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Loews Corporation (L) CEO Jim Tisch on Q3 2019 - Earnings Call Transcript

Oct. 28, 2019 1:19 PM ET | 1 Like
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Loews Corporation (NYSE:L) Q3 2019 Earnings Conference Call October 28, 2019 11:00 AM ET

Corporate Participants

Mary Skafidas - VP of IR and Corporate Communications

Jim Tisch - Chief Executive Officer

David Edelson - Chief Financial Officer

Conference Call Participants

Josh Shanker - Deutsche Bank

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Loews Corporation Q3 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. [Operator Instructions] Thank you.

I will now turn the call over to Mary Skafidas, Vice President of Investor Relations and Corporate Communications.

Mary Skafidas

Thank you, Laurie, and good morning everyone. Welcome to Loews Corporation's third quarter earnings conference call. A copy of our earnings release, earnings supplement, and company overview, may be found on our Web site, loews.com.

On the call this morning, we have our Chief Executive Officer, Jim Tisch; and our Chief Financial Officer, David Edelson. Following our prepared remarks this morning, we will have a question-and-answer session, which will include questions from shareholders.

Before we begin, however, I will remind you that this conference call might include statements that are forward-looking in nature. Actual results achieved by the company may differ materially from those made or implied in any forward-looking statements due to a wide range of risks and uncertainties, including those set forth in our SEC filings. Forward-looking statements reflect circumstances at the time they are made. The company expressly disclaims any obligation to update or revise any forward-looking statements. This disclaimer is only a brief summary of the company's statutory forward-looking statements disclaimer, which is included in the company's filings with the SEC.

During the call today, we might also discuss non-GAAP financial measures. Please refer to our security filings and earnings supplement for reconciliation to the most comparable GAAP measures.

In a few minutes, our CFO, David Edelson will walk you through key drivers for the quarter, but before he does, Jim Tisch, our CEO, will kick off the call.

Jim, over to you.

Jim Tisch

Thank you, Mary, and good morning.

Loews had much better quarter than the numbers might indicate with our largest subsidiary CNA contributing positively to our results. CNA is continuing to see solid growth in rate which increased about 6% across the P&C business. Even as rate increased retention remained in line with past quarters at 83%. New business also increased 10%

over last year's third quarter. While higher rates and new business growth are already forming through net return premiums, which are up about 8% compared to the prior year, the full positive impact will take time to be reflected in earned premium.

Additionally, the third quarter is the time when CNA reviews its long-term care book of business. For the first time since 2015, CNA's assumptions were unlocked resulting in a third quarter after tax charge at CNA of $170 million. The charge predominantly relates to expectations for lower interest rate in both the short and long-term. As a reminder, this is a GAAP charge that as no impact on statutory capital. Also, this charge was partially offset by a $44 million after tax release from CNA's long-term care claims reserves.

As is my custom, every quarter I pick a few key topics to talk about. This quarter, I would like to focus on capital allocation and the growth prospects for several of our subsidiaries. Loews typically allocates capital at the holding company in three ways; share repurchases, investing in our subsidiaries and acquiring the new subsidiary. Over the past five years, we have allocated capital using all three of these levers.

As anyone who follows us knows stock buybacks are a primary capital allocation tool and a significant means of creating shareholder value at Loews. In 2014, Loews had 30% more shares outstanding than at the end of this quarter. In 2018, Loews spent a little over $1 billion to repurchase about $20 million of its shares. So, far in 2019, we have spent about $725 million to repurchase approximately 14.5 million. That means at over the past 22 months we have repurchased over 10% of our outstanding float. As you might imagine, we believe these purchases will prove to be accretive for long-term Loews shareholders.

Our second capital allocation lever is investing in our subsidiaries, the businesses and industries we know best. Loews Corporation's recent investments in Loews hotels provide a good illustration of this lever.

Since 2014, the parent company has supported Loews hotels growth with an investment of $820 million and as received over 80% back from the hotel company for a net investment of nearly $140 million through the end of the third quarter of 2019. During this period of expansion and development, Loews hotels have grown its adjusted EBITDA from a $123 million in 2014 to $228 million in 2018.

