Y 2020 Earnings Call

Company Participants

- Euan Sutherland, Group Chief Executive Officer
- James Quin, Chief Financial Officer

Other Participants

- Abid Hussain, Analyst
- Ben Cohen, Analyst
- Edward Morris, Analyst
- Nick Johnson, Analyst
- Penelope Fitzherbert, Analyst

Presentation

Euan Sutherland

Good morning and thank you for joining the call everyone. Our intention is to highlight the progress made by Saga across three time frames in, what is a slightly more complex update than a normal trading update and mindful of the FDA guidelines, which have delayed the publication of our annual report and accounts until April 9. We will cover the highlights from the last 12 months up to the financial year end of 31st of January 2020, where the business has shown strong progress of turnaround plan set out last April. We will also talk through the fast start we've made into 2020 with further actions on cost and debt, completed before the end of February. And then as I'm sure everyone will want to know the deep, but we will give a comprehensive update on our response to the COVID-19 situation.

Saga has made strong progress as we work to improve our financial position, lowered short-term debt and operating expenses and improved cash flows. This has been achieved while maintaining the highest levels of customer service at all times. Even during the last few weeks of country locked down, where full working from home capability has been set up across the business. I'll make some summary comments and then I'll hand over to James Quin, our Group CFO to go into the financial detail for you and then we'll open up for questions.

We will use a slide on the screen to help illustrate points and the presentation should take around 20 minute to 25 minute to help with your planning. Upfront, however, let me reinforce three critical points. Firstly, that while many are focusing on recent travel sector impact of COVID-19, Saga has the benefit of its complementary insurance business based mainly in Motor and Home, which is not only largely unaffected by the current COVID-19 situation, but is also performing well as we enter the new financial year. This performance is underpinned by being able to achieve full work from home capability across the Group with over 2,300 colleagues already operating successfully at home. We are 100% open for business in insurance with what surely must be the large home- based call center in the UK today, with over 850 colleagues keeping up a seamless service for our customers. This is a vital service for our customers and is working really well.

Secondly, the while our Cruise business has been imposed and many of you will have questions on future trends we are seeing strong demand for later in the year and into 2021, and I will update with more details in a minute. Thirdly, I'd like to be clear, we've inherited a turnaround situation with Saga and therefore, we are moving at pace to address a series of historic issues that have not been fully dealt until now. So moving on to slide three. Three time frames in focus right now. For the year end 31st of January 2020, Saga has made good progress on the goals that tied last April with underlying profit before tax of GBP110 million, in line and in fact slightly ahead of the wider expectations, while reducing short-term bank debt by 20% or GBP30 million.

Our Motor and Home insurance business continues to show progress and the launch of the new three-year fixed product has been a success with over 320,000 policies written in the last financial year. Overall, we are pleased the progress that our wider Insurance business and confident about the future. Cruise had a good year in 2019 with the first of our two new ships coming into service and achieving the metrics laid out in the business case. With GBP20 million EBITDA for the half year or diems of GBP278 and average load factors of 86%. Finally, in January, we strengthened the executive team who have landed with pace and our step changing a bit. Our focus was a fast start into 2020 which has served us well so far this year. As we enter 2020, we have made that fast start into the year with progress being made on non-disposals, with a further GBP37 million of cash secured in half one with the sales of Bennetts and the healthcare businesses.

We also took rapid action in January and February, on the organization design and capability, flattening the, frankly unbelievable historic 17 colleague levels down to five, lowering headcount by 285 colleagues, cutting out non-value-added activity and lowering operating expenses by GBP15 million and CapEx by GBP5 million, all before the end of February and before the COVID-19 crisis took hold across the UK. These savings have been put to work with investments in the areas of digital, data and brand that have been poorly executed in the past. These early actions on cost are the right things to do for the long-term efficiency and effectiveness of the business and we know at the time that they would prove to be still helpful so quickly, given the environment the world is now in. These are also key and important proof point of the new management team approach.

Our action to respond to the COVID-19 situation is multi-layered. Insurance is operating well and unaffected in the main businesses at Motor and Home and we have been fast and effective in moving the entire business to working from home. Our priorities have been to protect our colleagues and to protect our business. And our actions have been swift and comprehensive, alongside a full effect of cash protection and maximization measures in place including a precautionary drawdown of our RCF, resetting our debt covenants and posing the dividend. We are in good shape to weather the unusual set of issues hitting the world this summer and our insurance business continues to generate profit and cash in line with plan.

Moving on to slide four. It's worth reinforcing some of the key metrics in insurance with now over 400,000 three-year fixed policies sold by the end of March 2020 under reinsurance solutions in place. We have seen good retention with Home up 3.2% and Motor up 1.5% year-on-year and margins are at the top end of our range. Our goal to drive our direct business is own plan with 57% direct share and the cost base is well managed. While travel insurance has been impacted recently, this is a smaller element to the Saga and is more than offset by progress in Motor and Home, as well as the likely lower claims frequency through the summer. And alongside the benefits of combining broking and underwriting under Cheryl Agius, our new insurance CEO, which all mean that our insurance business is in a stronger position after the reset last year. I've said is largely unaffected by the current COVID-19 situation. Albeit, we recognize that the insurance business is subject to a further technical goodwill impairment to year-end and James will walk you through the details in his section.

