Q4 2018 Earnings Call

Company Participants

- Gary Duggan, Chief Executive Officer
- Jonathan Stanley Hill, Group Chief Financial Officer & Executive Director
- Lance Henry Batchelor, Group Chief Executive Officer & Executive Director

Other Participants

- Andreas van Embden, Analyst
- Ben Cohen, Analyst
- Charles Eden, Analyst
- Greig Paterson, Analyst
- Robert Rampton, Analyst

MANAGEMENT DISCUSSION SECTION

Lance Henry Batchelor {BIO 6884486 <GO>}

Good morning everybody. Great to see you here. Welcome to Saga's Year-End and Prelims Presentation. As I think you probably all know, I'm Lance Batchelor, the CEO of Saga. On my left is Jonathan Hill, the CFO. Again, many of you all know Jonathan. Also, I'm going to introduce you to a number of members of my leadership team who've joined us today and, perhaps, if you don't mind, I'll ask you to stand as I name each person.

So, also, on my left is Gary Duggan. You don't need to stand, Gary. Everyone can see. Gary joined Saga in September as part of the planned succession to take over our most profitable division, which is insurance broking, and he formally stepped up into that role in January. I'm going to say more about Gary in a couple of moments.

Sitting mostly in the front row, but also other parts of the audience are Robin. Can I ask you to stand, Robin? Thanks. Robin Shaw is the CEO of Saga Travel and Cruise. This division makes over half of our revenue and it's very fundamental to our growth aspirations. Robin has been with us for about eight years where he's done a fantastic job taking the cruise business forward, laying the foundations for the next stage of growth. Andrew Button, Andrew is the CEO of our immensely effective underwriting division, AICL. Julius Christmas, Julius is our IT Director. He has led the replacement of pretty much all of the IT across the group over the last four years with great success.

Stuart Beamish. Hi, Stuart. Stuart is our Group Marketing Director. He was promoted into the role last year, having previously been the Marketing Director of our Travel division. He is doing an excellent job driving Saga Possibilities, our membership program, and the implementation of the Adobe Marketing Cloud, and the investment that we're making into customer growth. I saw Orna, Orna NiChionna, where are you hiding, Orna? Orna, one of our Non-Executive Directors, indeed, our Senior Non-Exec. Nice to have you here, Orna. Thank you.

And finally, let me introduce our incoming Chairman, Patrick O'Sullivan. Patrick officially steps up on May the 1 as Chairman, but he has managed to join us here today and I'm delighted to welcome you Patrick to your first set of Saga results.

Looking quickly at the agenda for today, fairly standard format, I will do an introduction to the business focusing on last year. Jonathan will then step up and take you through the financials in more detail. We're then going to ask Gary to give some first impressions and direction of Travel for his insurance broking division, and then, finally, I will step up and talk about the future for the group, where we're going. Of course, we will allow time for Q&A at the end of that.

So, let's have a look at the key highlights for the business. In some challenging markets, we have delivered numbers in line with the rebased guidance that we've put out in December. That includes a strong performance from Travel, a strong performance from underwriting, and a solid financial performance from broking.

The Saga model has again done what it does so well and demonstrated that it generates lots of cash. That cash has allowed us to reduce our leverage to a level that allows for the significant investment in cruise ships over the next few years. It's also allowed us to pay a good dividend. As well as driving the business, we've also taken further steps towards making Saga more efficient in the targeting and the acquisition and the development of new customers. Just a few weeks ago, we switched on our new insurance broking IT platform, Guidewire.

In December, we announced an investment in adding new customers. Today, we're going to show you that we are starting to deliver the customer growth, which is so important to the long-term future of the brand. As projected in December, our full-year underlying PBT was slightly higher than the previous year. A fall in broking was offset by strong growth in Travel, which has performed really well. Cruise, in particular, had a very good year helped by a reduced number of maintenance days. Continuing strong cash generation and the resulting de-leveraging has given the board confidence to recommend a total annual dividend of £0.09. That's up 5.9%. This is comfortably covered by our cash flows, and we have great confidence in the stability of our highly cash-generative model.

Let's look now at a little bit of history. Just over three years ago shortly after the Saga IPO, I set out a revised strategy for Saga. At that time, I said I would aim to do four big things. Firstly, to grow PBT at a mid-single-digit level and to generate lots of cash to pay down the 3.1 times debt ratio that we inherited at at float (00:05:16).

Secondly, to grow the broking business particularly motor, by launching a panel of external underwriters and extending our footprint. This would also serve to improve the quality of earnings. Thirdly, to grow the cruise and Travel business significantly from being a small nice (00:05:36) to have, to being a meaningful part of our P&L. New cruise ship tonnage was central to that proposition. Fourthly, to invest to update our IT platforms and our marketing capabilities, which were outdated and inflexible.

So, three years on, how have we done against those four goals? While we have grown PBT every year, we've delivered strong cash generation and de-leveraging. Our debt ratio is significantly down, as I said at 1.7 times. We've launched the motor panel and it has grown, but it has not yet delivered the growth in the footprint that we wanted to. And I'm going to talk more about that in a minute.

Our quality of earnings has improved as well as the home and motor panels; we also put in place a quota share arrangement which removes most of the downside risk from our in-house underwriter. Travel and Cruise have done well. PBT has grown from about £4 million at the time of the float to about £18 million last year. The launch of the new ships is now fast approaching and we have replaced the vast majority of our IT with world-class up-to-date systems. We've put in place an excellent CRM suite and we've launched membership.

But the biggest disappointment has been the lack of footprint growth in motor broking. Let's take a look at that in more detail. The motor panel comprises four external underwriters and our own underwriter AICL. It's working but it's immature. It's not yet optimized. The share of underwriting by third parties has grown fairly steadily since its launch in 2015 and now nearly 30% of the value of the renewal book is underwritten by panel members as well as a growing share of new policies.

