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Verisk Analytics, Inc. (VRSK)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Verisk second quarter 2020 earnings results conference call. This call is being recorded. At this time, all participants are in a listen-only mode. After today's prepared remarks, we will conduct a question-and-answer session.

For opening remarks and introductions, I would like to turn the call over to Verisk's Head of Investor Relations, Stacey Brodbar. Ms. Brodbar, please go ahead.

Stacey Jill Brodbar

Head-Investor Relations, Verisk Analytics, Inc.

Thank you, J.P., and good morning, everyone. We appreciate you joining us today for a discussion of our second quarter 2020 financial results. Today's call will be led by Scott Stephenson, Verisk's Chairman, President, and Chief Executive Officer, who will provide an overview of our business. Lee Shavel, Chief Financial Officer, will follow with the financial review. Mark Anquillare, Chief Operating Officer; Nick Daffan, Chief Information Officer; Neal Anderson, President, Wood Mackenzie; and Lisa Bonalle Hannan, President, Verisk Financial, will join the team for the Q&A session.

The earnings release referenced on this call as well as the associated 10-Q can be found in the Investor section of our website, verisk.com. The earnings release has also been attached to an 8-K that we have furnished to the SEC. A replay of this call will be available for 30 days on our website and by dial-in.

Finally, as set forth in more detail in today's earnings release, I will remind everyone that today's call may include forward-looking statements about Verisk's future performance, including but not limited to the potential impacts of the COVID-19 pandemic. Actual performance could differ materially from what is suggested by our comments today. Information about the factors that could affect future performance is contained in our recent SEC filings.

Now I'll turn the call over to Scott.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

Thanks, Stacey. Good day, everyone, and I'm glad to be with you today. The second quarter was unique as we dealt with the macro effects of the COVID-19 event, and I hope you and your families continue to stay well in this moment. At Verisk, our priorities are unchanged as we remain committed to delivering for our customers, protecting the health and well-being of our 9,000-plus teammates, and continuing to drive our innovation agenda.

I'm pleased but not surprised that our second quarter results reflect the strength and stability of our business model, the mission-critical nature of our solutions, and the hard work and resilience of our teammates who quickly adapted to the work-from-home environment and have remained focused on customer needs and innovation. I'm proud of our team and want to thank each teammate for their dedication and focus during a fluid moment.

Before we discuss the quarter, I want to make two related points about where Verisk stands. First, we believe that the net effect of the COVID-19 moment should benefit Verisk in the long run given that our customers will persevere and make it through to the other side with even more focus on becoming the better digital versions of themselves. This should make our customers more capable and desirous of using our many solutions.

And second, the consistent performance you see from us now and into the future is a function of our structure and position and not any cyclical or momentary effects. Our results are a function of the steady and ongoing accumulation of innovation and success with customers.

Our business performed as we had expected in the second quarter. We previously communicated to you our analysis that approximately 85% of our revenues are subscription based and subject to long-term contracts, and therefore we did not see any material impact on these revenues from the COVID-19 environment. In the second quarter those revenues grew approximately 6.5% on an organic constant currency basis when normalized for the one-time impact of the injunction related to roof measurement solutions. Of the remaining 15% of revenues that are more transactional in nature, and thus subject to COVID-19 impacts, those revenues declined approximately 20% on an organic constant currency basis in the second quarter, in line with our expectations. We experienced sequential improvement throughout the quarter and into July as the underlying causal factors began to diminish, and we expect to see continued progress on that front.

During March, as the extent of the pandemic became clear, we quickly moved to action and deliberately protected profitability without, and this is important, cutting investment in our business. We did this by moderating head count growth but without resorting to large-scale furloughs or lay-offs by focusing on operational discipline and by benefiting from the natural responsiveness of our compensation structure. Together, these actions delivered strong organic constant currency adjusted EBITDA growth.

Even while delivering strong profitability, we continued to fund investments in our innovation agenda and continued modernizing our technical infrastructure through cloud migration, tokenization of key datasets, and leading edge data fabric supporting great analytics, as we have done for the last several years. Lee will provide more details on our performance and his financial review.

During the second quarter, Verisk operated predominantly in a work-from-home environment, and our teams across the organization have remained highly effective. Operationally, our computing and network capacity has consistently and comfortably exceeded our daily requirements, even as demand for our solutions and platforms have increased meaningfully in this remote environment. For example, in our Insurance segment, usage of our digital claims settlement tool increased over 55% in the second quarter, and we are successfully converting free trials into paid subscriptions as customers realize the benefit of this new, innovative platform to help them on their journey to becoming more digitally engaged. And in the Energy vertical, we saw visits to our portal grow by over 40% as customers value our content, particularly in moments of uncertainty.

We moved our innovation agenda forward, evidenced by our continued investment across the enterprise, and the use of the digital collaboration tools has helped our team stay connected to develop new and updated solutions for our customers. A few examples: in Insurance, we launched a new micro business insurance program with advisory forms rules and loss costs specifically for the smallest businesses. This program is designed to help insurers cover the unique risks of micro businesses that are often part of the gig economy, often operated out of home or shared spaces and having fewer than four employees. We also released an updated cyber risk modeling platform and launched Life Risk Navigator, our cloud-based stochastic risk modeling platform that offers in-depth portfolio analytics which can enhance risk selection, quantify changes in mortality rate, improve hedging strategies, and drive better financial decision-making for our life insurance customers.

In our catastrophe modeling business, we have released Version 8 of our Touchstone platform which includes timely updates for many of our models in the US, Australia, and the Caribbean, and continues to fulfill our innovation promise.

In Energy and Specialized Markets, we continue to push forward with our differentiated analytic platform called Lens, and are on track for further releases in the back half of the year related to upstream portfolio optimization, renewables, and carbon emissions. Despite the softness in the energy market, we continue to see demand from our customers for Lens which is reflected in both adoption and constructive pricing.