Moving then on to slide five. Cruise had a good year in 2019 as we began the transformation of that business. Customer feedback is consistently excellent and the proposition is working well with a high-quality boutique ship for under 1,000 passengers. Load factors across both ships remained strong throughout the year. And importantly, really in January and February and up to the government shutdown where our guest wanted to continue cruising with us. We are seeing strong demand for bookings in the second half of 2020 and into 2021. Importantly, looking forward, we have 81% load factors in the period September 2020 to January '21 and we are building a strong pipeline for the '21 season with 16% already booked. This pent-up demand, we believe, is based on the Saga proposition of quality, peace of mind and extra care, which has driven strong customer loyalty.

Moving then on to slide six on Tour Operations. Tour Operations, in contrast to insurance and Cruise has had a tougher year in 2019 with Brexit and the wider economic conditions hitting demand in the sector. Despite falling demand, the tour ops margin grew by 5 percentage points in half two versus half one and within the Group Titan performed well. But there is a clear need to reset and improve the Saga Holidays business, which is already a priority for us this year. Focus is on the more successful tours and river cruise offering with two new river cruise ships ordered and arriving in Spring 2021 and Spring 2022. The Saga difference has been ignored for too long in tour ops and we are returning to our heritage of quality, peace of mind and added value services within this business.

Moving then on to slide seven. Importantly, much of our focus for this update is on Saga's response to the COVID-19 situation. And in summary, we are in good shape, both operationally and financially and remain focused on further mitigating actions if and when required. Firstly, within cruise, our two ships are made at Tilbury with an estimated GBP50 million impact to the end of May. We have taken action to mitigate layup costs, while maintaining the good working order on both ships, so that we are ready to sail again as soon as the government advice changing. Very significantly 57% of customers affected by the current cancellations have already re-booked future cruises rather than taking a refund. This is a strong indication of the Saga brand loyalty and gives us confidence in the future demand. As you can see we've built significant capability within Cruise and we have a positive outlook in booked revenue and passenger days, both up year-on-year.

On page eight, in line with government guidelines, we've also paused our tour ops business with an estimated GBP9 million impact through to the end of May and 20% of our customers having already re-booked their holidays with us. Importantly, the customer repayments have been met from the CAA ring-fenced group cash and advance bookings have been impacted with booked revenue from September 2020 to January '21, down from GBP89 million to GBP79 million and passenger numbers down from 39,000 to 33,000. We've applied a number of stress tests to the travel business and James will take you through these in a minute. I am confident we have planned in a cautious and prudent way. And I want to stress that these are financial stress test scenarios and not prediction as to when travel will resume. It's clear from our customer feedback that as soon as the government changes its advice on travel, then we can resume Cruise and Tour Ops with confidence and strong demand.

Moving on to page nine. Overall, Saga is in good shape operationally given these extreme circumstances we find ourselves in and we have acted swiftly and with care for colleagues and for customers. In addition to the 2,300 colleagues working from home effectively we are working through the details of the government furloughing scheme over the coming weeks. Saga also lived up to his brand promise in repatriating over 3,000 customers from all over the world in our tour ops business ahead of government guideline. And we ensured all cruise colleagues were able to return to their homes across the world, including 645 crew members able to fly home to the Philippines before the lockdown. As you can imagine, this has been a huge amount of work and Saga has stepped up to the plate very well. All of these actions have left the business in good shape and able to operate, as well as ensuring our customers and colleagues are safe.

I'm now going to pass over to James to run through the headline financial numbers, and I'll come back and summarize in a minute. James?

James Quin {BIO 18345789 <GO>}

Thank you. Good morning, everybody. Now in normal circumstances, I go through our results in some detail. Given COVID-19, I'm expecting the main focus will be on liquidity, bank covenants and stress testing. However, let me make a few comments on last year's results, before I turn to the main topic. I'm going to start on slide 11. As Euan has mentioned, we expect underlying profit before tax for last year to be GBP110 million, in line with our target range of GBP105 million to GBP120 million, and also in line with the indications we published in January.

Given how challenging Travel and Insurance markets were through most of last year, this is a solid result. There are a number of significant items that are excluded from underlying profit before tax, as we have looked to address several legacy issues. Most notably, we've taken a GBP70 million impairment of insurance goodwill. I want to stress that unlike the impairment that we took a year ago, this is not due to a change in underlying cash flow expectations for the insurance business. Our model cash flows for Insurance are broadly unchanged from a year ago and with both years including areas of prudence. What has changed is a discount rate we used in the goodwill calculation, which has increased from 8.55% to [ph]10.7% and this reduces the value of goodwill by GBP320 million. The reason for this change is due to external inputs we need to consider. Most notably, the share price of the Group in January of this year. I want to emphasize that this is not a reevaluation of the prospects of the insurance business. We would not expect to have to revisit the discount rate again, as a result of COVID-19.

The other items excluded from underlying profit before tax includes an impairment of the goodwill intangibles of the Destinology business of GBP20 million, restructuring costs of around GBP6 million, a write down of property, plant and equipment around GBP10 million and losses relating to the insolvency of Thomas Cook of GBP4 million. These are for the most part non-cash items, as is evidenced from the fact that net cash generation for the year was better than expected. While we will incur some further restructuring costs in the current year, we do not expect to see anything like this list of items in future reporting periods.