Loews hotels continues to focus on its strategy of attracting group business as well as developing properties near demand generators such as sports stadiums and the universal Orlando theme parks. In pursuing this strategy, the hotel company has found its niche as a developer, owner and operator. Since most of its competitors are not able to fulfill all three of these functions, Loews hotels has a unique sweet spot as a partner for municipalities and developers, it has the capacity to co-invest and provide meaningful input on the design and development of new construction and to manage the hotels operations upon completion.

As the portfolio of hotels continues to grow through ground up development, it will take time for these investments to produce a noticeable return as development costs, pre-opening expenses and ramp up periods for each new hotel somewhat obscure initial results.

Our third level for capital allocation is adding another leg to the proverbial stool. In 2017, we acquired Consolidated Container Company for approximately $1.2 billion consisting of $600 million in cash and $600 million of debt at the CCC level. This acquisition gave Loews our total hold in the packaging industry. Over the past two years, CCC has added six tuck-in acquisitions, all of which were funded at the CCC level. These acquisitions added scale at extremely attractive post synergy multiples and increased CCCs presence in higher growth pharmaceutical segments.

It's worth noting that Loews does not frequently acquire subsidiaries and given the sky-high valuations in today's market, I don't see that changing. Multiples have moved higher as the private equity world has become accustomed to easy money, low interest rates leading to cheap and readily available debt financing, make levered acquisitions possible even at these precipitous multiples again that we are unwilling to play.

Now I want to talk briefly about growth prospects of CNA and Diamond. At CNA, we remain very bullish both on the fundamentals of the insurance industry and on CNA's growth trajectory which is fueled by the strength of the team that they have put together. CNA will continue to focus on maintaining and improving its strong underwriting culture, recruiting and retaining top talent, leveraging technology and expanding distribution. These steps will enable CNA to capitalize on its organic growth opportunities. If you talk to Dino Robusto, CNA CEO, he'll tell you that there was plenty of room for organic growth.

The focus for Diamond Offshore is quite different. The company is less occupied with growth and more occupied with managing its liquidity. Diamond continues to concentrate on controlling its cost structure, strengthening its balance sheet and building its revenue backlog. Even as Diamond has kept its foundation solid, it continues to develop process innovations then make it more efficient and a value added partner for its customers.

Finally, last year we began making more detailed information available on our websites about our subsidiary strategies and mid to long-term prospects for growth. In response to your request, we have updated and reposted these presentations for CCC, CNA, Diamond Offshore, and Loews hotels all narrated by their respective CEOs and leadership teams.

We're happy to provide these virtual Investor Day style presentations and we encourage you to listen to them and reach out to us if you have any questions.

And without any further ado, I'll hand the call over to David Edelson. Loews' CFO.

David Edelson

Thank you, Jim. Good morning everyone.

For the third quarter, Loews reported net income of $72 million or $0.24 per share down from $278 million or $0.88 per share in last year's third quarter. Page 13 of our earnings supplements sets forth the key quarterly drivers.

A quick summary of the quarter, CNA accounted for most of the year-over-year decline in net income, largely due to the strengthening of its long-term care active life reserves. CNA's property casualty results also reflected a modest reserve charge this year compared to a meaningful reserve release in Q3 last year. Importantly, however, underlying P&C underwriting results at CNA continue to show improvement. Boardwalk's earnings contribution was essentially flat with the prior year, whereas contributions from Diamond and Loews hotels were down for reasons I'll explain shortly.

Parent company investment income showed a nice year-over-year quarterly increase, driven namely by better returns on equities and short-term investments.

Now for more detail, CNA is after tax earnings contribution was $96 million down from $300 million in Q3 2018. Let me start by focusing on the positive, which is continued progress in CNA's core P&C business. The underlying combined ratio was 94.6, the same as the last quarter and almost 1 point better than full year 2018. Net written premium was up 8% in the quarter and rate was up almost 6% and what is typically a heavy quarter for catastrophe losses, CNA incurred only 1.8 points of cat losses compared to 2.6 points in last year's third quarter and 3.7 points for full year 2018. The year-over-year comparison for P&C, however, was hurt by modest adverse prior year development compared to meaningful favorable prior development in last year's third quarter. This adverse development was driven by legacy [indiscernible] exposures in commercial and health care and specialty. Several other lines in commercial and specialty, however, including surety and management liability posted reserve releases during the quarter. Absent the impact of prior year development in both periods, CNA's after tax PNC underwriting income increased 33% from Q3 2018 to Q3 2019. CNA completed its review of its long-term care reserves this past quarter.