On the upside, we've continued to deliver industry-leading levels of cross-sell between our insurance products. On the downside, we've been running a 20-year-old IT platform, which has held back our innovation in our product offerings. However, and here's the big point, with hindsight, there is no doubt that the balance between investing in growing our customer numbers and delivering profit has been too heavily skewed towards short-term profit growth.

As you know, adding new policies comes with a short term cost. Typically, the cost of an acquisition and a setup at a competitive market rate means that a new motor customer might take between one and two years to become profitable. Saga has been so focused on hitting mid- to single-digit annual PBT growth targets that we have underinvested in new volume. Over time, that means we're extracting more and more profit from a flat base and that is simply not sustainable over the long term.

Now, looking to the future, three things have set Saga broking up for growth. Firstly, the arrival of Gary. Am I supposed to say that? Gary brings with him a fresh perspective, a hunger for growth, a track record of innovation and deep expertise in working with third-party panel underwriters. Not sparing his blushes, he's the right man at the right time. Secondly, the financial reset that we did in December. It was a painful event, but it was the right thing to do. In one step, we corrected pricing, which had pushed our motor margins up too high. We also gave ourselves headroom to invest in volume growth for the first time in many years.

Thirdly, technology and marketing. The implementation of Guidewire, plus our new claims platform, plus the new Adobe Digital Marketing Suite, plus membership; all this means that we have the platforms in place that we need to grow efficiently.

Now that we are more focused on customer growth, we plan to add more underwriters to the motor panel. There's clearly an opportunity to work with external insurers in more of a partnership, and the new technology that we've launched will help us to do that. Gary's going to talk about all of this in more detail.

The ability to use the strong relationships that we have with our customers, in particular through the Possibilities membership scheme, and our ability to further improve the efficiency of the Saga model gives us a great deal, more flexibility and functionality. We're now able to grow our customers through targeted investment, better customer relationships and, over time, a broader panel.

Now, let's turn to the rest of the insurance business. Home broking continues to be robust albeit in a challenging market. Home is a more sticky product. It's one that we can differentiate more clearly. Our well-established home panel continues to deliver competitive rates and the changes that we've made in our customer relationships will give us even more ability to differentiate, as well as the introduction of Guidewire. We're also looking to expand our market footprint in home, staying firmly in the over-50s camp and using the strong panel to help us to grow.

Medical and travel insurance are performing well. And our own underwriter, AICL, continues to deliver excellent results. This remains an area where the advantage of Saga's customer knowledge is very clearly evidenced. We've recently updated and improved still further our quota share arrangement and Jonathan is going to take you through the details of that later.

Looking out at Travel. Travel has always been right at the heart of the Saga brand. It's the area where our ability to differentiate for the benefits of our demographic is most obvious. Despite the inevitable issues that the Travel industry always faces we've continued to make good progress.

Our first new cruise ship, Spirit of Discovery, is due in July 2019. That's just 15 months away now. That project is on time, it's on budget, and presales continue to be strong. In fact, she's already more than 50% presold. The order for our second new ship, Spirit of Adventure, was confirmed last year, and that ship will arrive in August 2020.

In the years to come, Travel and especially cruise, will grow to be a more and more significant part of the Saga Group profitability. We're good at it. It's strongly differentiated, and we're getting better at it all the time. By the way, one of the last pieces of the IT refresh at Saga, which is a new reservations platform for Travel, will go-live in the first half of 2019. We call that Project Darwin, and it's now well under way.

So, let me summarize this section and look back at 2017. PBT was up, in line with the December forecast. Cash generation was excellent. Our debt is down still further, and we're recommending a good dividend. Travel and Cruise had a very strong year. Our quality of earnings is enhanced, but we have under delivered on broking growth, and we've learned some painful lessons in quarter four last year. So, when I stand up again, I'll take you through how those lessons have helped us to reset the business for growth. I think we've got a great plan.

I'm now going to hand over to Jonathan.

Jonathan Stanley Hill {BIO 16892113 <GO>}

Thanks, Lance, and good morning, everybody. So, for the year ending 31 January 2018, we have delivered profit in line with our revised guidance from December with underlying PBT up by 1.4% at £190 million. Our customer spend, which measures the entirety of the spend of our customers with Saga, has increased by just over 2% to just over £1.2 billion. Our reported profit before tax was £179 million, down from £193 million in the prior year.

So, the difference between the current year underlying and reported PBT is due to three items being the exceptional restructuring costs associated with that cost saving being delivered in 2018/19, a charge related to the refinancing, which was undertaken in May 2017, and finally, a charge for the fair value losses on derivatives. Our profit after tax was £138 million, which included a charge of £7 million in relation to discontinued operations. We took the decision to write down in full the value of the deferred consideration associated with the Allied sale, given our reduced expectations of recovery.

One point that I really want to draw out on this slide is the fact that our free cash flow before financing activities was £145 million, which compares to our profit after tax from continuing operations of £145 million. This demonstrates the highly cash-generative nature of the group, and the fact that we turned profit after tax into cash after tax. From this free cash flow, we have paid dividends during the year of around £99 million. And comparing this to the free cash flow, this dividend was covered around 1.5 times.

Additionally, we are able to reduce our net debt by £33 million to £432 million at the year end. The consequence, our leverage ratio is reduced to 1.7 times from 1.9 times a year earlier. Given the stability of our highly cash-generative model, we have proposed a final dividend of £0.06 per share and when combined with our interim dividend, the full-year dividend of £0.09 per share is 6% higher than the prior year.

Okay. So, this slide shows a summary of the profitability of each line of business with a bit more detail on later slides. In motor broking, we delivered a significant uplift in written profit. While this is a strong performance, it could have been even better. Our written performance in H1 of last year was a £24 million profit, which reduced to £15 million in H2 impacted by the changes in market conditions particularly in Q4.