Also within our Energy segment, we launched a solution in April which analyzes pandemic-related supply chain risk and allows our energy customers to anticipate potential disruptions in their business operations. We are currently enhancing the existing solution by adding datasets from across Verisk that address additional elements of supply chain risk such as vulnerability of suppliers to extreme events, the environmental, social, and governance risk factors that suppliers may pose, and movements in commodity markets impacting supplier costs.

And in Financial Services, our loan loss forecasting model called LookAhead is gaining momentum with customers as it helps them understand the changes to their anticipated loan loss curves related to government stimulus programs, trends in unemployment, and COVID-19 generally. This solution is unique to the marketplace given that it is founded on the total customer wallet viewed dataset which is proprietary to Verisk Financial Services.

On the sales front, our teams have adjusted nicely to a fully digital sales model. To help our sales force adjust to the virtual environment, we developed a series of trainings for best practices to use virtual tools including Skype, Zoom, Teams, and Prezi. These sessions were very effective in making our sales teams comfortable with the new formats. Outreach to our customers is robust, and with customers in their home offices, we have found they are often more reachable than ever. As a result, calls with customers increased over 50% in the second quarter versus the prior year.

In addition, we successfully converted most of our scheduled in-person customer events to virtual events. Virtual events have enabled us to increase reach and attendance, including at our signature London-based InsureTech event in June called Verisk Vision which saw a 63% increase in attendance this year versus the prior year's in-person gathering. Additionally, we hosted 48 webinars across the Insurance segment in quarter two and had over 8,000 customers in attendance which is more than a doubling versus last year. In Energy, we hosted a number of virtual events throughout the second quarter, delivering thought leadership and content to more than 3,000 clients and prospects. We continue to invest in the virtual space and make enhancements to our platform. We've decided that all events for the remainder of the year will be virtual, and we're making plans accordingly.

Virtual engagement with customers extends to the executive level. It is clear from these discussions that the pandemic has heightened the recognition among our customers that they need to become more digital and more automated and to do so at pace. At the CEO level, I have also been pleased to maintain a steady and high degree of contact with our customers' CEOs in the virtual moment. Like me, our customers' CEOs are highly focused on the well-being and productivity of their teams and consider the further digitization of their companies to be a highest priority. I continue to receive feedback along two lines. One, Verisk is a unique and differentiated partner, and, two, our customers look to us for a steady stream of innovation to help them on the journey to becoming more digital and more automated. Even with a video screen between us, the depth of alignment and degree of mutual respect is as high as ever.

The net result of all this activity across all levels is that sales opportunities and our pipelines continue to grow as we capitalize on this structural growth trend. We are experiencing a modest lengthening of our sales cycles across our businesses as compared to historic norms. We are managing this closely and view this more as a

timing issue and a function of the complexity of bringing stakeholders together and closing deals in a remote environment.

While we have been successfully executing in a work-from-home format, I'm pleased to share that we've begun to open some of our global offices for a safe and phased return to office for those employees who would like to work from the office. In fact, we have opened more than 50 of our global locations in a phase 1 format over the past few weeks including our headquarters in Jersey City. I'm hosting this call from our offices, and it feels great to be back in the office. Additionally, as the stay-at-home restrictions have been lifted across the US, we have seen our field force return to a five-day-a-week schedule so that they can begin to work on the backlog that built up when entering commercial buildings was restricted.

I also want to note how pleased we are with the integration and sales momentum of our recent acquisitions including FAST, BuildFax, and Genscape. While still early, we are realizing both revenue and cost synergies consistent with our expectations at the time of those deals. We're monitoring these acquisitions carefully and supporting the management teams to ensure that we are generating a solid return on invested capital.

With that, let me turn the call over to Lee to cover our financial results.

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

Thank you, Scott. First, I would like to bring to everyone's attention that we have posted a quarterly earnings presentation that is available on our website.

Moving to the financial results for the quarter, on a consolidated and GAAP basis, revenue grew 4% to \$679 million while net income increased 19% to \$179 million. Diluted GAAP earnings per share increased 20% to \$1.08 for the second quarter 2020. The year-over-year increase in GAAP net income and EPS is primarily the result of organic growth in the business, cost discipline, the impact of the timing shift of a \$10 million expense related to annual long-term equity incentive grants, and a decrease in acquisition-related costs.

Moving to our organic constant currency results, adjusted for non-operating items as defined in the non-GAAP financial measures section of our press release, we are pleased with our operating results, particularly in light of the impact from COVID-19. On an organic constant currency basis, Verisk delivered revenue growth of 1.1% for the second quarter of 2020. This growth was driven by positive results in our Insurance segment offset in part by modest declines in Energy and Specialized Markets and Financial Services. Normalizing for the \$8 million revenue impact of the injunction on roof measurement solutions, revenue grew 2.4%.

As we detailed last quarter and Scott mentioned in his prepared remarks, we completed a careful review of our solutions and services to evaluate their potential exposure to COVID-19 impacts. Through that exercise, we noted that we did not expect to see any material impact from COVID-19 on approximately 85% of our consolidated revenues because they were generally subscriptions or subject to long term contracts. As such, in the second quarter, those revenues grew approximately 6.5% on an organic constant currency basis when normalized for the injunction. This speaks to the stability of our subscription business model.

Moreover, as we expected, we did experience a negative impact from COVID-19 on certain of our products and services, largely transactional in nature, which represent the balance or 15% of our consolidated revenues. These revenues declined approximately 20% on an organic constant currency basis during the second quarter, owing to weakness in the underlying causal factors including lower auto and travel insurance activity, the inability to enter

commercial buildings to perform engineering analysis, decreased capital expenditures in the energy sector, and reduced levels of advertising spending and project-based work from the banks.

