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QBE Insurance Group (QBE)

A taste of honey

Recommendation

Buy (Hold)

Price

\$10.74

Target (12 months)

\$11.90 (previously \$10.60)

GICS Sector

Insurance

Expected Return

Capital growth	10.8%
Dividend yield	4.2%
Total expected return	15.0%

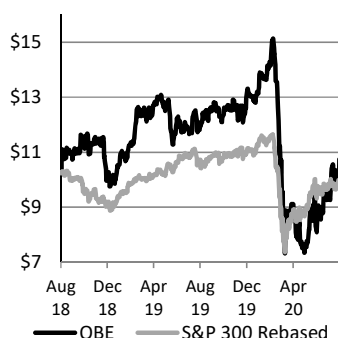
Company Data & Ratios

Enterprise value	n/m
Market cap	\$15,779m
Issued capital	1,469m
Free float	100%
Avg. daily val. (52wk)	\$70.0m
12 month price range	\$7.13- \$15.19

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	9.26	7.56	11.80
Absolute (%)	15.98	42.06	-8.98
Rel market (%)	13.15	29.13	-1.55

Absolute Price



SOURCE: IRESS

1H20: US\$712m statutory loss, A4¢ interim dividend

QBE's statutory loss of US\$712m was broadly in line with guidance of a ~US\$750m loss. While noise in the result was mainly due to COVID-19 impacts (as flagged in its 22 July trading update), underlying performance remains strong given strong premium rate increases (including material pricing momentum especially in North America and International) and retention rates, improvements in attritional and large individual risk claims ratios across North America, International and Australia Pacific, and ongoing operational efficiencies (ahead of schedule, targeting US\$825m run rate net underwriting expenses). Despite the pandemic, QBE continues to manage capital well (PCA 1.8x, at the top end of its 1.6-1.8x target range). Strong organic capital generation and offshore contributions have allowed QBE to pay an interim dividend of A4¢ (10% franked with a 1.5% DRP discount), a pleasant surprise. Looking past the current noise and based on its strong underlying fundamentals, QBE appears well-placed to withstand the residual impacts of COVID-19. Operating at the top end of its target PCA range should also enable the insurer to capitalise on emerging organic growth opportunities and participate in inevitable global economic recovery.

Price target increased to \$11.90, Buy rating reinstated

Given a better 1H20 outcome, we have revised our US\$65m cash loss in 2H20 to a US\$146m cash profit. This is based on lower net claims expense and better investment outcomes on policyholders' and shareholders' funds. While we still forecast a cash loss in FY20 (US\$520m), we have increased the figure in FY21 by 9% to US\$737m mainly due to stronger GWP growth momentum. While FY22 cash profit is almost unchanged, we have increased subsequent years' cash profit by 3% (and simultaneously forecast dividends after applying the target cash payout ratio of 65%). However, our valuation/price target is increased by 12% to \$11.90 – this is after taking into account 3% higher cash profit forecasts, 3-4% higher dividend payments and adjusting SOP component PE multiples for recent market movements. QBE's rating is thus upgraded from Hold to Buy.

Earnings Forecast

Year end 31 December	2019	2020e	2021e	2022e
NPAT (statutory) (US\$m)	601	-553	763	998
NPAT (cash) (US\$m)	733	-520	737	953
EPS (cash) (US¢)	56	-37	50	65
EPS (cash) growth – US\$ terms (%)	8%	-166%	-237%	29%
EPS (cash) (A¢)	78	-53	71	89
PER (x)	13.8	-20.2	15.2	12.1
P/Book (x)	1.4	1.2	1.2	1.2
P/NTA (x)	2.1	1.7	1.7	1.6
Dividend (A¢)	52	15	45	58
Yield (%)	4.8%	1.4%	4.2%	5.4%
ROE (cash) (%)	8.8%	-6.5%	8.3%	10.2%
Insurance margin (%)	6.1%	-2.8%	8.0%	9.6%
Franking (%)	44%	10%	10%	10%

SOURCE: BELL POTTER SECURITIES ESTIMATES

A taste of honey



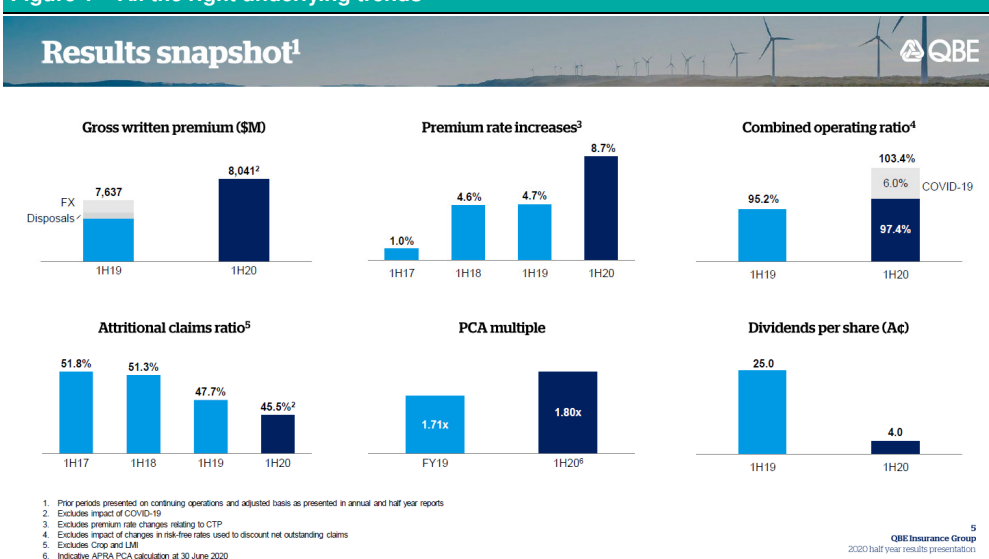
1H20: US\$712m statutory loss, A4¢ interim dividend