I'm now going to return -- to turn to slide 12. As already mentioned, underlying profit before tax is expected to be in line with the target range we set a year ago. The key point here is that we have not needed to rely on expense reserve releases to get there, which is in mark contrast where the company was in previous years. I'll expand on this point shortly. I will now turn to slide 13 and the Retail Broking business. On this slide, I show the movement in Retail Broking earnings from year to year. For new business, we've invested in advertising launching our first TV campaign. New business acquisition costs have also increased the direct business, and that is in part because of a switch from direct mails to Internet channels. This was all expected. For a new business profitability reduced due to the impact of discounting in the prior year and price cuts for long-term customers that were implemented in July. This was also in line with expectations. While not shown on this chart, average gross margin per policy was GBP74, at the top-end of the range of GBP71 to GBP74. This benefited from a mix shift in terms of lower new business volumes and higher renewals.

Last year, I indicated that the margin per policy for the 2020/2021 year, would be between GBP67 and GBP70 per policy, reflecting a full year of the price cuts just mentioned. On our latest numbers, I see a likely range of GBP69 to GBP73 per policy for the current financial year. So a bit better than previously indicated. As I also said a year ago, we would look to get external reinsurance in place for our three-year fixed product and I'm pleased to say that we do now how cover -- has cover in place reduces our exposure to extreme inflation scenarios and that is with a third-party reinsurer.

Turning now to the underwriting business on slide 14. One of the main reasons for the reset last year was the recognition that period of exceptional insurance reserve releases was drawing to a close. A year ago, we indicated that reserve releases would likely be with within a range of GBP30 million to GBP40 million for the 2019-2020 year and our actual reserve releases last year were GBP36 million. Based on what I've seen in the last 12 months, my expectations for reserve release trends are unchanged. For the coming year and assuming no major ups or downs from COVID-19, we would expect reserve releases to be in a range of GBP15 million to GBP25 million. Looking into 2021-2022 and again as signaled a year ago, I expect reserve releases to be at relatively low levels consistent with a target reported combined ratio of around 97%.

I'll now say a few words on cash generation, on slide 15. Net bank debt excluding Cruise debt, reduced from around GBP390 million to around GBP360 million. And with several one-off factors here with a net impact of an adverse GBP15 million. These factors include two items that I highlighted a year-ago plus one new one. We see the GBP23 million increase in available cash from the carve-out of the Cruise business from the travel ring-fenced. This is something we were asked to do by the CAA in order to more fully separate Cruise from ST&H which is the parts of the business that they regulate. Going forward, the cash flows of the Cruise business will be shown as part of Group available operating cash.

Now let me now turn the information you are perhaps most interested in, which is of course, how we are responding to COVID-19. Starting with slide 16. Since the end of February we've been running numerous business resilience stress tests. As you can imagine the scenarios we are using are constantly evolving and I'm sure they will evolve further in the next weeks and months. Our analysis is centered around a scenario in which we experienced a long suspension of both Cruise and tour ops. Specifically we assume a six months suspension of Cruise and with all tour ops departures suspended until September. We assume a three-month delay for the Spirit of Adventure. Increasingly we also assume a slow burn pickup in travel departures in the following months. For example, we assume a load factor for Cruise in December of 54% and we have seen a 40% reduction in passengers for tour ops departures from September to January compared to our plan. In this scenario, we estimate the full year revenues would reduce by around 65% for tour ops and Cruise, in comparison to our planned assumptions.

We illustrate the potential impact of this decline in revenue on underlying profit before tax by reference to a drop-through rate. Not applying the expected decline in revenue by the drop-through rate would give you a view of the impact from COVID-19 comparison to full year planned earnings. Note this is a relative change not absolute position. The game here is how analysts and investors model the potential impact of COVID-19 on travel results and on our overall financial strength. There are two other points I would make. First, although we expect insurance results to be resilient, we have incorporated some downside stress tests into our analysis. And second, we've taken a prudent approach in a number of our assumptions, in particular, we assume almost all travel customers take cash instead of re-booking. We make no allowance for any payment deferrals and although we allow for mitigating actions in divisional costs, we do not factor in further Group level savings at this stage.

I'll now expand on the first of these points on slide 17. In our analysis, we have, as you would expect consider stress test apply beyond travel again relative to core plan assumptions. Specifically, we have considered downside risks to demand for travel insurance and PMI, and potential risks to motor claims costs as a result of supply chain issues. However, we also see areas of potential positive offset too. We start in a prudent reserving position. We think that motor frequency is likely to dip albeit temporarily. We think there is upside to customer retention as the first round of three-year fixed policies come up for renewal and we also think we're in a good position in terms of customer service relative to some of our competitors. Overall, we see the position as fairly balanced. So we have still applied a level of downside sensitivity for insurance in our scenario analysis.

On the next few slides, I'll expand on our current financial position and capital structure, starting on slide 18. To keep the balance sheet resilience relates to our good starting liquidity position. At the end of March, we had around GBP92 million in available shareholder cash resources, increased from GBP33 million at the end of February. This is mainly to a precautionary drawdown on the revolving credit facility of GBP50 million in the months and the receipt of GBP14 million from the sale of two healthcare companies, offset by GBP7 million cash injection to the ring fence travel business. We are to receive around a further GBP23 million in cash, when the sale of Bennetts is complete, which should happen in June. In addition to our own shareholder resources, we have GBP55 million of cash in the ST&H ring fence fund. This cash is backing GBP69 million of advance customer receipts and we are voluntarily holding a higher level of liquidity in the business than is required by the CAA.