While we did experience revenue declines in this group of products and services in each month of the quarter, as the underlying causal impacts began to diminish, we did see some of the pressure on our revenues abate. For example, we have seen trends improve sequentially in our auto insurance lines as driving mileage has recovered and are also experiencing improvement in our commercial surveys as our field staff is now allowed to enter buildings. On the Energy side, the macro backdrop continues to pressure consulting, but trends seem to have stabilized, and we are starting to have early discussions with the strongest operators about future engagements. The net result is that we have experienced continued progress in sequential revenue improvement throughout the second quarter and into July.

Despite the impact on revenue in the second quarter, we are pleased to report that we maintained strong EBITDA growth and expanded margins as the result of effective expense and head count management. Organic constant currency adjusted EBITDA growth was 12.4% in the second quarter, and normalizing for the impact of the injunction and the LTI timing shift, organic constant currency adjusted EBITDA increased 11.6%.

Total adjusted EBITDA margin for the quarter, which includes both organic and inorganic revenue and adjusted EBITDA, was 51.3% in the quarter. This margin included a one-time benefit of approximately 150 basis points from the previously communicated timing shift of annual LTI grants. Despite the expense control driving EBITDA growth and margin improvement, we continue to invest substantially in our business and infrastructure including our cloud transition, and those costs are reflected in this margin as well.

On that note, let's turn to our segment results on an organic constant currency basis. As you see in the press release, Insurance reported 2.5% growth while our adjusted EBITDA increased 13.8% for the quarter. We saw healthy growth in our industry standard insurance programs, catastrophe modeling solutions, and repair cost estimating solutions, offset by the impact of the injunction on roof measurement solutions and a decline in certain transactional revenue that was negatively impacted by COVID-19. Normalizing for the impact of the injunction and LTI timing, Insurance would have achieved 4.3% organic constant currency revenue growth and 13.8% organic constant currency adjusted EBITDA growth, demonstrating strong margin expansion despite certain revenue declines and investment in our breakout areas.

Energy and Specialized Markets' revenue decreased 2.8% in the second quarter due to declines in consulting and implementation projects and lower events revenues across the Energy segment. We were very pleased to see continued growth in our subscription-based core research and data analytic platforms, environmental health and safety services solutions, and weather analytic solutions, resulting in outperformance relative to the end market.

We believe our strong performance is a function of the must-have nature of our solutions, the diversification of our revenue streams into breakout areas like the energy transition practice, and the strength of our relationships in the industry. Despite the revenue declines and normalized for the LTI timing, adjusted EBITDA grew 2.4% in the second quarter driven by strong operational controls and modest actions taken to reduce head count to be more balanced with the current level of consulting work.

Financial Services' revenue declined 2.7% owing to weakness in project-based retained analytics and spend-informed analytics as our bank customers reduced spending due to the pandemic. Despite decreased spending across the banking industry, we experienced growth in our subscription businesses, an area that has been a strategic focus for us over the last six quarters. Normalizing for the LTI timing, organic constant currency adjusted

EBITDA remained flat for the quarter while margins declined owing to portfolio actions we closed earlier in the year.

Our reported effective tax rate was 20.4% for the quarter compared to 19.7% in the prior-year quarter. Looking forward, we now believe that our full-year tax rate for 2020 will be between 21% and 23%, up from the 19% to 21% range we had previously provided. This is primarily the result of UK legislation that was enacted in July but retroactive back to April 1 of 2020 that increases the UK corporate tax rate from 17% to 19%. As a result, we will take a one-time catch-up charge in the third quarter of this year related to the valuation of a deferred tax liability which will likely drive the quarterly rate above the full year range provided. But we do not anticipate a material long-term impact from this increase.

Adjusted net income was \$213 million, and diluted adjusted EPS was \$1.29 for the second quarter, up 15.8% and 17.3% from the prior year, respectively. These increase reflect the cost discipline in the business, lower travel and entertainment expenses, contributions from acquisitions, the above-mentioned timing shift in expense related to annual long-term equity incentive grants, and lower average share count. Net cash provided by operating activities was \$250 million for the quarter, up 24.6% from the prior-year period.

Capital expenditures were \$57 million for the quarter, up 20.9% from the prior-year period, and CapEx represented 8.4% of total revenues in the quarter. We now believe that CapEx in 2020 will likely be toward the higher end of our previously provided range of \$250 million to \$270 million as investing in our business and our people continues to be among our highest priorities.

Related to CapEx, we now expect fixed asset depreciation and amortization to be within the range of \$185 million to \$195 million, higher than the prior provided range of \$170 million to \$180 million. This increase is related to the timing of implementation of certain internally developed software projects as we continue to push forward on introducing innovation to the marketplace. We continue to expect intangible amortization to be approximately \$165 million in 2020.

Free cash flow was \$193 million for the quarter, an increase of 25.7% from the prior year, primarily due to an increase in customer collections and operating profit, a reduction in travel and entertainment expense as a result of COVID-19 as well as the deferral of federal income taxes and certain employer payroll taxes resulting from the CARES Act, partially offset by earn-out payments of \$65 million.

During the second quarter, we returned \$119 million in capital to shareholders through share repurchases and dividends. And I'm pleased to report that our Board of Directors has approved a \$0.27 per share dividend for the third quarter to be paid in September.

As we detailed last quarter, we continue to believe that the collective causal factors from COVID-19 represent pressure on achieving our 7% long-term growth objective in 2020. However, we do not think it represents a structural change in our fundamental growth drivers and believe that as the underlying causal factors abate we will show strong resilience in recovery. Each of these causal factors has its own recovery curve, making it difficult to predict the duration of the impacts to our revenue growth. We continue to have confidence in our ability to manage the cost structure effectively and deliver operating leverage while also continuing to invest in our innovation agenda. While we have restricted head count growth in the shorter term, we will pace new hiring as we see a return to a more normalized operating environment.