QBE's 1H20 result components are:

1. Gross written premium (GWP) US\$8.01bn (BP US\$8.04bn), +5% pcp;
2. Net earned premium (NEP) US\$5.51bn (BP US\$5.86bn), -3% pcp;
3. Group COR 109.5%, excluding COVID-19 103.4% (BP 107.3% net of COVID-19);
4. Net investment yield -0.6% (BP -3.1%);
5. Reported insurance margin -10.6%, excluding COVID-19 -4.5% (BP -9.5% net of COVID-19);
6. Statutory loss US\$712m (BP US\$748m, guidance of ~US\$750m);
7. Cash loss US\$682m or US\$666m excluding one-offs (BP US\$736m);
8. Cash EPS -US49¢ (BP -US56¢);
9. Interim ordinary dividend A4¢ (BP nil);
10. Cash ROE -16.6% (BP -18.2%);
11. Reserve strengthening 1.8% NEP (BP 2.0%); and
12. PCA multiple 1.80x (BP 1.78x, target 1.6-1.8x).

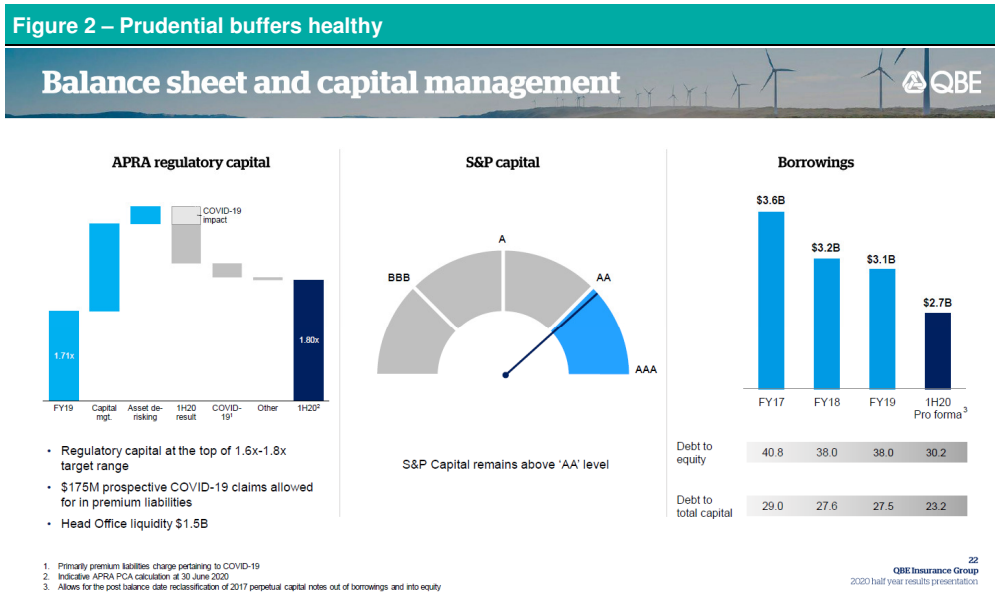
QBE's statutory loss of US\$712m was broadly in line with guidance of a ~US\$750m loss. While noise in the result was mainly due to COVID-19 impacts (as flagged in its 22 July trading update), underlying performance remains strong given strong premium rate increases (including material pricing momentum especially in North America and International) and retention rates, improvements in attritional and large individual risk claims ratios across North America, International and Australia Pacific, and ongoing operational efficiencies (ahead of schedule, targeting US\$825m run rate net underwriting expenses or 14.4% NEP).

Figure 1 – All the right underlying trends



SOURCE: COMPANY DATA

Despite COVID-19 charges, QBE continues to manage both its capital (PCA 1.80x, at the top end of its 1.60-1.80x target range) and gearing (wholesale borrowings further reduced from US\$3.6bn at the end of FY17 to a pro-forma US\$2.7bn after reclassification of 2017 perpetual capital notes into equity; debt to equity down from 41% at the end of FY17 to pro-forma 30%) well. Strong organic capital generation and offshore contributions – following MQG’s playbook in our view – have allowed QBE to pay an interim dividend of A4¢ (10% franked, payable 25 September and with the DRP offering a 1.5% discount), a pleasant surprise.



SOURCE: COMPANY DATA

The swing to a statutory loss from 1H19 mainly reflected COVID-19 impacts: (1) investment losses from market volatility; and (2) US\$335m charge (US\$50m NEP impact from additional reinsurance reinstatement premiums in North America, US\$151m net claims – property, business interruption (BI), reinsurance, workers’ compensation, casualty including D&O, accident & health, trade credit, LMI and landlords’ insurance – largely in North America and International, US\$115m risk margin charge within Corporate for the pandemic and US\$35m refunds – the benefit of lower personal motor claims frequency was returned to customers as premium refunds – and bad debts largely in North America and Australia Pacific).