This profit improvement was offset by a reduction in the written to earned benefit, which is moving towards a more normalized position and I'll cover that in a little bit more detail later. As Lance said, home profit reduced as tough market conditions continued from H1 into H2. And we achieved another solid result in other broking. Profits in underwriting were again significant supported by ongoing reserve releases from our excellent claims management and the positive experience that we've had on both large and small PI.

And finally, the Travel division increased profits materially. Just looking to the right-hand side of this chart, the written profit performance from our retail broker plus the Travel business profit has delivered a profit improvement of 8% year-on-year, and this highlights the profit uplift in what I consider the underlying businesses. I'd like to put this into the context of the guidance that we have given for 2018/19 of a profit - PBT reduction of approximately 5%. We expect to deliver a modest uplift in profit in both written broking and in Travel.

Firstly, within motor broking, our guidance takes into account the trading conditions during the second half of last year. Our recent trading experience in terms of improved retention from Q4 2017 and the net revenues being generated per policy support this guidance as well as a lower rebased cost base in our Retail Broking business.

Overall, our experience year-to-date in the motor market has been consistent with the comments from the broader industry with price rises flattening out on average. We believe that this is reflective of trends of falling claims frequency and moderating severity that we have talked about previously. We do expect the overall profitability in the market to remain good, and we are comfortable with these trends and are confident in our ability to compete in this environment. One final point on motor is that the material premium inflation seen in 2017 resulting from both the Ogden changes and IPT will ameliorate clearly in 2018, which should prove beneficial for our retention levels.

For home, we are also expecting a continuation of current market conditions, and we have seen some limited premium inflation in the market. Again, our recent trading is consistent with the guidance. Other broking has remained robust and our ongoing claims performance in AICL again is supportive of our expectations.

For Travel, we will be mainly sold by the end of April for this year's departures. So, we already have a lot of visibility on the outcome for this part of the business. In summary, the group guidance provided is supported by what we're seeing in the market and how we're currently trading across our different lines of business.

Okay. So, this slide shows the written performance in the different business lines within Retail Broking. Starting with motor on the left-hand side, profit has increased, as I said earlier, from £28 million to £39 million. This resulted from the strong premium inflation that we saw during the first three quarters of 2017, combined with a lower level of claims inflation. We benefited from our underwriter, AICL. In our view, pricing Ogden - the Ogden impacts effectively. Profit per policy increased strongly to £30 from £21. However, Saga-branded policies reduced by 3%, partially due to some of the effects of our Q4 trading.

Moving across to home broking, this remained a tough market with a continuation of what we saw during H1 and H2. Claims inflation continued to run ahead of premium inflation with ongoing escape of water issues. Against this tough market backdrop, our profit per policy reduced by 3%, and we traded some volume for value leading to Saga policies being down by 5%. Therefore, profits from this line of business were lower at £53 million compared to £58 million in the prior year.

And, finally, within the other broking, we delivered a robust performance, primarily from our PMI line of business. Policies were significantly down in travel insurance due to the issues already highlighted during H1 and added to by the severity of the hurricane season, which reduced longhaul policy sales in Q3 and into Q4. In aggregate, our written profit on our Retail Broking business increased by £5 million to £123 million year-on-year.

This slide breaks out the written to earned benefit during the year. The written to earned adjustment reflects our choice to move from more of an underwritten business towards broking, as well as the impacts of the introduction of the arrangement fee. As mentioned in December, there have been benefits from written to earned since the point of IPO. Between the financial year 2017 and 2018, the written to earned benefit reduced from £20 million to £7 million. There were two contributing factors to reduction. Firstly, £6.6 million was from the increase in deferred broker revenue on policies underwritten by AICL with the increase in the average premium earned. And secondly, £6.5 million from the arrangement fee impact, which commenced in November 2015 unaffected only the previous year. So, there's no impact from the arrangement fee in the written to earned at all in the financial year 2018.

The reduction in written to earned benefit has been marginally greater than guided in December. That is because it is very difficult to precisely model the outcome given that it is affected by the number of motor policies, who underwrites them, the level of net revenue per policy, movements in the cost base, which are deferred as part of the deferred acquisition costs.

The outcome is mathematical and objective and mirrors what is within the accounting standards. We do expect the written to earned benefit to reduce in the current year that we are in, and settle at a small positive or negative number depending on the interaction of those aforementioned factors.

So, coming onto our underwriter, AICL, as we've said previously, AICL targets on the current underwriting year a 3% return on premium, plus an investment return on our equity capital. To the extent that we can deliver consistent performance metrics, our in-year profits from this business should remain relatively constant. We have delivered another strong year from AICL with profit increasing from £77 million excluding the impact of Ogden in the previous year of £4 million to £79 million.

Revenue is marginally ahead year-on-year from a combination of lower policies underwritten more than offset by an increase in net revenue per policy. Pure combined operating ratio improved by 2 percentage points to 97% benefiting from the positive experience on the business written in year. Reserve releases were £60 million compared to £63 million in the prior year, driven again by our excellent claims management and further positive experience on small and large PI. And the combined operating ratio remained at 71%. Excluding reserve releases, our underwriter made a profit of £19 million compared £14 million in the prior year, also benefiting from some realized gains on investments. The group has seen improvements in claims frequency over the last year and we continue to expect reserve releases to gradually decrease over the coming years.

This slide shows the accounting impact of quota share on the reported revenue of the underwriter. Reported revenues reduced year-on-year from £112 million to £99 million, and the net cost of quota share was around £2 million in the year.

The key point in this slide is the new quota share arrangement covering 80% of the underwriting risk, and this will be split between two reinsurers from the 1st of February 2019, when the current arrangement expires. This new policy will be on a three-year rolling basis and will enable us to retain a relatively capital-light position in AICL and supports ongoing dividends from AICL payable to group, giving more certainty over future cash flows.