Finally, as mentioned previously, we've applied prudent assumptions in our working capital projections. We expect to see a level of working capital outflows in the next few months and this may peak over the summer. In assessing the downside risk here, we've assumed that only 20% of Cruise customers defer bookings, when experienced to date points to conversion rates in excess of 50%. We've also not made allowance to tour ops customers re-booking for later departures even though a portion are doing exactly that and we've made no allowance for any provision of government support other than an element of colleague furloughing within travel mitigation action.

Overall therefore, we see ourselves as being in a good liquidity position. On slide 19, I set out our banking facility. There is no change to our capital structure, with no maturity events until repayment of the term loan in May 2022 and the maturity of our RCF which occurs in May 2023. As previously mentioned, we drew down GBP50 million of the RCF in March, and we have a further GBP50 million available if needed. Into the debt repayment this financial year, we are due to repay GBP20 million of the term loan on the 31st of January 2021 and we have two instalments of GBP10 million each due on the Spirit to Discovery refinancing. No amounts are due on the Spirit of Adventure until the next financial year. While there are no changes to our capital structure, we have however, agreed amendments with our lending banks in relation to the debt covenants in banking facility and this is shown on slide 20. As the COVID-19 crisis unfolded, and as we ran sensitivity analysis, it became clear to us that we needed to talk to our banks about debt covenants in the current exceptional circumstances. We therefore approached our banks in early March to discuss with them potential relaxation of the covenants relating to the term loan and the RCF. Following the conclusion of these discussions, we have agreed pleased to the main covenants, which is the ratio of increased debt to exclude EBITDA from [ph]4.5 times to 4.75 times. We've also agreed other changes that will help ensure we have the financial flexibility we need to navigate the current crisis.

As you would expect this does come with some conditions including a moved quarterly covenant testing and we need to reduce ex-Cruise leverage to below 3 times before we can resume paying dividends. The practical impact of this is limited since we would in any case be unlikely to consider paying dividends until this level has been achieved. There are also covenants in the ship debt and we will apply for a one-year waiver of these covenants will be available as part of our package of support provided to the cruise industry. We are currently assessing whether to apply for a debt holiday enabling us to defer the GBP20 million of capital repayment due this year on the Spirit of Discovery. This is not factored into our central scenario planning. I'd like to thank all our banks for the support they've shown us and extremely rapid response to a challenging environment.

Let me conclude by providing an update of the chart that will be familiar to those analysts and investors who know us well, on slide 21. Of course, the current environment is highly uncertain, cannot predict when our travel business will return to normal. We also cannot predict what normal will look like at least in the next year or two. That said, with a good starting point for liquidity and resilient insurance cash generation, as well as the proceeds from announced disposals, we expect to significantly de-leverage the business in the next few years. With headroom to our new debt covenant in our central scenario and further mitigating actions available in the event of a longer travel suspension, we expect to be able to trade through an exceptional period.

With that I will hand you back to Euan.

Euan Sutherland

Thank you, James. And just moving on to the summary on page 23, you can see our clear focus across the business and I just want to conclude with four comments. Firstly, Saga has made good progress and is on track with the turnaround outlined last April with profits in line with guidance, debt and operating cost reducing alongside a fast start into 2020 with the new management team. Secondly, the current environment we are preparing for the worst with the better prudent and cautious actions across the business alongside a strong Motor and Home insurance business that is largely unaffected by COVID-19 and continuing to contribute strong profits and cash flows. We have a tight control of costs and cash and we have further mitigating actions that can be taken if we need to. Thirdly, and saying that we are planning for the best with over 2,300 colleagues working brilliantly and in agile way from homes across the UK delivering great customer service for our loyal customers and we believe we have the largest at home call center in the UK with 850 colleagues manning [ph]this post for our customers. This is not only achieving record call answer rate, but it's also helping fulfill an essential service and the connection with our older customers.

We have the capability to do this for the duration of the lockdown no matter how long this lasts and a huge thank you to our amazing colleagues. And finally, my sense is that this is a great and strong business at its core. It is beginning to operate at its best and it will get even better as we improve further. Insurance has begun to turn the corner. Our new cruise ships are in a winning proposition and our tour operations will be better once we relaunch it in the autumn. While it's difficult time for everyone across the UK and across the world, Saga as a small part of that is focusing on emerging as a stronger and better business, and we want to play our part in supporting the UK at this time.

So with that we'll pause and open up for any questions that you may have. Thank you.

Questions And Answers

Operator

Thank you, Euan. (Operator Instructions) So first question today is from Nick Johnson from Numis Securities. Nick, please go ahead.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi, good morning all.

A - Euan Sutherland

Hi Nick.

Q - Nick Johnson {BIO 1774629 <GO>}

Two or three questions please, hi. Firstly on your cash projections in the six-month scenario, do you envisage further drawdown of the RCF in that scenario? And I guess same question for more severe Jan 2021 no Travel scenario. That's the first question. Secondly, Euan, really I think you mentioned that you view this business under invested in digital, data and brand, just wondering if you could elaborate a bit on the specific areas, perhaps some examples. And will the upgrades require involve incremental additional CapEx and operating cost or that was offset by efficiencies elsewhere. And then thirdly on Motor Home insurance, obviously most due to work from home capability there, could you just say in the last weeks since UK is nearly locked down, have you seen any discernible impacts on the business volumes? Thank you.