Table 1 – No surprises with COVID-19 underwriting impacts

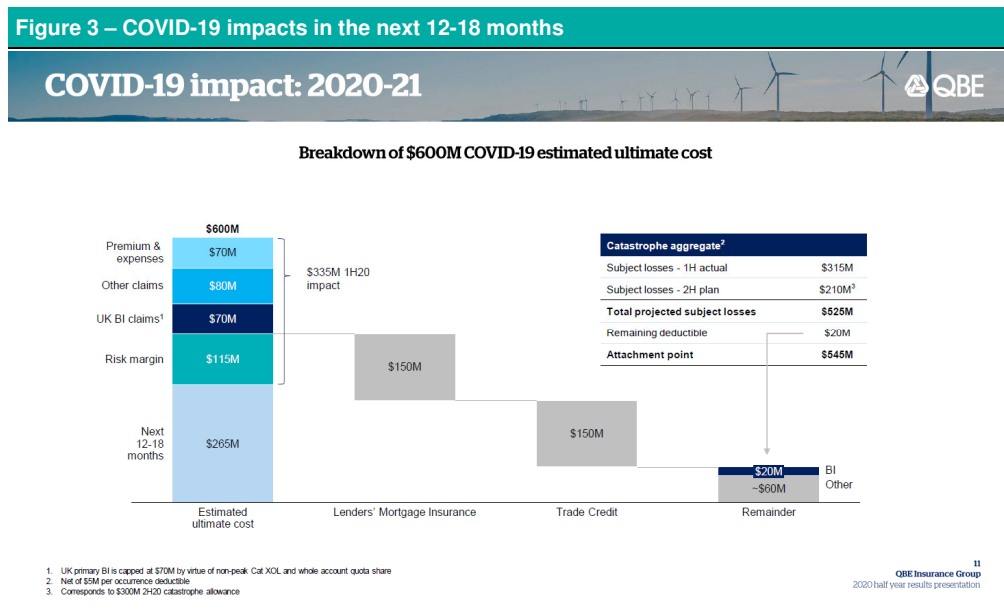
COVID-19 UNDERWRITING RESULT IMPACTS FOR THE HALF YEAR ENDED 30 JUNE	2020 STATUTORY RESULT US\$M	COVID-19 IMPACTS				2020 ADJUSTED EX-COVID US\$M
		NORTH AMERICA US\$M	INT'L US\$M	AUSTRALIA PACIFIC US\$M	CORPORATE US\$M	
Gross written premium	8,011	(30)	-	-	-	8,041
Gross earned premium	6,509	(30)	-	-	-	6,539
Net earned premium	5,506	(30)	(20)	-	-	5,556
Net claims expense	(4,307)	(32)	(116)	(3)	(115)	(4,041)
Net commission	(903)	6	2	-	-	(911)
Underwriting and other expenses	(820)	(9)	1	(18)	(1)	(793)
Underwriting result	(524)	(65)	(133)	(21)	(116)	(189)
Net investment (loss) income on policyholders' funds	(60)	-	-	-	-	(60)
Insurance (loss) profit before income tax	(584)	(65)	(133)	(21)	(116)	(249)

SOURCE: COMPANY DATA

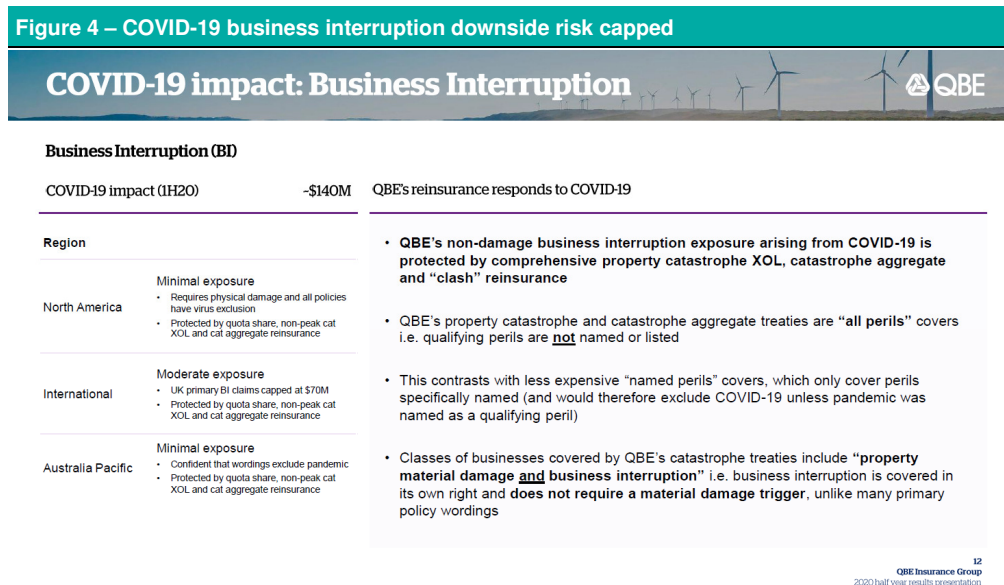
Adding to this loss was adverse CAT experience and adverse prior accident year claims development (US\$101m strengthening vs. US\$89m reserve release in 1H19) that more than offset improvements in attritional and individual risk claims. Group cash loss was US\$682m after adding back US\$30m amortisation and intangible impairment charges

while the adjusted cash loss of \$666m further included restructuring, minor business disposals and other one-off items. Group COR of 109.5% would have been 103.4% excluding COVID-19 impacts and 97.4% excluding risk-free rate changes.