Solvency II position. Our solvency requirement at the 31st of January 2018 had reduced to £80 million from £103 million a year earlier. And this has benefited from our claims experience and the ongoing impact of the quota share. We started 2017/18 with £147 million of available capital and reduced this by the end of the year to £137 million of available capital. Over the same period, our solvency capital ratio increased from a 143% to 171%. This is marginally above the level that I would expect it to be at going forward. This robust solvency position gives further support to dividend payments from AICL in the coming year. And we paid a dividend from our underwriter of £70 million during 2017/18 from the combination of post-tax profits recognized in the previous year and the reducing solvency requirements.

So, moving on to Travel. We had another good year in Travel, delivering a 37% increase in profit. Travel revenues overall were up by 4%, with increases in both tour operating and cruise. Firstly, just considering tour operating, revenue did grow from a mix – from an increase in the average selling price, increasing from a mixture of Fx and mix shift, offset by 3% reduction in passenger volumes, approximately half of that passenger volume reduction was due to the Monarch insolvency. So, while gross margins were lower due to Fx and costs associated with the Monarch insolvency, lower operating costs and marketing costs meant that profit increased by 20% to £14 million. As previously communicated, the Monarch impact cost around £2 million in the year.

Cruise profit nearly doubled to £7 million with lower maintenance days compared to year before, lower fuel costs, and some operational efficiencies. This profit uplift was after more marketing spend for the first season of Spirit of Discovery. And while cruise will have more operational days in the current 2019 financial year, higher hedged fuel prices and marketing on both of the new ships will restrict the profit growth compared to 2018. One other point to mention is the financing of the second ship, which has been secured at an all-in cost of approximately 3.3% fixed in sterling for 12 years from the delivery of the ship in August 2020.

We show on this slide the profits associated with the emerging businesses and central costs. In aggregate the emerging businesses delivered a consistent year-on-year profit of around £1 million. And we are developing some opportunities within Saga Money, which we believe could grow this business to the extent that these are likely to become material, we will update you at the right time. We continue to progress with the healthcare pilot. And, again, we'll update you in due course on the progress of that pilot.

Central costs reduced year-on-year, partially benefiting from lower bonus accruals. The IAS19R pension charge, which was disclosed and talked about at the half year, for the full year was £4 million higher than the year before. This is an actuarial non-cash charge based on the opening pension scheme deficit. We expect this charge to be relatively minimal in the current 2019 financial year. Finance costs again reduced with lower net debt, as referenced earlier.

Okay. So, we've included a few slides in here to explain how we look at the debt and hopefully to help you better understand this debt profile going forward. This slide looks at our debt, excluding the ship debt and excluding any profit or cash flow from ships in the forward view. Our debt has reduced, as we've said, from 3.1 to 1.7 times at the end of January 2018, and we expect this group level of debt to continue to reduce to very approximately 1 time over the next few (00:30:53) years.

Coming up to next slide. Okay. So, the two ships that we have on order have been funded with asset-backed finance, which is 12-year amortizing debt at low long-term rates of interest. This debt will give us a temporary elevation in the leverage of the Travel business. We have previously guided that we expect each ship to deliver a PBT of around £20 million. This is equivalent to an EBITDA and free cash flow before interest of between £40 million and £50 million per ship per annum.

Therefore, the free cash flow from the two ships of between £80 million and £100 million per annum will enable us to rapidly de-lever. And we have confidence in generating this cash flow evidenced by the booking for the first season of Spirit of Discovery when we are more than 50% sold, as Lance has touched on for the itineraries on sale, at rates that support this level of profit and cash flow.

Each of these debts is only tested one year after their drawdown, which is standard for asset-backed finance. These covenants are tested at the Travel level first, and then, at group only if they are breached at the Travel level. However, we expect there to be a minimum headroom of around 75% over the Travel level covenants. So, we are very comfortable with the covenants on this debt.

While the leverage of the group temporarily increases, we are looking at each of these two debt peaks when we have taken on the debt, but have not benefited from the asset's EBITDA or the positive cash flow impact on debt. And with the EBITDA of each ship, as I said, expected to be £40 million to £50 million per annum, the denominator in that leverage calculation will increase rapidly just from the impact of including the ship EBITDA in the previous 12 months. We do not expect the group's overall leverage ratio to go above 3 times. And we expect it to reduce back below 2 times around 12 months after the peak in January 2021.

One other way to look at this is, if we consider the pro forma debt at the peaks including what we have expect – what we would expect the EBITDA to be in the backward-looking calculation, our average – our leverage would actually remain below 2.5 times at all points.

Okay. The group's cash flow is made up of free cash flow from our Retail Broking business less the cash outflows to pay for central costs, plus dividends paid from the restricted funds of our underwriter, AICL. We have taken no dividends from the restricted funds in the Travel business in the last two years as these are retained profits, which are being used to fund the deposit payments on the ships out of the Travel businesses. Once the second ship is delivered, dividends will resume from the Travel business into group.

Dividends received from AICL in the previous year of £115 million were elevated and included capital reductions after the introduction of Solvency II and the first benefits of that quota share arrangement being put in place. And the positive movement in working capital is actually due to changes in the written to earned position. And an important point is that the written to earned is a non-cash item. And as we consider the guidance of a reduction in group profit from 2017/18 into 2018/19, the element associated with the lower written to earned benefit will have no impact on cash. We do expect available operating cash flow for this year to be between 70% and 80%.

Okay. The payout ratio of dividends underlying EPS was 65%. Looking at this compared to our operating cash flow, we have a payout ratio of about 74%. This equates to coverage of 1.4 times in the current year. This cash flow has enabled us, as I said earlier, to pay a strong dividend during the year and to reduce net debt. And we expect the stability of our highly cash-generative model to support further reductions in net debt, excluding that ship debt and ongoing payments of dividends.

