

Albert A. Benchimol
President, CEO & Director

Thank you, Matt, and good morning, everyone, and thank you for joining us to review our fourth quarter and year-end results. I'll begin by saying that this was a tough quarter. However, notwithstanding fourth quarter results that were clearly unsatisfactory, our overall performance for the year has continued to show progress on a multiyear trend of lower ex-cat combined ratios. Even as we've changed the mix of business to include less cat exposure and in a declining market. Overall, 2018 was undeniably a year where we steps forward both in terms of underwriting profitability and organizational progress. Let's first discuss our performance.

As noted in our earnings announcement, our fourth quarter results were negatively impacted by high attritional property loss and cat activity. Based on our research and conversation with our clients and brokers, we do believe that the higher property loss frequency is broadly based across our industry and that the fourth quarter experience is more of an unusual quarter than it is a trend.

Separately, if you step back and look at our results over the past year, you'll see that AXIS delivered an improvement in full year underwriting performance both with and without cats. We feel the best way to review progress from period to period is on an ex-PGAAP basis and also on an ex-cat basis. So on that basis ex-PGAAP, ex-cat, the full year, calendar year combined ratio improved to 97.6% in 2018 from 98.5% in 2017 with a full 2 point reduction in the ex-cat loss ratio.

We also looked at the pro forma combined results as of the merger were effective on January 1, 2017, to do 2 full years of comparison. And on that basis the full year ex-PGAAP, ex-cat calendar year combined ratio improved from a pro forma 99.5% in 2017 to an actual 97.6% in 2018, with a 1.4 point reduction in the ex-cat loss ratio, reflecting the significant actions that we took over the past year to strengthen our portfolio, and in our efforts in that regard have only accelerated in the past few months.

As we've discussed in past earnings calls, beyond the underwriting actions, we've also made tangible progress in furthering our strategy and in strengthening our business. A highlight for the year was a successful integration of Novae into our London operations to make us a top 10 insurer at Lloyd's. The market has enthusiastically welcomed our new status, and we've seen significant new opportunities as a result of our enhanced relevance, even as we've taken additional portfolio actions that have not yet been reflected in our results. You'll also recall that during the year, we launched a transformation program to allow us to better leverage data and analytics, make us more agile and better enable us to take advantage of opportunities in the market. We announced that between the synergies related to the Novae integration and our transformation, we were targeting $100 million in net savings off the 2017 expense levels by the end of 2020.

I'm pleased to say that as of fourth quarter of 2018, we've already achieved $70 million in annualized savings on a run rate basis. Again, to be clear, our fourth quarter results are unsatisfactory and we take ownership of that. But our performance of the quarter should not diminish the significant progress that was made in '18 to improve our business and strengthen our leadership position.

Last year was all about laying the groundwork and furthering progress in the construction of our portfolio. This year, it's all about implementation and delivering on the expected benefits of our work, and we feel that we have the wind at our backs. Later in the call, I'll speak to some of the trends that we're seeing in the market. But first, let's turn to Pete, who'll walk us through the results in more detail. Pete?

Peter John Vogt
CFO & Executive VP

Thank you, Albert, and good morning, everyone. During the quarter, we incurred a net loss of $198 million and an operating loss of $148 million. The loss was largely attributable to cat losses associated with Hurricane Michael and the California wildfires as well as an increase in our ex-cat and weather loss ratio. These negative factors were partially offset by continued favorable prior year reserve development and strong investment income.

Looking at the consolidated income statement for the quarter, the current combined ratio was 117.3%, an increase of 16.6 points from the fourth quarter of 2017. The year-over-year increase in the combined ratio is essentially driven by 2 areas. First, an 11 point increase in the cat and weather-related losses, primarily impacted by Hurricane Michael and the California wildfires. And an over 2.5 point higher ex-cat and weather loss ratio substantially caused by the reinsurance segment where we had both higher property per risk losses and a continuing change in mix of the reinsurance book to less cat business and more casualty business combining to increase the loss ratio. The cat and weather-related losses in the quarter totaled $269 million, net of reinsurance and reinstatement premiums. The insurance segment totaled $92 million in cat and weather-related losses, and the insurance segment totaled $177 million. The losses from Michael and the wildfires combined to come in at the midpoint of our previously provided guidance. The quarterly G&A ratio was 11.3%. This was a decrease of 0.7 compared to the same period in the prior year. The decline was driven by ongoing actions that we've previously communicated to you.

Notably, in the quarter, the Novae integration generated run rate savings of $10 million and our transformational initiative produced an additional $7 million of savings. There were some onetime expense benefits in the quarter that lowered the G&A ratio. And a normalized G&A expense ratio would be 12.8%. This compares to a normalized G&A ratio of approximately 14.1% for the fourth quarter 2017, a decrease of 1.3 points year-over-year. Fee income from strategic capital partners was $6 million in this quarter compared to $8 million in the prior year quarter. This quarter was negatively impacted as we wrote down profit commissions of about $6.5 million due to the impact of the cat losses. This important part of our business continues to grow well with year-to-date fees aggregating $48 million, up from $36 million last year. For the full calendar year, the company continued to show progress with an ex-cat and weather combined ratio adjusted for PGAAP of 97.6%. The ex-cat and weather loss ratio was down 2 points. The acquisition ratio was essentially flat after adjusting for PGAAP in one timers. And we generated a solid improvement in G&A expense ratio as the Novae integration delivered $38 million in full year savings and the transformation effort has delivered savings over the last 2 quarters.