A - Euan Sutherland

Great. Thanks Nick. I'll pick up the points on digital, data and brand and the work from home and perhaps James can pick up the detail on the cash projections even though I think we feel in a good place with our cash position. So I guess, picking up the under-investment, I think there are good examples around the business where we feel we can accelerate the move to digital, in insurance, in travel, in the operational capability of our website through to the digital capability that all of our customers need and want today. I think in data, while there has been some good foundational work there, we haven't turned that into really useful information yet. We have a data lake, so we have some good base capability, but we really have to turn that into something which is enabling our colleagues to connect with our customers in a far better way and we feel that -- that example has a fairly short lead time. So as we focus and continue to focus the business through this difficult time, there are some early wins in there. And then I think on brand to be honest, I think that we have not kept up with the relevance and temporary nature and modern outlook of our core customers who are using digital, who want to feel empowered as they travel the world and as they live their lives and there is some really interesting and exciting brand work going on in the background, which we hope to update on in September as we outline more details of the strategy.

In terms of costing that you're right that we've looked at taking some of the inefficiencies that were evident in the business from an early view from the new management team and to reinvest that into those areas. We think those three areas are the priority for the business. So we're being right disciplined in where we take the cash out or when where we put into. So we are cutting back on CapEx this year but we're refocusing what we have into those three areas. So hopefully, that gives you a bit of a flavor of where we're thinking but more detail in September when we update the full reset of the strategy.

In terms of working from home, I guess we have worked with speed and accuracy, I guess, huge amount of effort to move from everybody working in what we're five offices to working from home. We, on the last time yesterday we had 23 colleagues across five offices in the office, every other colleague was effective and working at home. We have the capability digitally to do that. We have moved at pace, which has meant that there has been no interruption at all in our service provision for insurance or from travel. And clearly both of those areas of the business working in credit card. The insurance call answer rate response times have actually gone up. And so we have been very impressed with the colleagues. They are working together on the technology, which has worked well for us and I think we were helped by getting on to this very quickly and even being very single-minded in our focus. And on travel, we are managing and helping thousands of customers move their holidays and their cruise bookings so that side of the business is very busy as well as we focus on customer care. So, hopefully that again gives you some sense of where we're working and the confidence we've got through this very unusual time.

James, could you pick up the cash projection point, the RCF drawdown.

A - James Quin {BIO 18345789 <GO>}

Yes. So I mean I think what we did in March, as we look to set ourselves up really for the sort of the liquidity scenarios that we've been running and again employing some pretty prudent assumptions around the return of travel customer cash and that was why we then drew down GBP50 million on the RCF and that included some relatively prudent scenarios now. I would, definitely not want to say that there are no circumstances when we would draw down maybe a bit more. But that isn't the expectation right now and I think that certainly as we look out over the the next six months what I think we would see is that the cash requirements in the business will probably peak over the summer because that will be the low point for advance receipts and if we start to trade again in September, October, or even actually in January, given that we collect customer cash three months in advance of departure you would then start to see some of that cash coming back in. So as I say, the peak cash drawdown period is probably going to be in the next three or four months, and then we'd expect it to pick up and that means, I guess there wouldn't be a huge difference as to whether we're in a six months lockdown or whether it's a 12 months lockdown. But you can never say never, but I think that in the RCF drawdown that we've done, we've looked to give ourselves a bit of buffer looking out over the next six months.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay, thanks, thanks. I'll quickly go back to the Motor Home insurance business. So you saying that service levels were seamless and actually call answer rates have gone up. I mean just to clarify, should I take from that, that there has been no real change in premium written or gross premium deemed in the last week.

A - James Quin {BIO 18345789 <GO>}

I can take that one Euan. I think the, what we've seen is the new business has been a little bit lower in the last couple of weeks. Maybe sort of 15%, 20% down on the two weeks before that. Having said that, retentions have been very good. And I think that in the aggregate, we definitely don't see any big change in the overall level of business that we're writing.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay, great, that's very clear. Thanks very much.

A - Euan Sutherland

Great. Thanks Nick.

Operator

The next question on the line is from Ben Cohen of Investec. Ben, please go ahead.

Q - Ben Cohen {BIO 1541726 <GO>}

Good morning. Hi, I had some three things that I wanted to ask. Firstly just the stress test on the health insurance volumes and profits. If you could say a little bit more about that. Secondly on the AICL solvency, just remind us the key sensitivities that I think you say there is no, there is no risk to the capital position, but obviously the solvency has come down from year end. And the third question was it just if you had a comment on cost inflation in the first quarter of this year, year-to-date weather that had changed from the end of last year. Thank you.

A - Euan Sutherland

Great, thanks, Ben. James, you want to take those ones up.

A - James Quin {BIO 18345789 <GO>}

Yes. So I think firstly on PMI and I think this is a, probably simple answer to this question. I think that we're still working through the impact on the prior [ph]medical care with with our (inaudible) provider. Now, I think that what we do think is that in the short term, there will be a decline in obviously the sort of discretionary operation inevitably because of course the hospitals are going to be focused on treating people with coronavirus. Equally though, I think that the, probably about half of the products is still serviced and that isn't dependent on essentially either in hospital treatment or it would be on in hospital treatment that is still continuing such as cancer care for example.