Okay. Final slide for me, we are maintaining our guidance as laid out in December with underlying profit for the year expected to reduce by approximately 5%. Uplift in profits, on the right-hand side, will come from the underlying profit growth across the business, a reduction in the IAS19 (sic) [IAS19R] (00:36:21) charge and obviously the £10 million of cost savings as well.

In terms of the specific right-hand bar, the £10 million to £15 million, the drivers of this are as follows: firstly, we have clear visibility, as I said earlier, on Travel, excluding our incremental volume investment and clearly with no repeat of Monarch coming hopefully in the current year compared to last year. We have reductions in group costs from pension charge and finance charge, which is incremental to the cost savings of £10 million shown here.

And in terms of our retail broker, while our revenue assumptions are sensible year-on-year, we have efficiencies and other savings, which sit outside the £10 million, for instance, the first cost benefits from Guidewire. These collectively are expected to deliver a small improvement in the written profit of the retail broker, excluding that investment for growth. Offsetting these uplifts, we obviously have the lower expected reserve releases, a reduced written to earned benefit, and the

£10 million investment in customer growth split roughly equally between Insurance and Travel. And we expect this - we expect to continue to reduce net debt.

So, as you'll be aware, this is my last results presentation for Saga. I have had a fantastic three years with the company. I think that the team have achieved a hell of a lot over this period. And it has been a real privilege to work with the team, with Lance, and everybody else in the business. And I firmly believe that I leave the company in a better position and in better shape than when I arrived. And I am absolutely confident in the future of Saga with the team we have here in place.

And one final point is, I am still going to be here for six months. So, this lot will still have to put up with me for that long. And during this period, I am fully committed to driving the business forward.

I'll now hand over to Gary.

Gary Duggan {BIO 18331803 <GO>}

Good morning, everybody, and thanks, Jonathan, for the introduction. It's a pleasure to be here today presenting to you all for the first time. I've been with Saga now for six months or so. And I'm delighted at the opportunity to work with Lance and the team at this really exciting period for the business.

I've run a number of insurance businesses for many years now at Barclays, Towergate, and more recently at Junction which was BGL's partnerships business where I managed the portfolio of home and motor broker businesses, including Lloyds Banking Group, M&S Bank, RAC, Post Office Insurance. And it's an act to experience that leads me to believe that Saga has all the core attributes that any broker business needs to win and more.

In terms of these trends, Saga has excellent brand presence in the over 50s market and is ideally positioned to win in a demographic that represents roughly half of the UK home and motor insurance market, and is forecast to significantly grow over the next 20 years. We have significant scale in the market, with roughly £600 million worth of GWP and 2.8 million policies. We have a recognized and trusted brand, high-quality products and services, extensive customer insight into our demographic, and a direct marketing engine that combine to give us competitive advantage in the broker market.

It's the combination of these strengths that is reflected in the fact that the vast majority of our customer acquisition is sourced through direct channels, typically at lower costs than many of our competitors, who are often more reliant on price comparison websites.

Another strength is the fact that once recruited, our customers are extremely loyal. Despite the introduction of the renewal transparency rules and the quarter four challenges that Lance has highlighted, retention levels in the past financial year remained at 75% for home insurance and 65% for motor, significantly higher than others that I've seen in the industry. I think that's due in part to the quality of the products and services that we offer and the broader relationship that we have with our customers.

Saga also has a flexible supply of underwriting capacity from across its products, from the solus arrangements that we have with two highly regarded and specialized insurers on PMI and Travel through to the broad underwriting panels that operate on home and motor. Having an in-house underwriter sitting on both our underwriting panels helps to drive competitive attention onto the panel and it provides us with some real flexibility. I think this was demonstrated actually through the Ogden rate change period when some of our panel members increased prices more aggressively and our in-house underwriter picked up some of the slack during that period. And then, as prices began to soften, then the panel came back and we started to see panel share increase again.

If you speak to any insurance broker these days, they will tell you how critical data is to secure competitive underwriting capacity. A broker who needs to be able to demonstrate that to provide the underwriters with more predictive data than other brokers in order to demonstrate the value add that we bring to the relationship. Because, we have the broad and deeper relationships with our customers and our members is this relationship that enables us to provide better data than many of the brokers operating in our demographic which also ensures that we have a more competitive cost of risk. So, my observations are that Saga has some real strengths that all the brokers don't have.

Having said that, there are areas that require some real focus and improvement. So, whilst the motor panel has been successful in writing business in specific segments of the market namely older customers, lower mileage, safer drivers, we haven't expanded the footprint as widely as I would like. In my experience, it often takes underwriters sometimes to become confident in the underwriting performance before they look to expand into other segments in market.

In addition to which, an observation of mine is that Saga has a pretty low profile in the insurer market and has sometimes been reticent to share some of our market intelligence to help the underwriters. And, frankly, this has resulted in a more cautious approach to some of the net pricing decisions by some underwriters on the panel, on the motor panel. And as a consequence, I think, as Lance mentioned earlier on, the panel has taken longer than originally anticipated to develop.

In addition, the legacy platforms and the complexity that exist within the organization has restricted our ability to innovate in recent times. In addition to which, a larger number of low-value products, multiple promotions, et cetera, have created some added complexity over a number of years now, which I believe has slowed the business down and resulted, to some extent, in some inefficiencies.

Now, if we turn to some of the opportunities for the businesses I see to grow our broking business. Lance mentioned some of the targeted investments that we're making in price and in marketing to acquire more customers and members. We will be using a combination of the new Adobe tools and the learnings from the work that we're currently undertaking to grow our customer numbers, including our high-affinity customers. As Lance mentioned, the early signs are that this is working. And as I expected, we now have some real momentum in growing our new business volumes.