Let's move on to the underwriting results of both insurance and reinsurance segments. Let's begin with insurance. The insurance segment reported growth in gross premiums written of $66 million in the quarter. Due to an increase in credit and political risk, liability and professional lines, partially offset by declines due to the Novae discontinued lines. The growth in insurance net premiums written was reflective of the growth in the gross premiums written. For the quarter, the insurance combined ratio was 106.3%, which was up year-over-year by 12.4 points. Year-over-year increase in the combined ratio is largely driven by almost 10 point increase in the cat and weather-related losses. The quarter included 15.6 points of cat and weather-related losses, pretax cat and weather-related losses were $92 million caused by Hurricane Michael, $62 million, the California wildfires, $27 million and other events in the quarter totaling $3 million.

This compared to $34 million in the same period of 2017. The ex-cat and weather loss ratio ticked up slightly in the quarter compared to the same period last year. The small year-over-year increase is due to premium adjustments in the quarter otherwise on a normalized basis, the ratio is essentially flat.

Nevertheless, this is still not a good quarter -- not as good a quarter as the prior quarter. This quarter's loss ratio reflects about 4 points of pressure coming from our property book, as the rest of the portfolio is performing well. Albert noted that we took a number of positive actions to improve the portfolio during the year, however, it does take time for the affected business to run off the books. We estimate that fully 2 points of the pressure we saw from the property in this quarter and in year-to-date came from business placed in runoff during 2017 and 2018.

It is these reasons that we remain confident in the book as we head into 2019. As discussed in prior quarters, we believe the best way to look at the acquisition cost ratio is adjusted for PGAAP. The insurance segment acquisition cost ratio on an ex-PGAAP basis was 21.2% compared to 20.1% on an ex-PGAAP basis in the prior year. An increase of slightly over a point. The increase was entirely driven by premium adjustments, decreasing the fourth quarter 2017 ratio. Without that adjustment in the prior period, the ex-PGAAP ratio would be flat year-over-year.

For the full year in 2018, insurance improved its ex-cat and weather loss ratio by 2.8 points. Insurance experienced improvement in both the legacy access and legacy Novae books, where we saw a progress across most lines of business and had improvement in its G&A ratio as the Novae integration started to deliver savings, as I noted earlier. We expect that the -- as the cancel business runs off, as we earn in the better priced business written in 2018, the underwriting performance should improve in 2019.

Let's move on to reinsurance. The reinsurance segment reported an increase in gross premiums written off $10 million in the fourth quarter. The increase is driven by reinstatement premiums in the quarter attributable to the fourth quarter cat losses as well as new A&H business. These increases were partially offset by premium adjustments in the property division as well as the restructuring of a significant treaty in our pro lines division.

Reinsurance net premiums written decreased by $38 million compared to the same period in 2017. The decrease in net premiums written, reflected the increase in ceded premiums in cat, A&H, credit and surety and liability, partially offset by an increase in gross premiums written in the quarter. The reported current quarter combined ratio is 124%, which was up year-over-year by 22 points. The year-over-year increase in the combined ratio is largely driven by a 12.5 point increase in the cat and weather-related losses as well as almost a 5-point increase in the ex-cat and the weather loss ratio. The quarter included 28.8 points of cat and weather-related losses. Pretax cat and weather-related losses were $177 million, primarily attributable to Hurricane Michael, $57 million, the California wildfires, $102 million and other events in the quarter totaling $18 million. This compared to $99 million in the same period in 2017. The reinsurance segment almost 5-point uptick in the ex-cat and weather loss ratio substantially drove the year-over-year increase in the group's ex-cat and weather loss ratio. The rise in the loss ratio was driven by a few items, including higher midsize property loss experience. Notably, we increased our estimate for the Colombian dam loss and this impacted the loss ratio by about 1 point. We experience some pressure on the property per risk book from a number of sources. There is no single event, and this impacted the book by about almost 2 points. The year-over-year quarters comparison is affected by about 1 point due to a favorable claim outcome reported in the fourth quarter of 2017.

Lastly, our current book has less cat premium and more a long-tail casualty.

This mix change drove almost 1.5 point increase in the loss ratio year-over-year. The reinsurance segment acquisition cost ratio was 24.1%, essentially flat to the prior year when adjusting for PGAAP. In 2018, as with insurance, the reinsurance segment saw a progress with an improvement of almost 1 point in its ex-cat and weather loss ratio across both the legacy AXIS and Novae books, and it had an improvement in its G&A ratio of 0.2.