QBE estimates total COVID costs to be ~US\$600m pre-tax (that includes ~US\$265m potential net claims in the next 12-18 months primarily in the above-mentioned business classes) – this appears to be very conservative provisioning. We note that QBE’s downside risk to potential BI claims is now only US\$20m. In terms of the UK test case for BI policy wordings, QBE’s primary BU claims is capped at US\$70m that is already booked into the 1H20 result. As for North America and Australia Pacific, exposure is expected to be minimal due to comprehensive reinsurance arrangements.



SOURCE: COMPANY DATA



SOURCE: COMPANY DATA

Result component trends were also broadly consistent with those outlined in the 22 July trading update that included hardening premium prices [ex-CTP, Group average renewal premium rate increases were 8.7% in 1H20 (comprising 7.3% in 1Q20 and 10.2% in 2Q20)

with North America (9.8% in 1H20 comprising 9.3% in 1Q20 and 10.4% in 2Q20) and International (10.0% in 1H20 comprising 6.1% in 1Q20 and 14.2% in 2Q20) being the best performers vs. Australia Pacific (5.5% in 1H20 comprising 6.8% in 1Q20 and 4.6% in 2Q20)] and strong Group GWP growth of 5% to US\$8.01bn [10% underlying on a constant currency basis and ex-business disposals mainly in North America (+14% underlying) and International (+12% underlying) but with Australia Pacific constrained by CTP market reform including market share normalisation (+1% underlying)].

Ex-COVID, Group GWP increased by 5% to US\$8.04bn while NEP fell by 3% to US\$5.51bn mainly due to FX translation, business disposals and higher reinsurance spend. On a constant currency basis and excluding US\$171m business disposal impact in 1H19, underlying NEP growth was a much healthier 4%.

Group net claims excluding COVID-19 increased from 68.4% to 72.7% largely due to lower risk free rates used in discounting net outstanding claims liabilities, while the improvement in attritional claims and a reduction in large individual risk claims were more than offset by higher CAT claims and reserve strengthening.

Table 2 – KPIs

FOR THE HALF YEAR ENDED 30 JUNE	2020		2019	
	STATUTORY %	EX-COVID %	STATUTORY %	ADJUSTED ² %
Net claims ratio	78.2	72.7	69.5	68.4
Net commission ratio	16.4	16.4	16.1	16.1
Expense ratio	14.9	14.3	14.8	14.8
Combined operating ratio	109.5	103.4	100.4	99.3
Adjusted combined operating ratio ¹	103.4	97.4	96.3	95.2
Insurance profit margin	(10.6)	(4.5)	7.6	8.7

1 Excludes impact of changes in risk-free rates used to discount net outstanding claims.

2 Excludes one-off impact of the Ogden decision in the UK.

SOURCE: COMPANY DATA

Table 3 – Divisional performance

FOR THE HALF YEAR ENDED 30 JUNE	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE (LOSS) PROFIT BEFORE INCOME TAX	
	2020 US\$M	2019 US\$M	2020 US\$M	2019 US\$M	2020 %	2019 %	2020 US\$M	2019 US\$M
North America	3,081	2,804	1,672	1,849	104.8 ¹	99.9 ¹	(227)	19
International	3,150	2,880	2,191	2,019	91.4 ¹	94.3 ^{1,2}	(5)	231 ²
Australia Pacific	1,829	1,960	1,696	1,797	95.3 ¹	90.5 ¹	25	244
Corporate adjustments	(19)	(7)	(3)	6	–	–	(42)	1
Group ex-COVID/adjusted	8,041	7,637	5,556	5,671	97.4 ¹	95.2 ¹	(249)	495
Risk-free rate impact	–	–	–	–	6.1	4.1	–	–
COVID-19 impact	(30)	–	(50)	–	6.0	–	(335)	–
Ogden adjustment	–	–	–	–	–	1.1	–	(62)
Group statutory	8,011	7,637	5,506	5,671	109.5	100.4	(584)	433
Direct and facultative	7,017	6,711	4,942	5,209	109.3	100.6	(516)	390
Inward reinsurance	994	926	564	462	110.9	98.7	(68)	43
Group statutory	8,011	7,637	5,506	5,671	109.5	100.4	(584)	433

1 Excludes impact of changes in risk-free rates used to discount net outstanding claims.

2 Excludes one-off impact of the Ogden decision in the UK.

SOURCE: COMPANY DATA

Looking past all the COVID-19 noise and based on its strong underlying fundamentals, QBE appears well-placed to withstand the residual effects of the pandemic. Operating at the top end of its target PCA range should also enable the insurer to capitalise on emerging organic growth opportunities and participate in inevitable global economic recovery.

Figure 5 – The right stuff

Performance update



Balance sheet

Executed comprehensive capital plan

Regulatory capital at the top of 1.6-1.8x target range

Surplus above S&P 'AA' increased

Pro forma gearing ~30%¹

Head Office liquidity \$1.5B



Brilliant Basics

Building a platform for sustainable growth

Portfolio optimisation with data & analytics

Improving large individual risk claims trends

Enhanced digital claims processes

Accelerating pricing momentum²

1H20 average rate increase of 8.7%

Momentum accelerating – 1Q20: 7.3% & 2Q20: 10.2%

Continued rate increases in all regions

Australia Pacific 2Q20 momentum impacted by COVID-19 response



Results

Combined operating ratio 103.4%³

COR 97.4% (ex. COVID-19)

Organic GWP growth ~10%

Attritional claims ratio down 2.2%⁴ (ex. COVID-19)

Large risk claims down 0.7%

Expense ratio down 0.5%⁵



Investments

Net return⁶ of (0.4)% ((1.7)% ex rfr) YTD

De-risked portfolio

1Q20 unrealised losses largely unwound

No sub-investment grade fixed income investments

¹ Allows for the post balance date reclassification of 2017 perpetual capital notes out of borrowings and into equity
² Excludes premium rate changes relating to Australian compulsory third party motor (CTP)
³ Excludes impact of changes in risk-free rates used to discount net outstanding claims
⁴ Excludes Crop and LHM
⁵ Excludes impact of COVID-19
⁶ Includes FX gains (losses) & other income (expenses)

QBE Insurance Group
2020 half year results presentation

SOURCE: COMPANY DATA

Variance analysis is listed below.