As a reminder, CNA's GAAP long-term care reserves have two components, future policy benefit reserves commonly referred to as active life reserves as well as claims and claims adjustment expense reserves. During the quarter, CNA strengthened his active life reserves by 216 million pretax and released 56 million pretax from its claims and claims adjustment expense reserves.

To put these numbers in perspective, at June 30, 2019, CNA had over $9 billion of GAAP active life reserves and almost $3 billion of GAAP claims reserves. CNA assesses the adequacy of its GAAP long-term care active life reserves annually by performing what's known as a gross premium valuation or GPV. In the GPV, management uses its current best estimate actuarial assumptions to calculate required reserves. If the required reserves exceed recorded reserves and unlocking occurs and active life reserves are increased based on the current best estimate assumptions.

CNA as Jim said, CNA last unlocked its LTC active life reserves at year end 2015. The company subsequently conducted reviews of these reserves in each of 2016, 2017 and 2018 and concluded that no unlocking was necessary. In this year's third quarter, when CNA applied its current best estimate actuarial assumptions towards LTC active life reserves, the result was an approximate 400 million increase in required reserves. The interest rate environment caused CNA to lower; it's assumed future new money rates and thus its discount rate. While there were gives and takes with respect to other actuarial assumptions such as morbidity, persistency, and premium rate actions lowering the discount rate drove the unlocking.

Given that CNA had $182 million of margin in its active life reserves before the review, this 400 million reserve increase resulted in a $216 million pretax strengthening of CNA's active life reserves. Note that this is a GAAP reserve charge and does not impact CNA statutory long-term care reserves. The strengthening of the active life reserves and the release from the claims and claims adjustment expense reserves taken together reduce Loews' net income by 112 million in Q3. Recall that in last year's third quarter, CNA booked a claims reserve release that added 21 million to our net income.

CNA has disclosed more information about its long-term care business in its quarterly investor presentation, which can be found on its IR Web site.

In summary, CNA's underlying P&C results were healthy, but its contribution to our Q3 results was hurt by the interest rate driven LTC active life reserve charge and the modest adverse prior year development in P&C.

Turning to Diamond Offshore. Diamond contributed a net loss of $48 million in Q3 2019 as compared to a net loss of $27 million last year reflecting the continued difficult conditions in the offshore drilling market. Contract drilling revenues declined 14% while Diamond's contract drilling expenses increased 7%, revenue earning days were actually up 14%, but this was more than offset by a 24% decline in average daily revenue earned. The drivers of the revenue decline were rigs working at lower day rates as well as shipyard time for two of the company's high [spectro] [ph] ships which had previously been earning day rates well above current market.

As a reminder, Diamond incurred the cost of illegal settlement in last year's third quarter which reduced our net income in that quarter by $8 million. Boardwalk's contribution to our net income was basically flat year-over-year at $29 million. As revenue declines from contract expirations and restructuring were more than offset by revenues from growth projects recently placed into service.

Operating margins declined somewhat, however, in part due to the timing of maintenance expenses. Loews hotels had a noisy third quarter as it contributed 3 million to our net income in Q3 down from 11 million in last year's third quarter. There were two main reasons for the year-over-year decline in net income contribution.

The first was the substantial disruption caused by the threat of Hurricane Dorian, which caused widespread cancellations at the company's properties in Orlando and Miami Beach. And the second were pre-opening expenses occurred in connection with properties under development including properties in Orlando, Kansas City and Arlington, Texas. As Jim said, and I'd remind you that was so much hotel development activity taking place, the company's underlying earnings will continue to be massed by pre-opening and startup costs.

Loews hotels adjusted EBITDA which is disclosed in our quarterly earnings supplement also declined year-over-year. The hurricane related disruption at the company's Florida properties was a major factor. Additionally, three properties were divested since last year's third quarter with one property leaving the chain altogether and two becoming managed only hotels. Despite what appears to be a weak quarter, Loews hotels continues to expand its footprint and post improved results at many of its properties.