What, what we're doing is we're working to essentially add new features into the product. So for example, potential sort of in hospital treatment cover not the Coronavirus, but on a sort of per diem basis. And we're also stepping up some of the sort of treatment at home features as well. So I think the point here is that we think that there is going to be, there is a bit of uncertainty in the short term, but actually we think that the long-term prospects for the products are probably going to be quite good because coming out of this, there's going to be a period where people will probably not feel comfortable relying internally on the NHS. So, I think there's a number of implications for the product. We have built a downside into our stress test, as I mentioned before, as well as for travel insurance. But I think in the aggregate, we would still see insurance as being resilient.

In terms of ACIL solvency I definitely will say there is no risk to the capital position. I think what, the way, I would characterize this is that when we got to the end of the year we ran the ACIL solvency numbers. That was coming out of 160% solvency ratio, was actually better than we've been anticipating. And so we started the year with a bit of buffer over what we were expecting. What we see is that in allowing for the market moves I guess a combination of widening and also the impact of the down in the yield curve that in the ACIL solvency position back down to probably, a probably a shade over 140. Certainly that's actually where we had been planning for it to be at the start of the year. So why I wouldn't, definitely wouldn't say there is no risk to the capital position, I would say that in allowing for the things that we know about, that's really just sort of taken us back to where we thought we were going to be anyway.

In terms, so I mean I think practically speaking, of course, what that means is that the ACIL dividend plans that we had for the year shouldn't be materially impacted. And when I say that what we're not doing is making any allowance for the possibility that claims frequency will decline in Motor and obviously that would in an itself of course help in terms of ACIL profitability at least in the short term. Now I think in terms of inflation, I think it's probably fair to say it's, I mean it's a bit too early to say. I mean inflation. I think that we certainly haven't seen any acceleration in what we saw before and I think that obviously what we're going to see now is the impact of COVID-19 on pricing. So I think it's a bit early to judge what that will mean. I think a critical point there is, of course, it doesn't really matter what's happening in the short-term because we're selling 12 months, or in our case 36-month policies. So a temporary dip doesn't really feature as an influencing factor.

In terms of the overall market environment, I think we can say it definitely has got a bit better and this is before Coronavirus. I'd hesitate to get carried away with that. But I think at the margin, certainly through January and into February, things felt that perhaps the market was starting to be a bit from a certainly compared to where it was in the fourth quarter of last year. I wouldn't want -- I actually wouldn't want to extrapolate that.

Q - Ben Cohen {BIO 1541726 <GO>}

All right. Okay, thank you very much.

A - James Quin {BIO 18345789 <GO>}

Thanks.

Operator

(Operator Instructions) The next question on the line is from Edward Morris from JP Morgan. Edward, please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Hi, everyone. Thanks for taking my questions. Sir, for you in just on the sort of overall strategic direction of the Group in your assessment as you come into the business. It's clear that you're sort of accelerating the attempt to dispose of non-core assets, but I just wondered in your bigger picture view around whether you think Travel and Cruise continues to belong with the insurance business and obviously COVID-19 introduces new challenges for Travel. Does it change anything in your view there? And the second point is, I mean a lot of the actions that you're taking you clearly been quite successful in raising cash, but you are still left with a fairly restrictive debt position overall even ex-Cruise, but then if we think about including the Cruise debt, it's obviously very significant. So just wanted your thoughts whether raising actually has been a consideration and why so far you decided against that.

Second question relates to goodwill, obviously second consecutive year with quite significant write down to the Insurance business, you mentioned that the share price was one factor that drove the decision, does the -- does this recent share price suggest anything in terms of what might happen in the current year. Or is there a reason why that might change again. And can you just explain whether there is any need to test the values of the cruise ships in light of what's going on COVID-19? Thank you.

A - Euan Sutherland

Great, thanks Ed. I'll ask James to pick up the answer on goodwill. But just on the strategy I guess that the top line thoughts on that is that we are not being distracted by the current COVID situation in delivering and thinking through the strategic reset of the business. We see that there is a core of our business, linked around a very attractive core consumer group that makes sense across the balanced offer of Travel and Cruise and the wider Insurance business. And as we develop the plan there around driving a stronger brand, more engaged membership, then we believe that there are some quite interesting strategic plays that we can deliver. Within the core of the business though, the first stage for us is to get a far more effective efficient business, which is what we have underway already and you've seen early examples of that with operating expenses reducing and a refocusing on the three big strategic priorities of data, digital and brand, which is the first level and foundation level against building a stronger business across all business units.

As we go through the summer and into towards September, we will pick up and show you where we believe the compelling element of Saga as a brand fit, and how does that should be consistently applied across all business units. I think there is some inconsistency today in what you see across the offer from Tour Operations to Cruise to insurers. And I think as we align those then it gives us the opportunity to present a single Saga proposition across not only those business units but potential new business units, that's [ph]part of our core target market. As part of those foundation levels then, our focus is on lowering our debt and clearly we've made some further inroads into that. And while we have had to pull any further non-core disposals there is still opportunity for us to pick up that mantle again when the wider level of upstead tops, but no, I think in total, we are very clear that the strategic direction is about optimizing where we are today and driving a core brand membership proposition for our core customers in the future. And as part of that having a stronger Saga business at lower debt and more efficiency, are the first stages in that overall strategy. James, did you want to pick up the goodwill point.