Building on our already market-leading retention rates is also another key focus for me. Possibilities, the membership scheme, is driving increased engagement from across our membership base. And I'm confident that this, along with the product innovation that we will gain from Guidewire, will help to support high retention from across our insurance products over a period of time. In addition, I'll be working firstly with our existing insurers to grow the footprint and obtain more competitive net rate pricing. We're currently in the process of sharing more data with the insurers, which we hope will support our desire to grow our business and expand our footprint.

And, secondly, we're also advancing other areas of our footprint where we don't have the right amount of competitive tension. And we're in the process also of identifying underwriters that we could add to the panel, who will complement the existing panel members, allowing us to win more business across the wider section of our market.

And, finally, I'll be focusing on simplifying the business model to ensure that we are operating as efficiently as possible. We've made some changes recently to re-baseline our costs, and the next steps are to leverage the Guidewire platform, to streamline our customer journeys and to improve our contact center efficiency further.

Ultimately, my goal is to use these two new platforms to help create the capacity for growth without significantly increasing our cost base. So, six months in and I like what I see. We have all the key components required to make this business a really successful broking business. And I remain confident in our ability to deliver that strong growth story that Lance outlined earlier on.

Okay. Thank you. And, now, I'd like to hand you back to Lance to complete the presentation.

Lance Henry Batchelor {BIO 6884486 <GO>}

Thank you very much, Gary. Earlier on, I focused on the company's performance since IPO and especially on last year. Now, let's look ahead. The time is now right to invest in growing our customer base. Why now? Firstly, we've replaced the majority of our IT systems. Secondly, we've put in place excellent digital CRM marketing systems. Thirdly, we've successfully launched membership. Fourth, we've got the new ships coming. But also, pragmatically, we've carved out £10 million of investment headroom to actually invest in growth. That's £10 million on top of our normal marketing run rate of about £60 million a year.

About half of that investment is going to drive insurance broking policies, which has already began. And the other half will go to drive new Travel volume across the year. The goal is to take a customer account which has been flat to gently declining over several years and tip it up gently onto a growth path. And there are early signs of success from our investment in motor and home broking. We are delivering new customers. Let's be clear, it's only two months in, and we're only looking at one metric here, which is new customer broking, but it's very encouraging nonetheless.

Travel is expected to be a slower burn. We'll see the impact of extra investment across Travel over the whole year. And in particular, the big delta in investment spend will be in the second half. Again, let's not get carried away here. It's early days but it confirms our view that our retail pricing is now in the right place and that Saga can attract new customers when the pricing is right.

I've highlighted the various elements that have come together to give us the confidence to invest in growth. An important backdrop to that is the real momentum of our new membership program, Saga Possibilities. We now have over half a million members. Over 80% of the customers that we talk to have chosen to activate their membership and a high proportion of those then start to interact with the brand. It's a real example of how we're driving customer engagement and ensuring that we remain clearly differentiated in our knowledge and our understanding of the over 50s. In the longer term, we expect to see a positive impact on churn rates and on cross-sell as the program matures.

What could the future look like? Well, how should you expect to see Saga's earnings evolving in the years to come? We have flagged that reserve releases will decline gently over time as the historic high reserves flow through. Now, it's notoriously hard to predict exactly how fast they will decline. And where they'll eventually settle will depend on exactly what the panel share looks like and the size of our overall broking business and so on. We have an excellent underwriting business. I have no doubt it will continue to make good profits and reserve releases too. But that will be at a lower level of reserve releases than today.

We're now investing in growing our broking business. I expect that business to gain momentum as extra policies become profitable over time and the panels mature. And there will be really significant growth in our Travel and Cruise division as the two new ships come on stream. We said last year that we are targeting a five-year PBT level for the whole Travel and Cruise division of over £60 million profit and that remains our firm intention.

So, if you look a few years ahead, what you'll see is less dependency on reserve releases much more from broking, as the investment that we're making becomes profitable. You'll see much more profit from Travel, a substantially higher quality of earnings, more diversified earnings. Also I'd like to say, the pie will get bigger and better.

So, in summary, after four years of investing in IT membership, the marketing platform, Saga is now ready to start growing customer numbers. We have absorbed the lessons of quarter four last year. Our pricing is now where it needs to be. We're investing in growth. Our cost base has been reduced by £10 million. It's still very early, but there are signs that it's working. Motor and home broking, new customer count is up. The progress that we've made with Saga Possibilities shows that we're not standing still. We're developing a differentiated relationship with our customers that only Saga can do.

Our business model remains highly cash-generative and of increasing quality. I've been the CEO of Saga for four years now. I'm more excited now about the potential of this great British brand than I have ever been, and it really is a great business. It's a hugely recognized and respected brand, totally focused on the fast-growing over 50s age group. We've got a great team at Saga and I believe we have a very strong plan for the future.

So, we will now turn it over to you to take questions. If I could ask you to ask for the mic, tell us who you are, and I'll direct the questions around the team as appropriate. Ben?

Q&A

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks very much. It's Ben Cohen at Investec. I had two questions. Firstly, back on slide 33, in terms of the new business growth that you will – that you've seen in the first couple of months of the year. Could you maybe go into a bit more detail in terms of where that has been coming from whether that's a sort of a panel element? How much you think relates to the investment? And maybe you could give some sort of forward-looking element in terms of how sustainable those growth rates are through the course of the year.

And the second question I had was just on the level of realized gains in the underwriting business. What would you see is a normal rate of gains to be to be taken through there? What would your – what sort of implicitly in your outlook if I could ask for that detail? Thank you.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

I'll take the first and then hand the second one to Jonathan. Look, Ben, I'm going to slightly duck your question and I don't want to say too much about where we are gaining our share at the moment. I don't want to give away too much competitive information about what Saga is doing well in the market at the moment.

And in terms of a forward-looking projection, I think I can only say it's captured within the numbers that Jonathan has described for the year as a whole. I want to focus your attention on the fact that the numbers you saw were new policy only for home and motor. So, that doesn't take into account the churn rates and so on. It's an indication that having got the pricing correct, we are able to attract new customers and so it's a fairly narrow cut on the business at the moment. But it does demonstrate that when we get the pricing right we can win in the market.