Taking this all together, we continue to believe that the stability of our subscription revenues along with our core operating leverage driven by the responsiveness of our compensation structure and cost discipline will continue to support revenue and EBITDA growth in 2020.

We hope this provides some useful context for you, and we look forward to addressing your questions. We continue to appreciate all the support and interest in Verisk. We ask for the Q&A session that you limit yourself to one question and one follow-up. And with that, I will ask the operator to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, speaker. [Operator Instructions] Your first question comes from the line of Manav Patnaik of Barclays. Your line is now open.

Manav Patnaik

Analyst, Barclays Capital, Inc.

Q

Thank you. Good morning, guys. I just wanted to focus firstly just on the Energy and Specialized Markets segment. Last quarter, you gave us some anecdotal commentary on the different mix between upstream and the [indiscernible] (00:25:39), so on and so forth. I was just wondering if you could just give us some color on how each of those are doing within that business.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Neal, would you like to speak to that?

Neal Anderson

President, Wood Mackenzie Ltd.

A

Yeah. Sure. Certainly, Scott. First thing is we're very, very pleased in terms of our subscription business, how robust our business has been. And as Scott already mentioned, it grew through the second quarter. Once we had, as we predicted, on the transactional, both the consulting and the events side, that was more of a challenge.

When we look at the Wood Mackenzie and the Energy Specialized business, it's a fundamentally different business than it was four or five years ago at the time of the acquisition. At that time, the majority of our revenue was more exposed to the upstream side. Today, that part of the business is less than 50% of our business. Just as Scott mentioned, we're much more focused on the energy transition and other key growth areas which will drive the business in the longer term.

Manav Patnaik

Analyst, Barclays Capital, Inc.

Q

Got it. And, Scott, just the other question I had was you've been talking a lot about software being an increased focus for you guys at Verisk. And I was just wondering, is there a way to quantify, like, how much as a percentage of your business software is today. And is that just an Insurance phenomena, or is it across Energy and Financial as well? Thank you.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

It's definitely a committed part of our strategy, Manav, in all parts of our business, and it is a growing part of the mix. What we talk about all the time at Verisk is the best expression of what we can do for our customers is to provide them platformed analytic environments and great what we call analytic objects. And the mix of both of those things inside of all of what we do is increasing, and it is a strong focal point.

You get kind of an interesting thing if you're trying to parse your revenue streams, taking Energy as an example. So Lens is our platform. Moving through that platform is content that customers – some of what moves through that platform is content that customers have made use of through time. And so if we talk about where the revenue stream is headed and growing, it's a little bit artificial to parse how much of that you're attributing to the software that you generated versus the total platform and the value that the customers find in it. But definitely software is a growing part of our mix, and it's meaningful in all of the verticals.

Manav Patnaik

Analyst, Barclays Capital, Inc.

Q

Thank you.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

You bet.

Operator: Your next question comes from the line of Toni Kaplan of Morgan Stanley. Your line is now open.

Toni M. Kaplan

Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. Wanted to start out with the margins. Really strong quarter there, EBITDA margins expanding 470 basis points. I know you attributed about 150 to the LTI shift. But wanted to ask if it's fair to say that the remainder is coming from lower variable comp and T&E. And should that come back once this period's over? Or is there some level of permanent savings that we should be expecting to remain?

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Lee, would you start with that question, please?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Sure. Absolutely. Thank you, Toni. So I think your observation I agree with, Toni. I would say once you eliminate the LTI impact, as we've indicated, of about 150 basis points, and then look at, as I typically described, at the businesses on a pre-investment basis, we are still seeing strong margin improvement across the three businesses. And to give you some sense of the overall contribution in the margin, the reduction in T&E was approximately 150 basis points. And the short-term compensation impact was about 100 basis points. So naturally that's a function of the growth impact that relates to the overall improvement.

So we are having the what you might describe as the COVID-19 impact on our cost structure that is benefiting us in that period. But there are efficiencies that we have identified that I think will enhance our operating leverage ahead. Some of that relates to the nature of our sales function and the sales productivity. We don't expect to be in

this completely remote format for an extended period of time, but we have found potential efficiencies that may improve the margin on a longer term basis.

So I think there are some structural elements that we've identified that will persist. But clearly a significant part of this margin improvement is a function of the responsiveness of our cost structure and the actions that we've taken to manage head count. So it's, as always, a blend of a lot of different factors that are influencing margin.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

I would just add, Toni, one item that you didn't have in the factors which you highlighted is the increasing efficiency of our technical infrastructure. So we have been, over the last couple of years, as many know, working to rotate to the cloud as well as upgrading the data fabric inside of our analytics. And that continues. And as we move forward, the unit cost economics associated with our technical infrastructure do improve. And that's happening now and will continue to happen.

Toni M. Kaplan

Analyst, Morgan Stanley & Co. LLC

Q

That's great. And wanted to ask about the 15% of the business that's non-subscription that you said dropped 20% in the quarter. It sounds like your business overall is improving. Just wanted to find out where that 20% would be in the July timeframe, what that looks like, and which segments saw the greatest declines in the non-subset. Thank you.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

So we, at our call in May, we actually parsed for you the relative impacts. We allocated the 20% across the three reporting verticals. I mean, generally, I would say that the recovery is being felt relatively evenly across the three verticals. We have noted in July even some positives in each of the three verticals. The one that I personally am going to watch the closest is the recovery in ad spending and how that relates to our revenues on the spend-informed analytics side in Verisk Financial. But as I say, all three verticals are showing that same upward movement.