A - James Quin {BIO 18345789 <GO>}

Yes, so on the goodwill write-down, I think, Ed first question, does the recent share price happen or could it have an influence on a further goodwill write-down, I think the answer is no, not anything we can see right now. Clearly when we decided on the the final number here, that was done with a view that I really don't want to ever have to talk about insurance goodwill on another conference call anytime soon or indeed ever. I think in terms of the cruise ships, and I guess Travel goodwill, I mean we only have GBP60 million of goodwill for the Travel business and when we tested that for impairment I actually couldn't really see a scenario when we would be able to take a write-down there. So there is, even if we allow for -- our sort of leave the worst case Coronavirus impact there will still be quite a lot of headroom to the goodwill for the Travel business.

And in terms of the cruise ship specifically, obviously what we are seeing is a one-time impact. I mean I think it's interesting if you were to look at, you obviously apply our stress test on profits for this year. You would say, of course, that those are relative to our plan assumptions. And the plan assumption is a very cash generative business. Clearly, it won't be cash generative this year, but I think there is nothing that changes our view fundamentally of the long-term and certainly even if demand was significantly lower than we had been anticipating before and EBITDA would not reach the GBP40 million level, we wouldn't see at the moment the need to impact the value of the discovery, of course, adventure is not even actually on our balance sheet right now. But even then we wouldn't see a need to impair that obviously ahead of its delivery.

I think, I guess you asked another question about the capital position and raising equity. And I guess I'll get -- I'll give you my view and I'm sure Euan will probably give his is as well. I mean I think that there is no question of course that we do have a lot of leverage on the balance sheet and I don't think there's any secret about that and I think we've also been very clear, we, we need to reduce that. I think our view is that we need to do that through self-help measures. And I think that was obviously one of the areas that has been a high priority for me and for others in terms of setting up the -- some of the non-core businesses. And I think we made, made some quite good progress there. And I think the other factor here is, of course, the fact that it is a very cash generative business. So I think really our starting point is making the most with what we got. And I think that in that sense, managing through the situation at the moment and demonstrating that we can still make good progress with our investors. But Euan, I'm sure you have a view on that as well.

A - Euan Sutherland

Yes, I mean I would be in the same place James, as you know, this is a strong set of self-help measures. We're making good progress on those. I see no reason to change that focus and I think we've benefited from having very single-minded focus on a couple of very big things in the last few months and we proved that Saga can deliver. And so I think that we're in the same place. As the wider longer term situation moves on it's kind of never say never, but it's, we have a clear focus of self help right now and we're making good progress. So I think that still will be up.

Q - Edward Morris {BIO 16274236 <GO>}

Okay, that's great. Thank you.

A - Euan Sutherland

Thanks Ed.

Operator

The next question on the line is from Abid Hussain from Credit Suisse. Please go ahead, Abid.

Q - Abid Hussain {BIO 20229932 <GO>}

Hi. Good morning.

A - Euan Sutherland

Good morning.

Q - Abid Hussain {BIO 20229932 <GO>}

Thank you for taking my questions. I really just have one question part I guess, and that's on the travel business. I was wondering if you could give us a sense of the cash burn rate for the Cruise business and the pool business separately. And then following on from that how long do you think would it take for you to use up all your available liquidity and cash resources before things start, use them all up. And are you basically, how long do you think travel restrictions need to be in place before you use up all of your available cash resources especially the second part of the question.

A - Euan Sutherland

Okay, thanks. I guess just in headline terms we think we're in a good position with cash. And we've given what we think are pretty prudent and pretty cautious set of stress test into the model that we put into the presentation deck. We don't believe that that is actually what's going to happen but there is a high degree of uncertainty out there. And clearly the overall decision for lifting any travel bans is out of our hands but I don't think it's a cash issue per se and James would go into the detail on that and I think we've got two parts to that which is further considerations. First is that there is a set of further mitigations that we can take that we haven't taken yet. And we've also put into the stress test a number of non-travel related elements so that we are super prudent in our thinking, but James, you want to pick up the detail of the cash burn rate.

A - James Quin {BIO 18345789 <GO>}

Yes, I mean I think that, I mean I think that, I mean, Euan made an extremely important point here, which is, it really isn't a question about running out of cash and I think that there are a number of reasons for that. One is, because we do have a lot of cash. And secondly, of course we do generate cash from the insurance business and of course, that gives us a lot more flexibility compared to a pure play travel company. And I guess the third point is, if we were to look at the the tour ops business as well. I mean it operates on a ringed funds basis and we held cash equivalent to 80% of all of the advance receipts. So I think the cash position is a good one, say we've taken the actions in drawing down on the RCF which we think give us the cash flexibility to operate through the, certainly in the next six months.

Now I think in terms of your sort of the burn rate question, I think you can probably work it out from some of the disclosures, which we've given you because we've given you the, the delta in revenues. And then the sort of the drop-through rate and essentially that is the profit on the cash is essentially the same here, that we're not changing depreciation rate or anything like that. Clearly as you have, if you have no revenues there are of course some operating costs, the ships actually don't cost that much to run or just to keep them ticking over but certainly would be a couple of million a month just to sort of keep the lights on. The tour ops business probably has more in the way of a sort of overhead cost, but of course, the longer the crisis goes on the more that you would think about taking bigger actions. So I think that the in many ways it's not that we've got a sort of regular cash outflow. Clearly, if you were taking a view that this business will not operate for nine months, there are basically a range of things you would do, and of course, under no circumstances would we allow one part of the business to become a sort of a tail wagging the dog.