Turning to the parent company, pretax investment income was $36 million up $31 million from the prior year's third quarter driven by returns on equities and short-term investments. During Q3 2019, we received $111 million in dividends from our subsidiaries, $85 million from CNA and $26 million from Boardwalk. We repurchased 3.4 million shares during the third quarter at an aggregate cost of $168 million. We purchased an additional 1.8 million shares since quarter-end for about $90 million. We have repurchased 15 million shares during 2019 for just over $730 million representing almost 5% of our shares outstanding at year-end 2018.

Loews ended the quarter with $3.5 billion in parent company cash and investments with cash and equivalent accounting for over 75% of the portfolio.

Let me now turn it back to Mary.

Mary Skafidas

Thank you, David. Before we open up the call for questions, we have a couple of questions submitted from our shareholders. First question deals with CNA. Jim, how do you feel about CNA's management of their long-term care business, especially in light of their Q3 unlocking?

Jim Tisch

So, all of us at Loews, we're extremely comfortable with how the CNA management team is managing the long-term care business. We're impressed by the operational discipline that they've brought to the business and we're also impressed by their efforts to mitigate the risks of this business. For quarter's reserve unlocking, which was caused by the current interest rate outlook, it doesn't change our view in any way.

Let me step back and give you a bit of history. About a dozen years ago, the CNA management team decided that one of the long-term care block of business is in runoff. It still needs to be vigorously and strategically managed. So CNA selected some of the best and the brightest within the company to run the business as a business, actively managing it from every angle. They looked at it from an operations, claims actuarial and more. The goal was to aggressively mitigate the risk and to manage the liability.

Changing the mindset from it being a runoff business to an active business has been critical in this whole process. So, the new team set about gaining a deeper understanding of the business, not just actuarially, but every facet of the business. This understanding has led the team to identify opportunities to mitigate the risks such as more supportable rate increase filings and offerings to policy holders that benefit them, while also enabling CNA to reduce risk.

I truly believe that CNA's actuarial understanding of its block of business is much deeper than it has ever been. Just two years ago, CNA moved to what's called first principles reserving and that gave us the ability to slice and dice the block much more deeply than they previously could. One huge advantage of the company's actuarial advances has been the ability to support ratings increases with much more targeted and credible data, including data from over a 100,000 claims that the company has already processed.

When I take a look at the assumptions made in the company's last unlocking in 2015 compared to the current unlocking what I see on net is a business that is actually pretty reasonably predictable in the medium term. I don't want to diminish the long-term tail risk, but over the medium term, our block of businesses performed basically in line with our expectations with a major exception of interest rates.

Here are some stats that I find compelling. So, since the end of 2015, total claims paid are 2% lower than expected. Our active policy count is 5% lower than expected and the total claim count during that period is slightly lower than expected. These broad measures help to define the risk in the block and they were all predicted quite accurately in the context of a five-year timeframe. So, what CNA got wrong was the interest rate and the spread environment, a problem that's being addressed this quarter. So, while I understand there's a lot of noise around the various long-term care blocks, what I have seen first-hand at CNA is that with the right data, with the management focus and with the appropriate resources thrown at the problem of these blocks are more predictable than I think most outsiders have come to believe.

Mary Skafidas

Thank you, Jim. Next question submitted by shareholder, it has to do with Diamond. With the prolonged downturn in offshore drilling continuing, do you feel Diamond is well managed from a cost perspective?

Jim Tisch

Absolutely. I think that Diamond has done a really good job of managing its costs. It's cut expenses by about 50%. That's at the home office and also across the company. I would say that the head count is as low as possible while also operating efficiently and safely. No expense categories have been spared; there has been cuts in just about everything including employee benefits as well as free coffee within -- at the home office. So, they're aggressively, aggressively managing their expenses and the company is doing its best to manage in what is a very difficult environment.

Mary Skafidas

Thank you, Jim. Laurie, we'd like to turn the call back over to you for questions in the queue.

Question-and-Answer Session

Operator

Your next question comes from the line of Josh Shanker of Deutsche Bank.

Josh Shanker

Yes. Good morning everybody.

Jim Tisch

Good morning, Josh.