Toni M. Kaplan

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Hamzah Mazari of Jefferies. Your line is now open.

Hamzah Mazari

Analyst, Jefferies LLC

Q

Hey. Good morning. Thank you. My first question is just on the Insurance segment. As it relates to COVID-19, I know it's a fluid situation, but if P&C insurance companies are on the hook for COVID claims, maybe you could walk us through what you're hearing there, how it impacts your business. A couple of years ago customer consolidation was a headwind. Claims tend to be good for you. And so I'm just trying to parse out how you think about that, just the puts and takes there.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Yeah. You actually had several points in there. Let me begin, and then, Mark, if you'd like to add anything. Specific to the idea of claims as they relate to the business interruption line of insurance, our view is, and we come from a very informed place because we actually author the contract language that goes into the policy, is that it's really pretty clear that, unless otherwise explicitly stated, and generally it's not explicitly stated, that business interruption insurance does not cover losses related to pandemics.

And that's not to say that there won't be some court cases maybe. Businesses which have taken out business interruption insurance naturally would like to be covered. But in reality, if you read the language carefully, our reading is that it's pretty clear. So we don't think that there is some substantial discontinuous event that's going to happen for our customers as a function of COVID-19 and claims related to business interruption.

It is true that activity inside the insurance industry is a positive for us. The insurance companies remained quite active in the second quarter, will remain quite active. Our customer demography actually doesn't change very much with the exception that, as the InsureTechs come into being, we actually do very well with them. But the existing insurance companies – there really has – the pace of consolidation really is not all that great, and we don't see anything in this moment that would stimulate that to higher rates.

Mark, anything you want to add to that?

Mark V. Anquillare

Chief Operating Officer & Executive Vice President, Verisk Analytics, Inc.

A

Yeah. I think I'd just highlight or echo a couple things you said. I think the language that we use in our programs clearly states that the effort around pandemic or the situation around pandemic will not affect the property, and the property is really what's the key to coverage. There are other programs out there, especially on the reinsurance side where some of this business interruption and the effects of pandemic will be invoked. So I think some programs, some insurers will have some payments to make, and it could be quite sizeable.

Think the other thing that factors into the insurance economics is the commercial lines premium. I think what we're going to see probably in 2020 is a combination of exposures and premiums down 5% to 6%. We do believe from a forecast perspective that those rates, the actual premium rate itself as well as the exposures, will rebound in 2021. So that may affect some insurers. I think overall we don't see that as something that is systemically problematic. I think during these times insurers look to focus on underwriting discipline, and a lot of the actuarial and underwriting solutions we provide, provide them what I'll refer to as that grounding. So hopefully that provides color.

Hamzah Mazari

Analyst, Jefferies LLC

Q

Yeah. That's very helpful. Thank you. My follow-up question is just around your commercial sales organization. We talked about investing in software. We've been in a elevated investment spend cycle as it relates to CapEx on new products, et cetera. Financial Services, there've been some changes in restructuring. Have you changed the commercial sales organization structure at all as it relates to either compensation or how it's structured from a vertical standpoint? Or has it been just pretty consistent over the last several years?

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

The go-to-market teams are specific to the three verticals, and even within that we have a multi-tier approach where we have account representation as well as product specialists. The way that we take our products to market has not changed. What we sell is complex. Our products need to be explained. They need to be demonstrated. Very frequently there have to be proofs of concept followed by trials before we get to enterprise-wide agreement.

So it's a process that takes time. We're good at it. We've done it for a long time, and we continue to do it the way that we have done it in the past. We're always open to and actually even interested to add teammates who, as the solution set expands, can take them to market and help customers find the value. But in terms of the general approach, no. We've done it successfully for a long time, and we're not going to fiddle with our successful model.

Hamzah Mazari

Analyst, Jefferies LLC

Q

Wonderful. Thank you so much.

Operator: Your next question comes from the line of Alex Kramm of UBS. Your line is now open.

Alex Kramm

Analyst, UBS Securities LLC

Q

Yes. Good morning, everyone. First is a follow-up to Toni's question when she asked about kind of what you saw during the quarter. And can you be a little bit more specific maybe on that 20%, how it trended in April, May, June, and maybe even into July, so we can just see the trajectory? And if there's any incremental color you can give what areas you think will improve over the course of the year. I guess trying to get to the trajectory a little bit. Any help you can give us would be helpful.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Lee, anything you want to add to your comments in the up-front part of the meeting?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Sure. Yeah. Thanks, Alex. So we're not going to get into monthly results, but what I will reinforce is that within the segments, we saw the underlying causal impacts improve. And so perhaps this is helpful. For instance, in Insurance, as we saw that driving activity begin to kick in, that clearly had a positive impact. And so across the quarter for the COVID-sensitive revenues, that 15%, we saw sequential improvement across the quarter, and that improvement continued into July. Obviously we're continuing to deal with a lot of uncertainty in terms of the impact across the country and how that impacts overall driving activity, but at least through July we saw a continued trend of improvement on that front.

Within Energy and Specialized Markets, we also saw an improvement through the quarter, and we are beginning to see some signs of reengagement around the consulting side of the equation. I do think that with that component there is going to be a longer term, or I should say a longer period in which that recovers as the timing of the response from our energy clients is going to follow the CapEx trend a little bit more closely in comparison to the driving activity where we're seeing that rebound more quickly. So I think if you think about the timing of that recovery, we are expecting that that will take a little bit longer, but into July we were beginning to see improvements.

And then finally in our Financial Services business, a lot of this relates to – it's kind of a blend of two dimensions. One is the advertising component which is down but is showing recovery, and so that's more like the auto activity. But we also have the project analytics and the retained analytics from the banks that probably have a somewhat slower recovery result in response to the COVID-19.