Table 4 – Variance analysis

QBE	FY20			Comments
Y/e December 31 (US\$m) (adjusted)	1H20	BP	Variance	
General Insurance				
Gross written premium (GWP)	8,011	8,042	0%	Broadly in line with expectations
Less: Gross unearned premium	-1,502	-1,281	-15%	
Less: Reinsurance expense	-1,003	-904	-10%	
Net earned premium (NEP)	5,506	5,857	-6%	Variance due to additional US Crop hail & CAT reinsurance expense
Gross claims expense	-4,206	-4,380	4%	Variance as a function of NEP (assuming gross loss ratio of ~77.5%)
Reserve release	-101	-120	-16%	Variance due to US\$17m reserve release in Australia Pacific
Net claims expense	-4,307	-4,500	4%	Variance as a function of NEP (assuming gross loss ratio of ~77.5%) net of AP reserve release
Commission expense	-903	-968	7%	Variance as a function of NEP (assuming commission ratio of ~16.5%)
Underwriting expense	-820	-818	0%	Broadly in line with expectations
Underwriting profit	-524	-429	22%	Largely impacted by lower NEP
Investment income - p'holders' funds	-60	-129	-53%	We had forecast losses on fixed interest, short term money & cash
Insurance profit	-584	-558	5%	Largely impacted by lower NEP
Other	0	0	n/m	
Associates	-2	-2	n/m	
Total divisional result	-586	-560	5%	Largely impacted by lower NEP
Amortisation and impairment	-13	-15	n/m	
Interest	-125	-94	-25%	
Investment income - s'holders' funds	-30	-247	-88%	We had forecast losses on fixed interest, short term money & cash
Other	-24	0	n/m	
Profit before income tax	-778	-915	-15%	Largely impacted by lower NEP
Income tax expense	68	165	n/m	8% effective tax rate reflects mix of corporate tax rates in countries where QBE operates and non-recognition of US current tax losses due to uncertainty over recoverability
Minority interest & discontinued	-2	2	n/m	
Reported NPAT	-712	-748	-5%	Largely impacted by lower NEP
Cash NPAT	-666	-736	-9%	Largely impacted by lower NEP
DPS (Ac)	4	0	n/m	
EPS (cash) (USc)	-49	-56	-14%	Reflects higher cash NPAT
ROE (cash)	-16.6%	-18.2%	1.7%	Reflects higher cash NPAT
Expense ratio	31.3%	30.5%	-0.8%	Largely impacted by lower NEP
Loss ratio	78%	77%	-1%	Broadly in line with expectations
COR (statutory)	110%	107%	-2%	Largely impacted by lower NEP
Effective tax rate	9%	18%	9%	See above
Insurance margin	-10.6%	-9.5%	-1.1%	Largely impacted by lower NEP
Net investment yield	-0.7%	-3.1%	2.4%	See above

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Price target increased to \$11.90, Buy rating reinstated

Given a better 1H20 outcome, we have revised our US\$65m cash loss in 2H20 to a US\$146m cash profit. This is based on lower net claims expense and better investment outcomes on policyholders' and shareholders' funds. While we still forecast a cash loss in FY20 (US\$520m), we have increased the figure in FY21 by 9% to US\$737m mainly due to stronger GWP growth momentum. While FY22 cash profit is almost unchanged, we have increased subsequent years' cash profit by 3% (and simultaneously forecast dividends after applying the target cash payout ratio of 65%).

However, our valuation/price target is increased by 12% to \$11.90 – this is after taking into account 3% higher cash profit forecasts, 3-4% higher dividend payments and adjusting SOP component PE multiples for recent market movements. QBE's rating is thus upgraded from Hold to Buy.

Table 5 – Composite valuation

Composite Valuation (A\$m)	Value	Per share	Weighting	Composite value per share
DCF	16,422	\$11.18	40%	\$4.47
Float plus equity valuation	23,276	\$15.84	20%	\$3.17
ROE (sustainable)	17,164	\$11.68	20%	\$2.34
Sum-of-Parts	14,258	\$9.70	20%	\$1.94
Surplus capital	0	\$0.00		\$0.00
Total				\$11.92

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 6 – SOP valuation

SOP Valuation (A\$m)	FY21e NPAT	Pros. PE (times)	Value (\$m)	Per share
North American Operations	175	12.5	2,187	\$1.49
Latin American Operations	-	-	-	-
International Operations	272	12.5	3,404	\$2.32
Australian Pacific Operations	249	12.5	3,119	\$2.12
Asia Pacific Operations	0	0.0	0	\$0.00
Equator and other	66	10.0	658	\$0.45
Total	763	12.3	9,368	\$6.38
- In A\$ terms	1,161		14,258	\$9.70