Moving on to investments. Our -- net investment income in the quarter was $113 million, an increase from $101 million in the fourth quarter of 2017, driven by growth in income from fixed maturity securities attributable to a rise in U.S. Treasury rates. This was partially offset by a decrease in income from the hedge funds due to poor equity market performance in the fourth quarter.

Our current book yield is 3.1%, and our new money yield is 3.6%. The duration of our portfolio is slightly less than 3 years. A 50 basis point spread between the current book yield and new money rates provides an ongoing opportunity for increased investment income in the future as our asset portfolio rolls over. Diluted book value per share decreased by 5.3% in the quarter to $49.93, principally driven by operating results. Net realized and unrealized losses on investments in common dividends. And lastly, one additional item to note. With regard to the acquisition of Novae, in the quarter, we've recognized amortization of VOBA of $23 million as well as approximately $16 million or in 1.3 points of DAC benefit as a segment level.

The net drag in operating income from the VOBA DAC adjustment was $9 million after-tax or approximately $0.11 per share in the quarter. For the year, we experienced the drag in operating income of $48 million after-tax from the VOBA and DAC adjustment. The good news is the VOBA is almost gone. And in 2019, we expect approximately only about $8 million net drag in operating income. That summarizes our fourth quarter results. And now, I'll turn the call back over to Albert.

Albert A. Benchimol
President, CEO & Director

Thanks, Pete. And now I'll spend a few minutes discussing market trends, and then we'll open the call for questions. The bottom line is that the fourth quarter exhibited an acceleration of the positive pricing trends we observed during the year. And everything we see points to a continuation of market discipline in 2019. Within our insurance segment, the fourth quarter was the strongest of the year with an average rate increase of 5%. This compared to average increases of 4% in the prior 3 quarters, bringing the average for the full year to about 4.3%. December was even stronger with average increases in excess of 6%.

From what we observed, we believe our average rate increases are ahead of the market. A belief that is supported by our retention rates that are almost 10 points lower than last year. In our U.S. division, average rate increases were plus 7% for the quarter, rising to nearly 9% in December. The rate was led by U.S. Excess Casualty and E&S property, which both finish the year at about 11% for the quarter and the year-to-date. U.S. programs generated rate increases at 3% for the quarter and 4% for the year, while our primary casualty book rate was up 3% in the quarter and 5% for the year.

Within our North American professional lines division, average rate was relatively stable at about 1% for the quarter and year. Although, hereto, we observed an acceleration in December. Within that average, there is a fair amount of variance. Primary business was strongest at about 4%, while excess layers averaged over 2%. Our profitable small E&O portfolio was essentially flat for the year. In our London-based international insurance division, pricing was strong in the fourth quarter with average rates up 8%, bringing the full year average up to 4%. After some firm action by Lloyds in the year, we saw the closure of 8 syndicates and over 70 different announcements of exits or significant reductions in various lines for market participants.

This newfound discipline is having a tangible impact on risk appetite and pricing. And there are several anecdotes of price increases and the plus 100% to 300% range in the market. Of all the major lines, only terrorism and political and credit risk showed average price reductions in the quarter. Even perennial laggards such as aviation delivered 10% plus increases. Overall, across our entire insurance segments, 87% of the business renewed at flat or better in the quarter. Let's now turn to reinsurance, where we just completed our 1/1 renewal season with more than 50% of our business up for renewal at that date. Our team achieved bottom-line growth and modest improvements in the price technical ratio. Consistent with industry trends, we saw price increases in loss-affected areas, but overall, the market was generally flat. Conditions vary greatly by line and geography. In EMEA, Europe, Middle East and Africa, the market is still quite competitive. Rates were generally flat. Loss affected non-cat property was modestly positive in the low single digit and liability was strongest as pricing reflected anticipated loss trends.

In our global specialty markets business, rates were again flat on average with the exception of engineering, in light of the recent poor results and lower Lloyd's capacity with up to double-digit increases for underperforming accounts. In North America, there was more price action, perhaps reflective of a greater dissatisfaction with recent results in loss trends. They were very little price reductions and price -- and pricing responded to loss activity. I would note that professional lines exhibited the strongest price action in the plus-5% to plus-10% range but in some cases, that was still not enough and we reduced exposures where warranted.

Global cat pricing was a disappointment to us at January 1. Loss exposure accounts achieved increases anywhere from 10% to 25%, but non loss affected accounts renewed flat or with reductions in the low single-digit range, especially in Europe where capacity was plentiful. Net-net, it could be described as a flat renewal. Generally, across-the-book, ceding commissions were flat, unless the underlying book was not performing adequately. Overall, we achieved modest growth in North America and Asia and reduced our renewing book in Europe and in global specialty markets. We believe we achieved better balance in our book with the modest improvement in the price technical ratio. Looking forward, we will have the large Asia-Pacific renewals in April and the North American renewals in June and July. Both markets experienced significant cat losses recently, and we would expect to see stronger price movements in Japan when the flood risks as well as the U.S. cat books, while other lines should continue to behave in a manner consistent with January 1. And by that, I mean, that reinsurers should share in the improvements that they're seeing in their clients. Our attitude across both insurance and reinsurance is that most lines of business require more price action for this industry to deliver an adequate return. And we intend to push hard for it.