So I don't know if that answers your question. I mean I think fundamentally the issue for us and of course what we have agreed with our banks is the maintenance of the debt covenants and so it's not really a question of liquidity for us, it's more about ensuring that we continue to comply with those covenants because providing we do, there'll be, as we've got loads of liquidity and there is more liquidity available. And so for us, that's really the question for us and of course, when we had the discussions with the banks over the last few weeks of course, we look to ensure we have a level of headroom above our sort of central scenarios that give us some downside protection in a range of different outcomes.

Q - Abid Hussain {BIO 20229932 <GO>}

Okay, thanks, that's helpful.

A - Euan Sutherland

Thanks.

Operator

(Operator Instructions) We have a question from Penelope Fitzherbert from Guy Butler. Please go ahead Penelope.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Thank you. Good morning.

A - Euan Sutherland

Good morning.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Could you just clarify with the second cruise ship which may be delayed, can you just clarify when the payments will occur and how you sort of viewing managing that transaction as the situation unfolds.

A - Euan Sutherland

Sure, we can do that. I'll ask James to jump in on the detail. We don't have confirmation that the second ship will be delayed. We're just taking a prudent position that that might happen with the current prices impacting the airport for as being constructed but James do you want to just outline the flows of cash, which are quite important.

A - James Quin {BIO 18345789 <GO>}

Yeah, so, so when we take delivery of the Adventure there is actually a small cash inflow to the company and that's because essentially, the loan that we draw down from the banks is slightly higher than the amount of money that we owe to Meyer Werft ship builders. And that's to cover something called owner supply. And that's the basically the money that we forecast ourselves for various elements of the ship build. So, actually when we, when we complete on the Adventure there is and it's not very big but it's, it's a small cash inflow to the business. Now we, we obviously won't, we won't take on those loans until we actually have the ship. So at the moment we are assuming that the that we are assuming certainly from a cash flow purposes that the ship will be due for delivery on the date, but has meant to due which I think is affordable list and actually in terms of the cash flow outflows then there is no amounts due on the Spirit of Adventure loans until at the moment (inaudible) either in interest or capital. Now obviously if the Adventure arrives late, then we will not draw down on the loans. Obviously, we would look to draw down the loans at the point of which we need to pay the money to Meyer Werft and we will obviously the money first on delivery of the ship. And then of course, essentially the funding will work in the same way. So it would be, presumably six months after delivery of the ship we will then have the first cash outflows on the interest and the capital.

And one thing we have actually modeled, and just for our own internal purposes of course in terms of our stress test is the impact of a delay on the Adventure on our own numbers and it actually doesn't have that big an impact and the reason it doesn't have that big an impact is because we assumed in our sort of central scenario some pretty low load factors in October, November time anyway. So actually, at that point it becomes a little bit marginal as to whether the ship is running or not.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Okay, thank you. So, basically, yes. If the ship is delayed it just pushes everything back and there is no, there is no extra or it is no --

A - Euan Sutherland

No. that's right.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Pulls if you like. Thank you.

A - James Quin {BIO 18345789 <GO>}

No, mean, I mean obviously we, we would need to, there is a little bit of, we've got a bit of exposure around currency and things like that we'd need to manage. But I think that, frankly, in the circumstances and we've had various discussions with the bank to administer the ship lending, they are being wholly pragmatic in, in the circumstances. So I think the main aim is to ensure that Adventure get delivered, the financing works and everything will continue as as we would expect.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

All right. And just one more if I may, is what -- under what circumstances would you or the other side, say look the ship can't come. I mean it's probably pretty much where by the fittings at this point, but is there any way that you could prevent that transaction happening at a later stage.

A - James Quin {BIO 18345789 <GO>}

Well, I don't think so. Because I mean, the ship is pretty (multiple speakers) as you imagine, pretty well completed and in fact it actually had its first floating out I think this week or next week which is sort of more testing the engines and everything else. But, it is a very long way towards completion and actually the head before this there was an expectation that it was going to be delivered early and so I think that there's certainly no sign the ship won't be completed. I mean is -- I mean, as a ship I actually the engineering is largely done anyway, the bit that needs to be done until the cabin fitting out. And of course, we don't, we don't want to not arrive, we wanted to arrive (multiple speakers) really good bookings for it and I think as we've mentioned in one of the slides, I think when we look at the bookings for the period from September to January, we've still got a booked rate on those ships of about 66% of target. We've given obviously that's still six months away from, I mean that's Discovery and the Adventure together, but I don't think there's a big difference between them. So at the moment, we've still got customers who very much want to probably looking forward to getting on those cruises.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Great. Okay, I'll hand it back to --

A - Euan Sutherland

And the extra point to that is that, what has helped us in the summer, is that we were planning to take the Sapphire out of service as of June anyway. So compared to our plan, we were only planning to run one shift through this period where we've been locked out. So it's helped us if you like with just one ship capacity through what is likely to be the lockdown period from the government. But as James said, the next ship is on plan. We're just being proportionary with our guidance.

Q - Penelope Fitzherbert {BIO 16415186 <GO>}

Okay, thank you.

A - James Quin {BIO 18345789 <GO>}

Thanks.

Operator

(Operator Instructions) It appears we have no further questions, so I'll hand back to you, Euan.

A - Euan Sutherland

Thank you. And thank you for being part of the call today. If there are any other follow-up question, James and I are around all day, happy to take a call with you. I hope you've seen that we are strongly positioned and to manage through the current external environment, and we're very pleased by the prospects for Saga. So thank you for being on the call and look forward to catching up later. Thanks very much everyone.