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 7 – Estimate changes

QBE Y/e December 31 (US\$m) (adjusted)	FY20e			FY21e			FY22e			FY23e		
	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Gross written premium (GWP)	14,157	13,820	2%	15,062	14,399	5%	15,946	15,040	6%	16,440	15,491	6%
Less: Gross unearned premium	-551	-260	-53%	-575	-268	-53%	-634	-298	-53%	-657	-307	-53%
Less: Reinsurance expense	-1,994	-1,807	-9%	-2,008	-1,881	-6%	-2,120	-1,960	-8%	-2,189	-2,018	-8%
Net earned premium (NEP)	11,612	11,753	-1%	12,480	12,250	2%	13,192	12,783	3%	13,594	13,167	3%
Gross claims expense	-8,374	-8,736	4%	-8,205	-8,211	0%	-8,589	-8,342	-3%	-8,852	-8,592	-3%
Reserve release	-63	-73	-14%	117	129	-9%	130	132	-1%	130	132	-1%
Net claims expense	-8,437	-8,809	4%	-8,089	-8,082	0%	-8,459	-8,210	-3%	-8,722	-8,461	-3%
Commission expense	-1,872	-1,927	3%	-1,947	-1,963	1%	-2,030	-2,022	0%	-2,074	-2,065	0%
Underwriting expense	-1,655	-1,629	-2%	-1,692	-1,650	-2%	-1,738	-1,693	-3%	-1,736	-1,726	-1%
Underwriting profit	-352	-612	-42%	752	555	36%	965	857	13%	1,062	914	16%
Investment income - p'holders' funds	23	-2	-1020%	244	321	-24%	296	360	-18%	306	372	-18%
Insurance profit	-329	-614	-46%	995	875	14%	1,260	1,218	3%	1,368	1,286	6%
Other	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
Associates	-4	-4	n/m	-4	-4	n/m	-4	-4	n/m	-4	-4	n/m
Total divisional result	-333	-618	-46%	991	871	14%	1,256	1,214	4%	1,364	1,282	6%
Amortisation and impairment	-28	-30	n/m	-30	-30	n/m	-6	-6	n/m	0	0	n/m
Interest	-208	-177	-15%	-166	-167	1%	-166	-167	1%	-166	-167	1%
Investment income - s'holders' funds	14	-155	-109%	151	202	-25%	153	206	-26%	155	210	-26%
Other	-24	0		0	0		0	0		0	0	
Profit before income tax	-579	-981	-41%	946	876	8%	1,237	1,246	-1%	1,353	1,324	2%
Income tax expense	30	177	486%	-180	-175	-3%	-235	-249	6%	-257	-265	3%
Minority interest & discontinued	-4	4	n/m	-4	4	n/m	-4	4	n/m	-4	4	n/m
Reported NPAT	-553	-800	n/m	763	705	8%	998	1,001	0%	1,092	1,063	3%
Cash NPAT	-520	-801	n/m	737	678	9%	953	955	0%	1,042	1,013	3%
DPS (Ac)	15	15	-2%	45	41	10%	58	56	3%	63	60	4%
EPS (cash) (USc)	-37	-58	-37%	50	46	8%	65	65	0%	71	69	3%
ROE (cash)	-6.5%	-9.9%	3.4%	8.3%	8.0%	0.3%	10.2%	10.7%	-0.4%	10.7%	10.8%	-0.1%
Insurance margin	-2.8%	-5.2%	2.4%	8.0%	7.1%	0.8%	9.6%	9.5%	0.0%	10.1%	9.8%	0.3%
Reserve release as % of NEP	-0.5%	-0.6%	0.1%	0.9%	1.1%	-0.1%	1.0%	1.0%	0.0%	1.0%	1.0%	0.0%
Loss ratio	72.7%	75.0%	2.3%	64.8%	66.0%	1.2%	64.1%	64.2%	0.1%	64.2%	64.3%	0.1%
Expense ratio	30.4%	30.3%	-0.1%	29.2%	29.5%	0.3%	28.6%	29.1%	0.5%	28.0%	28.8%	0.8%
COR (statutory)	103.0%	105.2%	2.2%	94.0%	95.5%	1.5%	92.7%	93.3%	0.6%	92.2%	93.1%	0.9%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

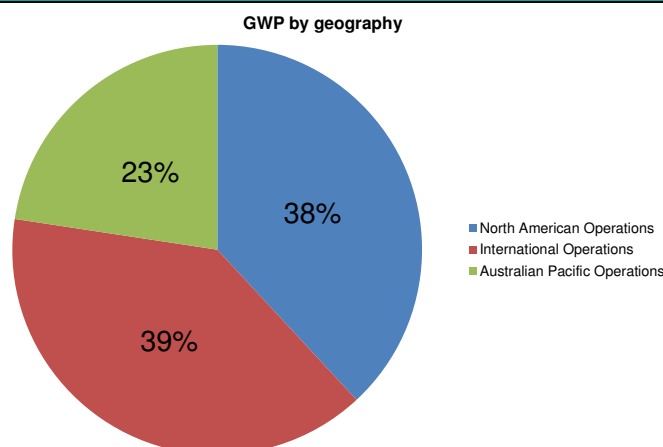
QBE Insurance Group

Company description

QBE's roots can be traced back to 1886 when James Burns and Robert Philp established The North Queensland Insurance Company (QI). In 1921, Burns founded Bankers' and Traders' Insurance Company (B&T) with QI being the largest shareholder followed by the owners' trading firm Burns Philp. In 1959, QI and B&T each acquired 40% of The Equitable Probate and General Insurance Company with Burns Philp taking the residual shareholding. QI and B&T then merged in 1973 to form the present day QBE.