So those are some of the factors, but within each of those categories there are multiple products with differing degrees of severity. But across them all we did see improvement through the second quarter and have seen a continuation of that into July. And that's probably as much texture as I can give you, Alex.

Alex Kramm

Analyst, UBS Securities LLC

Q

No. That's good texture. Thank you. A similar question maybe on the subscription side. You mentioned the sales cycles are lengthening. Not surprising. Any kind of dimensions you can put around that? And maybe related to that, how is the pipeline looking today versus maybe a quarter ago?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Yeah.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Pipeline is good. Oh, go ahead, Lee. Go ahead.

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Sorry. So, Alex, you have, I would just describe it generally as a lengthening, and so that can vary depending upon the project. Again, factoring in that we have a lot of different projects with different lead times, it's probably not useful to generalize across that. But we are seeing what has been described by the sales force as getting all of the stakeholders together with the disruptions is taking a little longer to get that done. So that's at what I would call kind of the back end of the pipeline closest to contract.

However, at the front end of the pipeline, as indicated by the increase in the sales calls, our engagement with clients, we're actually seeing a fairly healthy level of engagement on that front, I think because of the accessibility and the demand for our products. So we feel very good about what we've been able to generate from a pipeline perspective despite the disruptions.

And I think that feeds into a longer term perspective, meaning, as Scott indicated, we believe that in many ways the pressures, the operating pressures that COVID-19 has put on our client sets within all of the verticals recommends and encourages more utilization of our product sets and analytic platforms to support what they do. There is more pressure on them to digitize more aspects of their operations, and we think that's very constructive for the long-term opportunity within Verisk and why we feel confident our growth drivers remain certainly not diminished but probably enhanced as a result of what our clients have to react to.

Alex Kramm

Analyst, UBS Securities LLC

Q

Very good. Thank you.

Operator: Your next question comes from the line of Gary Bisbee of Bank of America. Your line is now open.

David Chu

Analyst, BofA Securities, Inc.

Q

This is David Chu for Gary. Just wondering, is there a lag effect to the 85% that is subscription? And so just wondering if net new sales is trending below the 6.5% organic that you mentioned.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Well, the nature of the subscription business that we have, first of all, a lot of that is multiyear, and multiyear agreements feature price escalators year over year. A good fraction of it also is perpetually renewing, particularly as it relates to the traditional rules forms and loss costs that we provide in the Insurance vertical. So actually there's a great deal of not just stability but actually momentum associated with the 85% because of the way that we contract with our customers. And so when we talk about sales cycles, we're really talking about the cross-selling of a solution which hasn't been used by a customer in the past or a brand-new solution into the marketplace.

And I think Lee was really taking pains to try to describe that we're going to move with our customers and at the rate that they want to move. And I think he put his finger on exactly the right issue which is just it's a big decision when customers decide to subscribe to one or more of our solutions. These are high-ticket items. And it's not as if the consideration has fundamentally changed from we're thinking about it in the year 2020 to like don't even talk to me about it until the year 2021. It's much more just them having found their feet underneath them in the COVID moment. And now, as they try to organize to make what is a material decision to buy one of our solutions, they just have to pull themselves together basically.

But it's not as if the fundamental decision matrix for them has changed. The value proposition is the same. And this relates [audio gap] (48:28) emergent or the cross-sell than it does to the thing which is already established. And again, there's momentum inside of most existing subscription contracts because they are multiyear, and they do have price escalators.

David Chu

Analyst, BofA Securities, Inc.

Q

Okay. That's helpful. And just has implementation of new products been an issue in this work-from-home environment?

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Not at all.

David Chu

Analyst, BofA Securities, Inc.

Q

Okay. Great. Thank you so much.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

You bet.

Operator: Your next question comes from the line of Jeff Meuler of Baird. Your line is now open.

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Thank you. Good morning. Scott, in your prepared remarks when you talked about the long-term benefits to Verisk of the digital transformation of your customers, you talked not only about them being more desirous to use your solutions but also their capabilities to consume what you provide. I guess just that, on that capability point, how much of a barrier is that today? And maybe if you could illustrate the point with how it's different to do business with one of the InsureTechs that you do well with or with a traditional carrier that's further along with their digital transformation.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Yeah. So actually I like the way you framed the question, Jeff, because I'm going to generalize a point here, and that is that as I observe some of the InsureTechs, which are kind of born from whole cloth and essentially platformed into a more modern infrastructure, they are born with a more modern infrastructure, I find their rate of adoption to be really high. And so it actually is a demonstration of what we're talking about here. Those who are more naturally able to connect to, to integrate, to consume from inside of an API, to render content from the outside into their own environment quickly or even more importantly to actually plant a platformed analytic environment right in the middle of their workflows, a company which is in that condition is able to consume the next thing from us just that much more easily.

And I think there really is an observation there about the relative ease with which some of the InsureTechs are able to begin to work with what we provide them. And what it comes down to fundamentally is that they have their own backlog of technology-oriented projects that they have to work through, and sometimes one of those technology-oriented projects might be them doing whatever it is that they need to do in their environment in order to adopt one of our solutions. We've seen this many, many times over in much of what we do actually.

And to the extent that they're actually able – they're more naturally digital, they'll be able to work through these kinds of implementations that much faster. And so I don't think that it – when they do their own ROI calculation on making use of one of our solutions, their cost of implementation in most cases is there's something there, but it really isn't going to make the difference in terms of whether or not to make use of our solutions. Maybe with some of our thickest platforms, that might be there a little bit more.

So my point here is that the fundamental interest in making more use of what it is that we do, the ease of implementation is a part of it. But also as they become more analytic in the way that they make their own decision making, the value of the content that we bring just stands up that much taller. And so there's also something about their own analytic environment and the quality of their own analytic environment. And so at the intersection of I can get you implemented faster and I can make more use of this unique perspective that you've got, Verisk, the value proposition just stands up even higher.