But apologies, I'm not going to give a forward-looking projection on how that comes out. I'll remind you of the phrase I used earlier, which is that our goal is to take a base that has been declining gently over several years and tip it into gentle growth. So, we're going for gentle growth and an investment of an extra £10 million on top of the £60 million marketing budget is a modest increase, it's not a dramatic change of direction. Jonathan, second one.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

Yeah. And I – the one thing I would add here is that obviously Gary is looking at the market circumstances he has before, and then he's confident in terms of the payback models he's working with in terms of the market circumstances he's playing with in terms of that new business. So, it is good quality new business that we're bringing in.

And on the others, realized gains are only worth what is – what asset movements make them at any point. So, I wouldn't assume those going forward. We had a low-single digit million gain on some investments during last year, but I certainly wouldn't bake them in going forward.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Thanks, Ben. Andreas?

Q - Andreas van Embden {BIO 1795530 <GO>}

Andreas van Embden, Peel Hunt. I have three questions, please. One on the – you're breathing new life into the footprint expansion strategy. I think at the time of the IPO when we looked at the business, AICL had a 25% footprint, which was basically AICL plus the Saga broker. And you've got a panel with new members. When you look at the business, Gary, where do you think the footprint should move towards not describing any niches or (00:56:21) giving away, any of sort of competitive items but could this footprint go towards 50% of the over 50s market, 75 or higher, could you just give a view around that?

Secondly, you mentioned that panel was immature. How many new panel members would you need to make it efficient and competitive?

And the final question is on the terms and conditions in the panel, have you looked at those, how the panel members operate and compete with each other in the panel, and would you look to change some of those terms and conditions at which panel members operate particularly on attacking the renewal book of AICL which has been, I think, an issue? Is there something you can do about that? Thank you.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Andreas, I just want to define one question, if I may, the first one around footprint and 25%, I think what you're referring to there is the rough conversion rate that we were getting on inbound quotes. And what we said at the time we launched the panel was that in three-quarters of the cases where a customer approaches us asking for a quote, we were unable to quote competitively because our focus was so tight in such a small part of the market. And so, I don't want to put words in your mouth, but I think you're asking how much could that grow by over time. Happy to hand over to Gary.

A - Gary Duggan {BIO 18331803 <GO>}

Yeah. I think in terms of the footprint, as I said earlier on, we are very competitive, over 65s, same drivers, low mileage. So, clearly, the opportunity designed in the 50 to 65s maybe driving slightly more miles and those kind of customers. So, that's I think one area of the footprint expansion and consistent to where we clearly need to focus on.

In terms of the number of members on the panel, it isn't just about numbers of the members on the panel (00:58:12), so it is a combination of driving more value out of the existing insurers as I think I mentioned earlier on. We did a lot work with the existing panel members to provide them with more data that enables us to understand where we are not competitive and kind of question to them is kind of where are we converting. And so, we're providing them with that information. Now, we can do some analysis and intelligence talks on where we're not converting, why we're not converting, and what we can do about it to recruit more of those customers.

Though there will be, as it always are, niches, elements of the business, which is kind of typically and maybe higher premium business even in that segment where there will be insurers that will specialize in that area of the footprint that we'll be talking to and hopefully (00:59:01) the panel. What we haven't got a specific target on is 1, 2, 5, members who would want to bring them onto the panel, we're just identifying those insurers that will complement the panel members that we've already got at the moment. And getting those guys and hopefully, at some point, bring them on.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Sorry. I hope you've all heard that. In terms of the T's and C's, I think the message is just that we are looking to be maybe more flexible in terms of the way in which we construct the insurer arrangements. And I think that will bring some benefits to us as well in terms of how we structure the arrangements with the insurers. I think I'll just go as fast as (00:59:40).

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

I mean, is it worth just picking up the point that at the minute, it's about their appetite and desire to allocate capital into the areas of the market they are supporting us in and put more heft behind that. So, I think competitive tension is going to come from that. We've talked previously about the home market taking four to five years to really get up to maximum efficiency. We're two and a bit years into the motor panel.

And as Lance said earlier, we haven't got as far as we wanted to. We hope we might get that competitive tension up quicker on the motor panel than we did under home because home was our first panel. And we probably haven't got as far as we want in terms of working with those things, the other insurers – I don't think it's a T's and C's issue. I think it's a mixture about us working with those people in partnership and, secondly, them saying this really is somewhere a growing business run by Gary. We really want to put some capital in there and get this business moving forward.

So, there's a range of moving parts in there that I think will ratchet up the tension, the competitive tension, and hopefully get us a broader footprint and better net rates.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Any more questions?

Q - Greig Paterson

Morning, everyone. Greig Paterson for KBW. Three questions. One is, these two FCA investigations, one into competitive of brokers the other one into a number of products, Travel and motor add-ons. I wonder if you can talk about the risks to your broker plans from that.

The second thing is, in terms of quota share, you used – you've mentioned the term rolling three-year. I wonder if you could explain exactly what you mean by that. And the third question is, this is in terms of the panel, do you currently have a real-time price elasticity conversion rate machine up and running? That's my question.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

Shall I take the second one first?

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Yeah, go ahead. Yeah.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

It basically means that at all points there is three years left in the policy. So, if we get two years into the policy, there's still another three to go until one of the parties serves notice on the other. So...

Q - Greig Paterson

(01:01:58)?

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

I'm not going to go into the specific details. It'll be done in three-year termination chunks. So, there will still be, and then there'll be a potential stub period at the end of one of the three-year periods. But it's all straight forward. It's in line with other rolling quota share arrangements.

Q - Greig Paterson

I don't think it is that's why I asked the question.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

Okay. So...

Q - Greig Paterson

Could you (01:02:21)?