QBE's head office is in Sydney and the company employs more than 17,000 people in 48 countries. The underlying business strategy is to maintain operations in all key insurance markets and act as a lead underwriter in selected lines of business. Core to QBE's risk management is its diversification strategy along product and geographic lines.

Figure 6 – Gross Written Premium by geography



SOURCE: COMPANY DATA

Investment strategy

Our current rating reflects:

1. QBE's focus on continuous risk management to maximise ROE;
2. QBE as a turnaround stock and an interest rate/currency normalisation play;
3. Productivity upside over the next few years as a turnaround story; and
4. Value upside given the potential to divest non-core operations and also the significance of the insurer's float in a rising rate environment.

Board and management

Michael (Mike) Wilkins (Chairman) – Appointed non-executive director in November 2016, Mr Wilkins succeeded Mr Marty Becker as Chairman in March 2020. Mr Wilkins has more than 30 years' experience in financial services and was the Managing Director and CEO of Insurance Australia Group Limited until November 2015. He also previously served as Managing Director and CEO of Promina Group Limited and Managing Director of Tyndall Australia Limited. Mr Wilkins is currently a non-executive director of Medibank Private Limited and previously served as non-executive director of AMP Limited from September 2016 to February 2020.

Pat Regan (CEO, previously CEO Australian & New Zealand Operations and Executive Director) – Appointed to the current role in September 2017, Mr Regan was previously CEO of Australia & New Zealand Operations and CFO of the Group. He joined QBE from Aviva where he was the CFO from 2010 to 2014. Mr Regan has over 25 years' experience as a practicing chartered accountant and 20+ years' experience in global insurance and financial services. Prior to Aviva, Mr Regan has worked as CFO/COO at Willis and in other roles at RSA and AXA.

Valuation

The price target is broadly aligned with the composite valuation below.

Table 8 – Composite valuation					Table 9 – SOP valuation				
Composite Valuation (A\$m)	Value	Per share	Weighting	Composite value per share	SOP Valuation (A\$m)	FY21e NPAT	Pros. PE (times)	Value (\$m)	Per share
DCF	16,422	\$11.18	40%	\$4.47	North American Operations	175	12.5	2,187	\$1.49
Float plus equity valuation	23,276	\$15.84	20%	\$3.17	Latin American Operations	-	-	-	-
ROE (sustainable)	17,164	\$11.68	20%	\$2.34	International Operations	272	12.5	3,404	\$2.32
Sum-of-Parts	14,258	\$9.70	20%	\$1.94	Australian Pacific Operations	249	12.5	3,119	\$2.12
Surplus capital	0	\$0.00		\$0.00	Asia Pacific Operations	0	0.0	0	\$0.00
					Equator and other	66	10.0	658	\$0.45
Total				\$11.92	Total	763	12.3	9,368	\$6.38
					- In A\$ terms	1,161		14,258	\$9.70

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SWOT analysis

Strengths

1. Global insurer with top line diversification benefits;
2. Risk management; and
3. Economies of scale in underwriting and reinsurance.

Weaknesses

1. Exposure to hurricane-prone geographies;
2. Claims inflation outstripping rate rises; and
3. Remains a complex global business.

Opportunities

1. Market power/efficiency gains/cost-outs to underpin growth in Core Australasian markets; and
2. Further non-core divestments and release of surplus capital in due course.

Threats

1. Significant CAT/claims events – usual operating risks;
2. Weaker commercial GWP outlook especially in North America, Australia and New Zealand;
3. Brexit risks;
4. Reduced investment income from widening credit spreads; and
5. Increased competition from new entrants and retailers.