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thank you.

Operator: Your next question comes from the line of Andrew Nicholas of William Blair. Your line is now open.

Andrew Nicholas

Analyst, William Blair & Co. LLC

Q

Hi. Good morning. Looks like at a geographic level growth in the US was a bit stronger than international in the quarter. I'm assuming that's primarily a function of business mix and secondarily exposure to transactional revenue. But I was wondering if there was anything else to call out in terms of regional growth differences in the period.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

No. I mean, I think you really caught it inside of your question. As many folks know, we're excited about the growth of our international business, and we have a variety of ways that we try to grow our international business. And in the early stages of developing a market, one of the things that's kind of a natural feature of our business is that some of it may be more transactional in the early going. Customers, when they're getting used to a new solution often want to start out in the transactional mode and/or it's just that much faster in terms of getting established with a customer. With time what we've generally found is customers would prefer to move towards a subscription model where they have certainty about what they're going to be paying for what they get, but that's not always the case when they get started.

So international being a newer part of our mix overall, it's not surprising that in this unique moment there might have been a little bit of a difference there. Don't expect that to relate to the long-term growth picture.

Andrew Nicholas

Analyst, William Blair & Co. LLC

Q

Got it. That's helpful. And then I was hoping you could provide an update on your relationship with Vexcel, how that partnership has performed this year relative to your expectations. And as it stands today, if you could just evaluate or speak to your evaluation of how those capabilities and that functionality is replacing Geomni.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Sure. Mark is one of our two board members at Vexcel, so, Mark, would you take that on, please?

Mark V. Anquillare

Chief Operating Officer & Executive Vice President, Verisk Analytics, Inc.

A

Absolutely. So what we attempted to do, and I think pretty successfully, is separate what is image capture where we thought there was an opportunity to scale and provide what I'll refer to as greater coverage by combining the two companies. So if I was to think about that as job one, the combination of what I'll refer to as the Geomni image capture and Vexcel image capture has maybe quite considerably increased the coverage in the United States. That is a combination of all of North America, US and Canada, but it also has two different types of coverage, kind of that high up across the landscape and then that more higher resolution five – north, south, east, west views of things. What we're also been able to do is start to extend geographically. So now we have access to imagery across Europe and certain parts of Asia Pacific. So there we have opportunities to leverage that analytic, and I think we've been quite successful.

On the Geomni front, where we're continuing to be focused on advanced analytics, A, we have more data to work with, so our algorithms, our machine learning is better and improved. And of course because we have more

coverage, we can provide more analytic across various places. So let me give you an example. We now have the ability to take some of the weather analytics we have, put it on top of all this imagery, and provide kind of a triage tool for analytic purposes. And that's not just in the United States, but we can go throughout the world where we have that coverage.

So I hope that provides you a little bit of color. The combination of leverage and getting access to all those images, we still have that from a Geomni perspective. And I think at Vexcel, because they're doing it once instead of twice, there's a lot of scale and leverage there. So they're doing it cheaper.

Andrew Nicholas

Analyst, William Blair & Co. LLC

Q

That's helpful. Thank you.

Operator: Your next question comes from the line of Andrew Steinerman from JPMorgan. Your line is now open.

Andrew C. Steinerman

Analyst, JPMorgan Securities LLC

Q

Hi there. Lee, I was wondering if you'd be willing to comment if Verisk expects company EBITDA margins to be up year-over-year just directionally, up year-over-year directionally in the second half of the year, and what puts and takes you might want to be willing to call out in terms of things that would affect EBITDA margins in the second half of this year.

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

All right, Andrew, thanks for the question. As you know, we don't provide forward-looking statements on the results. We're constantly looking to make certain that the operating leverage that we have in the business is expressed, and we certainly think that this quarter demonstrates the underlying operating leverage and our ability to manage that.

So certainly in this case it's I think a very important differentiation period for us as we are dealing with some of the revenue impacts. But it shows, one, the responsiveness of the cost structure, our ability to manage head count growth in order to control growth in expenses as well as achieve operating leverage through each of the businesses. So our focus is on managing the operations in the expense business to deliver that operating leverage, and we're constantly working to achieve improvement of that over – on a year-over-year basis.

Andrew C. Steinerman

Analyst, JPMorgan Securities LLC

Q

And some of the expenses that were held back in the second quarter, will they naturally come back in the second half of the year? Like, could you just highlight what you expect in terms of what types of expenses to come back?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

All right. So, I mean, I talked about this earlier, Andrew. So there are two primary elements that I think are influencing the margin excluding the LTI impact, but T&E is down materially as a result of COVID-19. So as the impact of that abates, as we begin to engage in a more normalized environment, you're going to expect that some of that will come back. I referred earlier to the fact that we will probably try to hold onto some of the efficiencies in

part, but there is no substitute to being in front of the clients in person. But we're going to follow the clients in that regard.

And then the second element is compensation, and two pieces of that: one, which is our incentive compensation, which is tied to growth. And so that is going to be impacted by our revenue growth and our earnings growth impacts. But the second element is our head count growth. And there we are managing that to be appropriate and consistent with the revenue growth impacts so that we can maintain that operating leverage. Those are the primary expense elements that I think are in flux in the second quarter and you can certainly expect will continue to be influenced by COVID-19 and our active management of that cost structure in the second half of the year.

Andrew C. Steinerman

Analyst, JPMorgan Securities LLC

Okay. Thanks, Lee.

Q

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

Thank you, Andrew.

A

Operator: Your next question comes from the line of Bill Warmington of Wells Fargo. Your line is now open.