We're not afraid to incur low retention rates or shrinkage in business that are not delivering the right returns. While it would be imprudent for me to make overly confident statements about the future, our expectation is that the market is gaining momentum in the right direction, as carriers recognize both recent claims and expected loss trends. We remain confident that we will continue to improve our underwriting results as the business that we canceled or nonrenewed runs off our books and the more recent better priced and more balanced business is running through. AXIS is poised for significant continued progress in 2019. And if we stay true to our strategy and our core priorities, we believe that we are well positioned to drive meaningful improved profitability. And now, let's please open the line for questions. Operator?

Question and Answer

Operator

[Operator Instructions] The first question is from Elyse Greenspan of Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question is, going back to some of your comments on the property losses and particularly, on the insurance book. So I think you guys made a comment in introductory remarks, pointing to margin improvement in net book in 2019. Can you just say if that's going to be loss and expense-ratio driven or I'm assuming, both? And then, as we think about the programs running off, what type of drag should we think about that we could potentially see if these property losses remain somewhat elevated in 2019?

Albert A. Benchimol
President, CEO & Director

Right, so let me start with the background and then, Pete, please walk us through the specific numbers. I think that it's important to state that with -- in the insurance book in particular, notwithstanding property losses that did not meet our expectations, the overall results for insurance actually did not deteriorate meaningfully. So most of the deterioration that you saw with us in the quarter really related to the elevated losses that we saw in the reinsurance book. And I believe, Pete walked us through those in specifics. And with regards to the improvement that we expect to see next year, it's our expectation that you should see improvement both in the loss ratios as well as our G&A ratios as we continue to achieve efficiency. But Pete, you want to walk us through some of those specific numbers on the improvements?

Peter John Vogt
CFO & Executive VP

Yes. So Elyse, we should see improvements in both areas. As I said, right now we know that there was 2 points of pressure associated directly with business that's already been canceled and that was just in the quarter. With regard to that, we think it's serious actions year-over-year with regard to what we did in 2018. So I would expect to see an overall improvement just on an ex-PGAAP basis and an ex-cat combined ratio. On the loss side, about over -- about 1 point associated on the entire company just from what we've already canceled on the insurance book. And that does not take into account, I'd say, other underwriting actions as well as doesn't take into account the expected higher rates that we got in 2018, starting to earn in 2019. In addition to that, we do expect the G&A ratio -- while I think this quarter was, as I said, was artificially low. I do expect the G&A ratio for insurance to continue to improve as we continue to get more synergies associated with Novae. As I noted, there was $38 million actually experienced in 2018, but by the time we got to the end of the year, we expect next year to be more like a $45 million. So an additional $7 million there just on Novae. And our transformation initiatives, too, will continue to kick in next year as we go towards our goal of saving a net $100 million by 2020.

Albert A. Benchimol
President, CEO & Director

Just let me come back to that point that Pete talked about up 1 point of improvement that's essentially baked in from the business that's been canceled. And we have on that nonrenewed or canceled business, probably less than $50 million all in of UPR. So there of course, we'll have some possible drag on that. But fundamentally, that book will be off the books and we should see that go away. I really do want to emphasize, however, that we continue to expect that other changes that we're making on our book both in terms of pricing, portfolio construction and selection, should also drive additional improvements.

Peter John Vogt
CFO & Executive VP

Just wanted to be clear, Elyse -- it's over 2 points on the insurance segment alone and right about 1 point to the entire company year-over-year.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then, maybe following up on Albert's comments in terms of pointing to price. So it seems like you guys are expecting some more price increases in reinsurance as we get to April in midyear. As you think about the reinsurance environment, some of the mix shifts that you guys pointed to a bit more casualty in the fourth quarter had an impact. How should we think about the underlying loss ratio within reinsurance trending in 2019?

Albert A. Benchimol
President, CEO & Director

Right. So 2 comments that I would make is, everything that I tell you with regards to what we're seeing on the primary insurance rate changes to the extent that we're participating in quota shares, and as I mentioned, by and large, we're not seeing major changes in the ceded commission, a lot of the improvements will drive through into the reinsurance book also. And in the XOL lines, we're also responding to losses with pricing increases where necessary. So we also expect positive trends in the underlying books in the reinsurance part. The second comment is, to your point, with regards to the mix of business. And it's interesting that the way that this industry captures the ex-cat combined ratio is interesting because it gives full credit to the premium that you collect on the cat line but it excludes the cat losses. So the more cat business you write, the more attractive your ex-cat loss ratio is. And that's really what's affecting the mix. We are writing less cat on a net basis through this year. My guess is that there will not be a major change of that into 2019. So I would hope that the full mix impact that we saw through the fourth quarter of 2018 is the bigger piece of it. There will continue to be some small impact in 2019. But Elyse, I think it's too small, and it'll be lost in the rounding. So I wouldn't model that. I would just note that we expect some, but too small to really stick out as a driving factor.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then one last quick question. You guys have said after -- I believe after 1/1 renewals when you had the sense of the market, they would reevaluate whether you guys sort of return on to buying back some of your stock, kind of, post Novae integration, et cetera. Now given where your stock is trading today, I would assume share repurchase is a bit more attractive. Can you just provide us an update on your views on repurchases for 2019?