Josh Shanker

Good morning. When the third quarter began on July 1. I know this isn't necessarily how you value the company, but if I take the value of Loews described by the market and subtract out the public values of CNA and Diamond, what I call the stub value was trading at about $5 billion. Two months later, given the decline in Loews price, but the relative stability of CNA's price, the stub value had fallen 45% over those two months. When you think about buying back Loews stock, are you thinking that the parts that are not publicly valued are dramatically undervalued by the market or you thinking that CNA is dramatically undervalued? I know the answer is both, but on a relative basis, there are difference between buying the stock on July 1st and buying the stock on August 30th?

Jim Tisch

Not really. I think of it that both CNA is undervalued and the stub is undervalued. So, and we've talked about this an awful lot. And that's what makes me so bullish on the stock.

Josh Shanker

Is there anything that we can detect in your repurchase appetite that at certain points there's certain valuation studies that you're doing that make you more or less anxious to buy stock over a short period of time?

Jim Tisch

You have to look at is how much stock we buy in a particular quarter. And that will give you a pretty good insight into what our appetite is.

Josh Shanker

So, if I look back over, let's say on the last 18 months, I don't know. I mean, I don't know has your appetite changed over the past 18 months or has it been steady the whole time?

Jim Tisch

It's generally been steady. We bought $1 billion of stock in 2018 and in 2019, through now we're just about at three quarters of $1 billion. So, yes, look, I'm frustrated. I think the stock has a lot of value. We haven't been shy about saying that and notwithstanding that to me, the stock still looks very cheap, but markets are markets.

Josh Shanker

And so, then I'm going to ask you [indiscernible] question I asked you last quarter, I was talking about where interest rates were and talked about if you would be willing to issue more debt simply because the markets were attractive. With your appetite in mind for your own stock. Isn't that a good trade right now to issue debt for the purpose of accelerating your repurchase?

Jim Tisch

Yes. I don't think so. First of all, if we issued debt, if you read the rating agency reports, they want us to hold as much cash as we have debt. So, there is nothing so exciting about issuing debt. Secondly, there isn't enormous volume in low shares, so there's just a limit to how much you can buy. So, I don't know that issuing debt would really do us any good.

Additionally, we have about $3.5 billion of cash now, if we wanted to -- and if the opportunity presented itself, we could use a good portion of that to repurchase more shares.

Josh Shanker

Okay. And then on another trek, you've talked many, many times on many calls about the market being overvalued for the purpose of buying both public companies and buying private companies competing with private equity. I haven't heard you say too often, which might be the same answer, is hotel starts right now. If you want to build a hotel or buy a hotel, has private equity inflated those values to the point where they're generally unattractive as well?

Jim Tisch

First things first, I don't think the public equities are expensive. I think that valuations in private equity land are expensive.

Josh Shanker

It didn't take out prices of public equity. I mean, if you wanted to take buy the whole thing, yes.

Jim Tisch

Okay. Yes. No, that I agree. With respect to hotels, we are operating in a very discrete, niche in the hotel industry. So, we're -- let's put aside Orlando for a second. We're not developing motels. We're not developing low service hotels. We're developing what we call and what the market calls upper upscale hotels. And generally we're marketing, we're building those hotels with significant meeting space to fit into the core competencies that we have. So, we're building hotels with meeting space near demand drivers. And, we're also doing it generally with help of one sort or another from the local municipalities, to make it so that, our hotels without that help just would not be economic to one that is economic without help.

In order to do that, you have to have a long-term view because it's not a matter of just putting a shovel in the ground. It's a matter of working with the community and negotiating a transaction that's both good for the hotel company as well as the community. And so, this is not an area where we've seen private equity participate. So, no, they're not a factor in this.

David Edelson

And if I could just add Josh, we're not, as you see, we're not going out and just buying existing hotels. We are developing hotels frequently, as Jim said, in conjunction with a municipality or with other partners. So, and what we bring is the ability to manage that hotel and our own capital. So, it's a very different thing than just going out and buying the existing hotel in some sort of option.

Josh Shanker

Okay. Those are all very complete and thorough answers. I appreciate it. Thank you.

Jim Tisch

Thank you.

Mary Skafidas

Thank you, Josh. And thank you everyone for listening. That concludes Loews' third quarter 2019 earnings call. A replay will be available on our Web site, loews.com at approximately two hours.

Operator

Thank you for participating in the Loews Corporation Q3 2019 earnings conference call. You may now disconnect your lines and have a wonderful day.