Table 10 – Financial summary

QBE Insurance Group						Share Price (A\$)		Market Cap (A\$M)		10.74	
As at						13-Aug-20				15,779	
PROFIT AND LOSS						VALUATION DATA					
Y/e December 31 (US\$m from 2009)						Y/e December 31 (US\$m from 2009)					
General Insurance						NPAT (cash)					
Gross written premium (GWP)	13,657	13,442	14,157	15,062	15,946	692	733	-520	737	953	
Less: Gross unearned premium	-56	-185	-551	-575	-634	31	46	-39	52	68	
Less: Reinsurance expense	-1,771	-1,648	-1,994	-2,008	-2,120	<i>- Growth</i>					
Net earned premium (NEP)	11,830	11,609	11,612	12,480	13,192	n/m					
Gross claims expense	-7,709	-8,137	-8,374	-8,205	-8,589	<i>EPS (cash basis) (US cps)</i>					
Reserve release	138	96	-63	117	130	n/m					
Net claims expense	-7,571	-8,041	-8,437	-8,089	-8,459	<i>- Growth</i>					
Commission expense	-1,951	-1,819	-1,872	-1,947	-2,030	n/m					
Underwriting expense	-1,793	-1,690	-1,655	-1,692	-1,738	8%					
Underwriting profit	515	59	-352	752	965	-166%					
Investment income - p'holders' funds	346	649	23	244	296	P / E ratio (times)					
Insurance profit	861	708	-329	995	1,260	15.3					
Other	0	0	0	0	0	P / Book ratio (times)					
Associates	-2	-3	-4	-4	-4	1.4					
Total divisional result	859	705	-333	991	1,256	P / NTA ratio (times)					
Amortisation and impairment	-80	-51	-28	-30	-6	2.1					
Interest	-305	-257	-208	-166	-166	51					
Investment income - s'holders' funds	201	387	14	151	153	4.8%					
Other	-13	-51	-24	0	0	4.7%					
Profit before income tax	662	733	-579	946	1,237	44%					
Income tax expense	-77	-114	30	-180	-235	10%					
Discontinued operations (after tax)	-177	-21	0	0	0	10%					
Minority interest	12	3	-4	-4	-4	19%					
Profit after income tax	420	601	-553	763	998	12%					
Amortisation, impairment & other	272	132	33	-26	-46						
Cash profit after income tax	692	733	-520	737	953						
CASHFLOW						CAPITAL ADEQUACY					
Y/e December 31 (US\$m from 2009)						Y/e December 31 (US\$m from 2009)					
Cash profit after income tax	692	733	-520	737	953	Tier 1 capital					
Increase in investments	3,612	-1,820	-696	-1,509	-1,323	6,306					
Increase in premium receivable	-1,264	975	-114	-220	-164	5,944					
Increase in other assets	1,944	67	-2,510	-506	-323	6,399					
Investing cashflow	4,292	-778	-3,320	-2,235	-1,809	6,813					
Increase in unearned premium	-675	248	-477	373	277	7,268					
Increase in interest bearing liabilities	-428	-93	-431	0	0	2,496					
Ordinary equity raised	0	0	1,308	0	0	8,985					
Other	-3,590	-426	3,831	1,126	579	9,309					
Financing cashflow	-4,693	-271	4,231	1,498	856	5,355					
Net change in cash	291	-316	391	0	0	1,81					
Cash at end of period	863	547	938	938	938	1,81					
BALANCE SHEET						PROFITABILITY RATIOS					
Y/e December 31 (US\$m from 2009)						Y/e June 30					
Cash and cash equivalents	863	547	938	938	938	Return on assets (cash)					
Investments	22,165	23,985	24,681	26,190	27,513	1.6%					
Premium receivable	4,394	3,419	3,533	3,753	3,917	Return on equity (cash)					
Trade and other receivables	791	1,202	1,677	1,677	1,677	8.0%					
Reinsurance and other recoveries	5,551	5,104	6,143	6,521	6,807	8.8%					
DAC and DRE	1,662	1,907	2,829	2,956	2,994	Growth in GWP					
Intangible assets and goodwill	2,800	2,791	2,731	2,695	2,695	2.5%					
Other assets	1,356	1,080	1,154	1,154	1,154	Growth in NEP					
Total assets	39,582	40,035	43,686	45,891	47,694	0.5%					
Outstanding claims	19,579	19,915	23,050	24,468	25,539	Loss ratio					
Unearned premium	6,212	6,460	5,983	6,356	6,633	64.0%					
Interest bearing liabilities	3,188	3,095	2,664	2,664	2,664	31.6%					
Other liabilities	2,203	2,412	3,030	3,030	3,030	- Commission ratio					
Total liabilities	31,182	31,882	34,727	36,519	37,867	16.5%					
Ordinary share capital	7,830	7,594	8,889	8,889	8,889	15.2%					
Treasury shares held in trust	-7	-1	-1	-1	-1	14.6%					
Reserves & other	-1,363	-1,335	-1,012	-1,012	-1,012	COR (statutory)					
Retained profits	1,921	1,895	1,082	1,496	1,951	95.6%					
Minority interests	19	0	0	0	0	99.5%					
Total shareholders' equity	8,400	8,153	8,958	9,372	9,827	103.0%					
Total sh. equity & liabs.	39,582	40,035	43,686	45,891	47,694	94.0%					
WANOS - statutory (m)	1,348	1,318	1,420	1,468	1,468	Insurance margin					
WANOS - cash (m)	1,348	1,318	1,420	1,468	1,468	7.3%					
Reserve release as % of NEP	1.2%	0.8%	-0.5%	0.9%	1.0%	6.1%					
Reinsurance as % of GEP	13.0%	12.4%	14.7%	13.9%	13.8%	-2.8%					
Debt to equity (target 25-35%)	38%	38%	30%	28%	27%	8.0%					
Gross unearned premium as % of GWP	0.4%	1.4%	3.9%	3.8%	4.0%	8.0%					
Cross rate (A\$1.00 = US\$)	\$0.73	\$0.72	\$0.69	\$0.71	\$0.73	8.0%					
Yield - policyholders' funds	2.2%	4.3%	0.1%	1.4%	1.6%	8.0%					
Net investment contribution	2.9%	5.6%	0.2%	2.0%	2.2%	8.0%					
Combined investment yield	2.3%	4.4%	0.1%	1.5%	1.7%	8.0%					
DIVISIONAL						Y/e December 31 (US\$m from 2009)					
Gross written premium (GWP)						North American Operations					
						4,711					
						Latin American Operations					
						4,637					
						International Operations					
						5,003					
						Australian Pacific Operations					
						5,253					
						Asia Pacific Operations					
						5,490					
						Equator Re & Other					
						78%					
						COR (statutory)					
						98%					
						108%					
						107%					
						96%					
						93%					
						97%					
						99%					
						102%					
						94%					
						93%					
						91%					
						92%					
						116%					
						91%					
						Insurance margin					
						4%					
						-5%					
						-7%					
						6%					
						9%					
						6%					
						8%					
						2%					
						14%					
						4%					
						9%					
						10%					
						13%					
						13%					
						ROTE					
						12.1%					
						13.2%					
						-9.6%					
						11.4%					
						13.8%					
						EPS (cash basis) (A cps)					
						70					
						78					
						-53					
						71					
						89					

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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T S Lim, authoring analyst, holds a long position in QBE.

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