Albert A. Benchimol
President, CEO & Director

I think that's fair. So we've got 2 countervailing positions that we will be discussing on our upcoming Board meeting. The first is that obviously, this was a disappointing quarter and our equity is down given the cat losses and that's something that we need to build back up. On the other hand, we recognize that the price of the stock is very attractive and that is something that we'll need to consider. So we will be considering both issues as we sit down with our Board and go through it. But I think given where we are, given the recent losses in the capital, whatever action we would do, if any, would be limited.

Operator

The next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Couple of quick questions here for you. First one I'm just curious, Pete, the G&A ratio that was lower this quarter or lower expenses, is there going to be any kind of reversal of that actually if you look into the next couple of quarters?

Peter John Vogt
CFO & Executive VP

Yes. It definitely will, Brian. As I noticed, it was normalized, it was low. On a normalized basis, it was closer to 13%. And I'd say that, you'll see it kind of rise to those levels over the next couple of quarters. It's not going to stay down at where it was this particular quarter.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes, yes, I guess what's this meant would've be maybe a little bit higher than usual in the next couple of quarters to offset that? It was a timing issue on kind of G&A expense recognition?

Peter John Vogt
CFO & Executive VP

Yes, as I've said through the year, I do think that right now we are running a little bit low that I would trend the expense ratio, the G&A ratio more to that, I'll call it, 13.4%, 13.5% level, right around there.

Albert A. Benchimol
President, CEO & Director

Okay. As you might imagine -- Brian, as you might imagine, there were a number of adjustments including certainly, incentive comp reductions that came in another quarter. But the thing that is relevant in my mind is that we look at both the reported number and then we look at the normalized number. And the progress in the normalized number I think is quite strong, because last year we also had a low fourth quarter G&A ratio. But if you look at the normalized for last year's fourth quarter and the normalized for this year's fourth quarter, the 12.8% number that Pete referred to, would have been a 14.1% in the fourth quarter of 2017. So we are -- the improvement is consistent and it's across the board. It's just that -- obviously, we hope to deliver results next year that will allow for a fuller incentive comp budget.

Brian Robert Meredith
UBS Investment Bank, Research Division

[Makes sense]. And then, Albert, I'm just curious, obviously, some fairly positive commentary about the rate environment at Lloyd's. You guys got a pretty big exposure there now. Are you in a position now given some of the underwriting actions that are going on with your existing book to actually see some solid growth at Lloyd's?

Albert A. Benchimol
President, CEO & Director

I think there are some opportunities, but I want to be very clear to everybody. Growth is secondary to profitability right now. And so if we get offered 5 or 6 points of pricing and we think we need 10, we're not going to take that growth. So I think there are opportunities. I think, this is probably the best market at Lloyd's in a number of years, and I think there are opportunities for growth. And where there are those opportunities, we will take advantage of them. But profitability is our #1 priority.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you, got you. I was just wondering, given that there are a number of syndicates that are having to shut business. So I was wondering if you're able to take a...

Albert A. Benchimol
President, CEO & Director

Oh yes, those opportunities are absolutely there.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then, I guess another question here for you. When we think about ceded reinsurance program here going forward, and I understand most of the large loss activity this year was some business that was kind of running off. But any kind of thoughts about changing in the ceded reinsurance program maybe to protect a little bit again some of the volatility in attritional or other things that you're thinking about as far as cat protection, et cetera?

Albert A. Benchimol
President, CEO & Director

Absolutely. And to be fair, we're always looking to improve our risk funding in our ceded program. And it's probably a good time to identify that we have made many improvements in 2018 and that we will continue to make some more. So I'll just give you a couple of quick examples. You've all heard about how difficult the third-party capital market was at the renewal. We think that we should take pride that we're one of the very few companies that actually was able to increase the amount of third-party capital support that we achieved in 1/1. We have more third-party capital. We have more diversified group of investors in our third-party capital. And we continue to expand the number of lines that we shared with third-party capital. And to you point, Brian, one of the new facilities that we created at 1/1 and Alturas is a property sidecar for our insurance book and that obviously increased quota share participation, will serve to reduce or mitigate the volatility in that property book as we look through that. We've also done a number of additions, including buying some aggregate excess of loss to -- which prevents tail-end exposure and by the way, would have been almost fully utilized in an HIM scenario. So these are in the working layers if you would -- if you know what I mean. And we are going to be renewing our various property programs in May and again, we will be looking for opportunities to enhance that. So net-net, our ceded-protection package is a better package at 1/1 '19 than it was last year.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then 1 last question, just curious, Albert, your thoughts on kind of California fire and availability of kind of commercial coverage there, pricing. And is it a spot that there could be opportunities here? Or do you intend to reevaluate it?