William A. Warmington

Analyst, Wells Fargo Securities LLC

Good morning, everyone. So CoreLogic owns Marshall & Swift/Boeckh which competes with Xactware in the residential property space. MSB is historically more weighted in the underwriting and Xactware more in claims. A couple of weeks ago, CoreLogic announced with a lot of fanfare the competitive takeaway of Swiss Re. How big a threat is CoreLogic's new property in term solution? Is it a change in the competitive landscape?

Q

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

Mark, you want to start with that one?

A

Mark V. Anquillare

Chief Operating Officer & Executive Vice President, Verisk Analytics, Inc.

Sure. So let me just remind you, Marshall & Swift/Boeckh is a tool used to understand the replacement cost value to understand the cost you have on your home, so what's the replacement value. What CoreLogic also has is a tool called Symbility which they acquired a couple years ago. These tools have been in the market for decades. I don't see or we haven't seen any material investment in the two clearly because Symbility is now a part of CoreLogic; they've talked about the two combined.

A

I would tell you that we continue to closely monitor all of our wins and losses. We are on it every single month. We understand where we're the incumbent, and there's a bake off. We understand where they're the incumbent. We do this beyond CoreLogic, so let me not be overly specific here. But what I will tell you is we continue to win much more frequently than we lose. And that's the story that we have been kind of on for probably five years now. I think we've been trying to share that at various Investor Days. And I think the message and the direction remains very similar. So I think we're pleased with our competitive advantages. I think we're very pleased with where we

are in the market. And I don't want to address a specific customer, but I'm not aware of that particular situation, no.

William A. Warmington

Analyst, Wells Fargo Securities LLC

Q

Got it. And then a follow-up on LightSpeed, I wanted to ask whether COVID-19 has impacted the usage and the adoption of the product.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

On – I'm sorry. LightSpeed was your question, Bill?

William A. Warmington

Analyst, Wells Fargo Securities LLC

Q

LightSpeed, the POS system.

Mark V. Anquillare

Chief Operating Officer & Executive Vice President, Verisk Analytics, Inc.

A

So, Scott, if you'd like me to continue...

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Yeah. Please continue.

Mark V. Anquillare

Chief Operating Officer & Executive Vice President, Verisk Analytics, Inc.

A

Yeah. So let me remind everybody, LightSpeed is our tool by which we're taking a lot of information and data and moving it forward in the underwriting process, hopefully over time eliminating the separation between what is the quote and then separately binding later on. We want to make that one process up front so you can quote and bind with confidence. And we're bringing in both our data, third-party data and scoring it in such a way that you have confidence in that information. And that has been quite a bit of – we've seen quite a bit of success both on personal lines and now moving into the commercial line side of things.

So the one point I'll make is back to Lee's comments earlier. During the middle of COVID, there was less driving. At the same time I think many personal auto policy holders were kind of waiting for maybe their refunds from insurers, so there was less shopping. There was less people going online and seeing if they can get a better quote. So we did see some decreased volumes. But as Lee described, we've seen that slowly return as driving has increased. So hopefully that's responsive to your question.

William A. Warmington

Analyst, Wells Fargo Securities LLC

Q

Yes. Thank you very much.

Operator: Your next question comes from the line of George Tong of Goldman Sachs. Your line is now open.

George K. Tong

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thanks. Good morning. After normalizing for the LTI shift, your EBITDA margins expanded much more materially in your Insurance segment than your Energy and Financial Services segments. Can you elaborate on what drove that relative outperformance, if it was related to the amount of investment spending in the other segment or other one-time cost actions impacting the Insurance segment more?

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

Lee, would you speak to that, please?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Yeah. George, one element that I think is a significant contributor to the Insurance margin, specifically that probably the largest factor is that, as a result of the Vexcel transaction, we have been able, as we've talked about in the past, of reducing the expenses associated with that activity. And so that is – part of that margin improvement, or a large part of that margin improvement, not solely related to it, is a function of that expense reduction specific to Insurance.

That being said, we still saw very solid margin expansion even absent that effect within the business, but that probably is the significant element of the differentiation.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

A

George, are you still there?

George K. Tong

Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thank you. Now turning to the Financial Services segment, when you divested the Argus data warehousing business, the underlying growth rate for the segment improved pretty meaningfully to the 5% to 7% range before COVID. I guess I'm surprised to see organic constant currency growth down as much as it is. Can you help unpack why Financial Services revenue declined as much as it did, especially given how you indicated that, of the 20% of non-sub revenues impacted by COVID, only 3% comes from Financial Services?

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

A

Yeah. So, George, keeping in mind, put that 3% in the context of Financial Services as a percentage of our total overall revenue. And so on a proportional basis, that transactional element is a larger element relative to the other businesses. And so if you take that and you recognize that we've had consulting impacts with regard to the retained analytics and the project analytics that have impacted, that's kind of a similar effect to what we've seen in Energy on the consulting business. That's one dimension. And then we also have the pull-back in advertising. And so in our spend-informed analytics business, the lower level of advertising is having a primary causal impact from COVID-19.

So both of those are influencing the revenue growth, and there is a higher concentration of that COVID-19 sensitivity to overall revenues that is resulting in a bigger revenue impact in comparison to the others.

George K. Tong

Analyst, Goldman Sachs & Co. LLC

Got it. That's helpful. Thank you.



Operator: No further questions from the phone line. Presenters, you may continue.

Scott G. Stephenson

Chairman, President & Chief Executive Officer, Verisk Analytics, Inc.

Okay. Well, thank you, everybody, for joining us today. As always, we appreciate your interest, your questions. We'll be following up with many of you. And so appreciate your time today. Have a great rest of the day. Bye for now.

Lee M. Shavel

Chief Financial Officer & Executive Vice President, Verisk Analytics, Inc.

Thank you.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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