Albert A. Benchimol
President, CEO & Director

I think that one of the things that we spoke about during the year and accentuated in the fourth quarter is that I think the industry, in general, has bit of an issue with property and some parts of the property cat. So I think it deserves more study before we jump in at the slightest offer of rate. I can tell you that we already got out of some of the most exposed liability lines in California last year. That turned out to have been a good decision. I think again, right now, caution is probably the right order. We're doing more studies. We think that we need to continue to make changes in the book that's exposed to the California wildfire. In fact, some of the nonrenewed business that Pete spoke about had some of that exposure. There are a lot of changes, I think, climate change is driving different patterns, different frequencies. I believe that caution and analysis it's probably the first order and then if we can't figure out good ways of taking that risk in a profitable way, we will do so. But I would caution before jumping in.

Operator

The next question is from Yaron Kinar of Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Albert, in your pricing commentary, it sounds like you are taking more aggressive pricing actions than the market. And it is somewhat reflected in lower retention rates. So how should we think about the premium growth opportunity into 2019? And potentially its impact on the expense ratio if growth maybe is impacted by these pricing actions?

Albert A. Benchimol

President, CEO & Director

Well, the good news is that, in delivering our plan, and of course, we don't share our plan, but I can tell you that in delivering our plan, we already took into account the fact that our pricing actions may result in lower retention ratios. And we still believe that we can deliver improvement in our core G&A ratio. So my view is that it's still there. There is still more efficiencies to be change -- achieved through the Novae and the transformation program. And I do expect that we will have some growth in some areas. So net-net, we're still optimistic, as we mentioned earlier that the results in 2019 will include improvements both in the loss ratio and in the G&A ratio.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay, got it. And then, with regards to the elevated frequency of non-cap severity and then property, you've mentioned it's an industry phenomenon. So is that something that's addressed through pricing? Or is that also addressed through the reinsurance program, just that you were talking about?

Albert A. Benchimol
President, CEO & Director

Well, honestly, I think, it ultimately has to be a ground of pricing issue. Because I mean, there's only so much that the ceding companies can stuff the reinsurers with to not expect it at some point, reinsurers they stop. The job of the reinsurance industry is not to subsidize the profits of the primary insurance company, it's the sharing risk. But the pricing has to be right, both at the primary level and at the reinsurance level.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. And then maybe one quick conceptual question on casualty lines. So it sounds like at the end of the pricing there has been relatively stable, maybe a little better in specialty lines. But as we think of possible inflationary trends especially social inflation, how does that impact the overall profitability and adequacy of those lines? How are you thinking of that into 2019? Especially if some of the pricing actions that you are getting tend to be in the lines that have struggled a bit more to begin with?

Albert A. Benchimol
President, CEO & Director

That's a excellent question, but I think there is both an industry comment and an AXIS comment. So I will tell you that our primary casualty and our excess casualty, we only play in the excess and surplus world, that's number one. And so they tend to be highly structured and analyzed. We are actually quite satisfied with the profitability that we see in both our casualty and our excess casualty books. We've achieved an average price increase of 5% on the primary casualty, which is certainly ahead of loss trends. I mean, there's always the risk if you would of runoff inflation, but I can tell you that when we price and when we reserve, we don't reserve to the most recent inflationary trends, we reserve at what we assume to be the longer-term trend. And frankly, one of the things that is driving our reserve releases is that these longer-term loss trends that we reserve with haven't -- have been developed. So that's why, we're getting reserve releases, but we will continue to reserve at what we believe is a reasonable prudent long-term trend. And the 5% for the moment on the primary casualty, we feel very good about. The issue that we have on the excess casualty where I believe we've got one of the best E&S, excess and umbrella casualty books out there. And we have very low exposure, net exposure to the auto liability, which has been one of the worst drivers of losses. We're achieving 11%, 12% pricing increase. The issue for us is that we believe that the definition of excess needs to change. 20 years ago, excess was above $2 million. Well, $2 million is a working layer today. And we think that where we're pushing is that excess needs to attached closer to $5 million to really be considered excess. And I think that speaks to your point you're on of inflation, but where we insure, where we participate, we're comfortable that we've got these issues of inflation and frequency covered but we believe the industry needs to change the definition of excess to something closer to 5%.

Operator

Next question is from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First question. And Pete, you mentioned that the quarter was impacted by 2.5 points of large losses. If you take this out, the underlying combined ratio about 96% in the fourth quarter, still higher than the average about 94% previous 3 quarters. Just wonder, what's the sort of base to starting with, running into the next 4 quarters?

Peter John Vogt
CFO & Executive VP

Yes, so Kai, probably a better way to look at it. As I said in the quarter, you had some noise especially, on the reinsurance property book. And then, with the dam loss. So I would probably tell you, if you're steering towards the next year, maybe look more towards how our full year 2018 numbers were. And then, as we mentioned earlier, we do think that even when you look at the full year, given some of the portfolio actions we've taken, you should see improvement, so you should be able to see the combined ratio coming down from there not only on the ex-cat loss ratio but also on the G&A ratio.

Albert A. Benchimol
President, CEO & Director

And I think what you're refreshing to is that at that point of runoff business that should go away.

Peter John Vogt
CFO & Executive VP

Yes, yes, the point of runoff business that should go away. But also as we noted in the quarter, we had just in the quarter, on the reinsurance side, we had almost 1 point hit due to moving up the dam loss for the year. So I think when you start to normalize some of those things, Kai, I would say, start with the full year look of '18. And then, with the actions we've taken, we think that you should be able to see improvement as we get into 2019.

Kai Pan
Morgan Stanley, Research Division

Okay. Just on that, besides the runoff business, what exactly you're doing try to reduce some of the volatility and improve these sort of results?

Peter John Vogt
CFO & Executive VP

I'd say couple of things building on what Albert said. One is we have seen a positive rate and trend in 2018, rate over trend, and that's now going to start to earn in as we go into 2019. We've seen better terms and conditions for our underwriters on the primary side as they've seen what's going on with losses there and moving up on layers to get out of some working layers. And on the reinsurance side, they continue to restructure the book, to actually get pricing improvements, which we've definitely seen in order that will continue as we go into next year. And then probably lastly, on the volatility side, as Albert mentioned, we've actually put more ceded and retro programs in place on both the insurance and reinsurance books that we go into 2019.

Albert A. Benchimol
President, CEO & Director

Let me add a little to that, Kai, because I think you raised a very important point. We're not going to improve the numbers simply by canceling business. And there are number of areas that we are focusing for improvement. And let's speak to property first. One of the issues of property is that we can always take a look at a number of programs that just are not working for us. Some, honestly, we knew early on that we would want to nonrenew but 1/1/18 was just too late to act on some of them, so we took some opportunities to be able to -- that will have 2 factors. One in terms of the profitably but also, the truth is that a number of these programs also had significant impact on volatility, so they will have that issue. But more importantly, we're doing more work around geospatial modeling to make sure that we are looking at our micro zonal concentrations. We've taken significant actions around especially tornado hail, the kinds of occupancies that we're looking at, the kinds of rules, the kinds of deductibles that we're looking into. So this is not just canceling business and saying everything stays the same, every part of our business is being reviewed and property is job #1 for us, right now. And there are significant changes both in the risk appetite, in the structures, in the deductibles and in the distribution of that portfolio, on top of price. And so we obviously don't want to make any promises, but we're working hard to make sure that we see significant improvements in that book. With regards to other books of business, the truth is that if you look at professional lines -- what I think we were early. I mean, we spoke to you about some of our concerns, professional lines in '13 and '14, we acted aggressively on that. We've taken a significant number of loss ratio points off that book. Our exposure to class action is much lower than it's been in the past. And we continue to be releasing reserves because we realize that the last year, the year before, the year before that, we're actually better than we reserved. So from our perspective, while we're always cautious, I think that's an area where we've got proof positive that we can identify portfolios and we can fix them. So that's working well. Casualty, as you now we're being very cautious. We're looking to elevate attachment points. With regards to reinsurance, we're making sure that we're supporting only those customers who have good long-term relationships with us. So we're taking actions across the entire book to ensure that the continuing book is improving, not simply through the removal of bad programs. I hope that it helps to you understand what we're trying to do.

Kai Pan
Morgan Stanley, Research Division

Yes, that's very helpful. But if you're putting everything together, my last question is that you've been getting close or above 10% ROE in the first 3 quarters of the year. And so if you consider normalized environment, consider all the improvements you're making in your business, do you think in a normalized cat environment in 2019, you could get to 10%?

Albert A. Benchimol
President, CEO & Director

Absolutely. I thought we were going to get it in 2018, and it's a real disappointment to us, that it isn't. And one of the reasons that the incentive comp is down, because we didn't achieve our target. It's that simple. And I fully expect that everything that we're doing will deliver double-digit ROE assuming reasonable cat activity next year.

Kai Pan
Morgan Stanley, Research Division

That's great. I'm now assuming your internal target is 10%?

Albert A. Benchimol
President, CEO & Director

No, you should not assume that our internal target is 10%.

Operator

The next question is from Meyer Shields of KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Albert, you've talked, I think, a fair amount about reducing volatility, and we're seeing lower P&Ls in most zones. Does that imply the potential for investment portfolio duration lengthening?

Albert A. Benchimol

President, CEO & Director

That's a very good question. So there are 2 things that this will address. One, believe it or not, longer term is that you're prepared to take a little bit more equity volatility risk since you've got less volatility risk around the cat. But the 2 factors that will affect our duration is both our liability duration but also, our view with regard to interest rates in spreads. And so right now, we're cautious. I don't know if -- I forget if Peter mentioned it but we're about -- 2.8 is our average duration. And I think certainly, the pressure in the near term is to slow the rate increases but our view is that longer term, we're probably still in an increasing rate environment. So we are currently below our liability duration. And in the near term, I expect that we will remain below our liability duration. But there's opportunity to extend at the right time.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's very helpful. And second question just in terms of, I guess, trying to forecast reserve development. Clearly, your ticks have been very conservative. In light of the accelerating loss cost inflation that we're seeing, are you sticking with the same level of picks? Or you actually dialing them up so that the delta is confident?

Albert A. Benchimol
President, CEO & Director

It's not that picks that stay the same, it's the underlying assumption that stay the same. So by definition, you're working with different ab initio loss ratios. You're reflecting the transfer for the mix of business but when it comes to long-term inflation and long-term trends, we're keeping those at the higher levels that we've used in the past.

Peter John Vogt
CFO & Executive VP

And Meyer, I'll just built on that for a second. One thing that I did not mention in my remarks. That impacted the prior period development in the quarter was on the reinsurance side, we have acknowledged that the ADNOC loss that occurred in 2017 that -- very tragic event, the industry loss estimate's now up to $2 billion. And so we've moved our reserve up, expecting it to be a $2 billion event. I don't know if everybody else in the industry has done that yet, but we felt that, that was very prudent to do and that kind of weighed on some of the prior period development for the reinsurance segment.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

That's fair. Is there any way of quantifying that?

Peter John Vogt
CFO & Executive VP

Yes, I'd call it that -- yes, yes, probably about...

Albert A. Benchimol
President, CEO & Director

For the industry?

Peter John Vogt
CFO & Executive VP

Yes, that was a 30% increase for the industry.

Albert A. Benchimol
President, CEO & Director

1.5...

Peter John Vogt
CFO & Executive VP

So cost is about the same, yes. Dollar wise, it was about $8 million -- about $6 million to $7 million.

Operator

The next question is from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Excluding the commentary about the dam. How are we looking at past year cats and other man-made losses? And how does that impact the reinsurance net prior period development numbers?

Albert A. Benchimol
President, CEO & Director

So the prior losses on the cats overall have been very solid. We've done very well on that. I think the last time we had some really bad surprises was in New Zealand. I will say this about our HIM losses, is that we got the total number, right? We were a little bit high on the insurance number, we were a little bit low on the reinsurance number, net-net, those reserves actually developed favorably for AXIS. And so our reinsurance book, as you might imagine, was not immune to some of the adverse development that we saw in Irma. And so we had some modest deterioration in the reinsurance book, but that was more than offset by favorable developments in the insurance book.

Joshua David Shanker
Deutsche Bank AG, Research Division

All right. And so -- and when we look at the -- I mean, look, you did have favorable development in reinsurance here in the fourth quarter. It was lower than it usually is. And obviously, HIM aren't all the losses, there were some man-made events. Can we sort of go through a catalog of what's -- of whether there were offsets, whether it was a quarter like previous others with some one-offs or whatnots?

Albert A. Benchimol
President, CEO & Director

Look, I think to Peter's point, I mean if you look at the favorable development in the fourth quarter, the bulk of the reduction over longer-term trends really related to both the ADNOC that we've just discussed and the thing that was a little bit surprising is we got some adverse development for non-cat property, which we thought was a bit late in terms of the reporting in the fourth quarter of '18 for losses that apparently occurred in '17. So we're digging into that, but those are the 2 reasons why the favorable development in the fourth quarter for reinsurance is lower. Anything you want to add to that, Peter?

Peter John Vogt
CFO & Executive VP

No, those are the 2 major drivers both on the property line, one is the increase in the man-made losses, we mentioned earlier as well as some late reporting on 2017 property per risk losses.

Joshua David Shanker
Deutsche Bank AG, Research Division

And just to put a bow on this, the previous cat picks, have they been accurate? Or have they been redundant?

Peter John Vogt
CFO & Executive VP

For the most part, Josh, we've been redundant, we tend to rightfully do a conservative view as to what we do for the cats. Overall, we've been -- overall -- our history other than New Zealand and the specific event of Irma, but when you look at HIM altogether it's been redundant. We've been pretty conservative as we put our initial estimates up. And as you know with regard to the fourth quarter, we've -- we do announce the large losses. We had 2 press releases in the quarter, 1 for Michael and then 1 for the wildfires which updated Michael. And net-net, over final number came in within the range that we reported in those press releases.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Albert Benchimol for closing remarks.

Albert A. Benchimol
President, CEO & Director

Thank you, operator, and thank you to everyone on the call this morning. So as I said, at the beginning of the call, '18 was a year where we took steps forward both in terms of underwriting profitability and organizational progress. Look, we're not happy with the fourth quarter results. But we do remain confident that we have the right strategy and that our pace of progress will continue as we execute that strategy. Before we conclude, I'd like to take a moment to express my appreciation to our employees. We have a great team and they've expended some pretty substantial amount of work and delivered strong progress in '18. For which we expect to see some tangible results in '19. And to everyone, we look forward to reporting to you on that progress in future calls in the year. Thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.