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

We don't publish the details of the commercial sensitivities around the quota share arrangements specifically. But what you should expect is that at any point, we will let you know that the quota share arrangement is still running in a three-year forward basis as we go forward. And if there's a termination, we will let you know that we have now three years to find somebody to replace the party that has served notice either us on them or them on us. So, it gives us certainty over – at all times, over a three-year period. And if there is a termination, then we've got three years to find somebody to replace them. It just gives us an ongoing certainty and an ongoing longevity to that quota share arrangements, which we didn't have in the first one, which is just a three-year cliff edge effectively.

A - Gary Duggan {BIO 18331803 <GO>}

As far as the – sorry, it's not working then. As far as the response to the FCA investigations (01:03:17) et cetera into add-ons is that we have a – I think one of my observations that (01:03:22) is that Saga actually has a very positive, very proactive relationship with the regulator, it meets on a quarterly basis proactive engagement basis (01:03:31). And we have responded then to every element of regulatory challenge that we've been faced within the past, and we will continue to do so in the future. I don't think there's much more to be said on that.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

The only thing I could add to that is that our dependency on things like motor add-ons is far lower than many other insurers. We have never aggressively upsold add-ons in the way that some insurers have done because, we're into long-term relationships with our customers. And so, making a fast buck by selling something to somebody that they don't really need makes no sense for Saga at all. What we want to do is to build relationships with our customer base that lasts, ideally, for decades, and then, trade them on later on into cruise ships and so on. You can't do that if you missell add-ons. So, we've always been very cautious and conservative about that, and a much smaller proportion of our P&L comes from that than most of the other big insurances.

Q - Greig Paterson

(01:04:32).

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Yes.

Q - Greig Paterson

(01:04:33)

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Yes.

Q - Greig Paterson
(01:04:34)

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Yes

Q - Greig Paterson
(01:04:35)

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Yes.

Q - Greig Paterson
How long they've been in place?

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Well (01:04:40)...

A - Jonathan Stanley Hill {BIO 16892113 <GO>}
Many...

A - Lance Henry Batchelor {BIO 6884486 <GO>}
... (01:04:41).

A - Jonathan Stanley Hill {BIO 16892113 <GO>}
Many years...

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Many, many years.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}
Many years. The pricing elasticity model is in place.

A - Gary Duggan {BIO 18331803 <GO>}
Yeah. An in-house built model, but obviously, it's based on detailed customer insight from our demographic that's built and built of over a long period of time.

A - Lance Henry Batchelor {BIO 6884486 <GO>}
Any more questions, please? In the middle here.

Q - Charles Eden {BIO 19069384 <GO>}
Hi there. It's Charles Eden from Bernstein. Just a question on the Travel spend, the sort of £5 million you talked about there. Can you just give us a more color on, is that primarily driving new

customers from existing insurance customers, i.e., cross-selling, or is it really expanding more broadly in the market, bringing new Saga customers who don't buy any Saga product currently?

A - Lance Henry Batchelor {BIO 6884486 <GO>}

It's an interesting philosophical question for us. So, the answer is, it's both. If you're running the Travel and Cruise division, then a customer who arrives from outside the franchise is new and, frankly, from your perspective, a customer comes across from Insurance is new as well. And so, if I'm Robin and I'm looking at my marketing budget and trying to work out the best place to decide where to invest, it's done on an ongoing basis, looking at both of those as an opportunity area. It's also a fantastic place for us to build the brand when we go external. So, if we're in a newspaper offering a great deal on a Saga Holiday, it's very, very good as a brand halo and it halos across into Insurance as well.

And the answer to the question is that the marketing team and the travel team have a couple of dozen ideas that they're going to be deploying across the year. It will bring customers in from both. We do actively want to go outside and bring in more customers into the franchise. The average age of a new Saga customer is about 61, for those who didn't have that number in front of them. And we're always looking for customers to refresh and take the business forward. Travel is a great way for us to do that.

Any more questions? Oh, one more there? Certainly. You go first. Yeah.

Q - Robert Rampton {BIO 20079733 <GO>}

Hi. Robert Rampton from UBS. First question, so you rebased pricing in October. Has retention improved from the 65% from that point?

The second question, if you could give a bit more color on how your Retail Broking policies are sold through distribution channels. So, last year and at 1H you saw less through price comparison websites than you had previously, and I'm just wondering how that's evolved.

And thirdly, in-home, so there's a number of players pushing into the home markets and the price comparison website distribution channels becoming increasing prevalent. I wonder how you are seeing these structural challenges and what your assumptions are by the market going forward. Thanks.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

I mean I'm happy to take each of those quickly. So, we did rebase our pricing in December. Persistency has recovered in both home and motor to a level that we're extremely comfortable with, and that's all I say about that.

On PCW, it slightly echoes back to a question earlier on. I don't want to say where we are at in the market gaining new customers at the moment. I don't want to give away to the rest of the market which channels we are using successfully to add volume. And then, on the third one, our dependency on PCWs in-home is very low. Only about 10% of our customer base in-home – of our new customers come from PCWs. So, it's a relatively small channel for us in that space. Thanks, Rob.

Any more questions? Yeah. (01:08:14).

If one perceives the quota share as additional debt, in other words, off-balance sheet or alternative financing of required capital. I was wondering what would your SCR go up by if you didn't have the quota share insurance in terms of millions of pounds.

That's your favorite kind of questions, Jonathan.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

I'm going to have that whatever lancet is (01:08:45). I will come back to you with the information. I mean, my view is that we put a three-year deal in place. We've now got a very long-term rolling deal in place. I see no reason to expect that that deal won't remain in place for a long time. Our underwriter does a fantastic job of delivering really great returns on a very consistent basis, and the rates that we think we've got and the deal we've got which you believe may be different than the market I think is a great deal we've got, and I think it's testament to the quality of the underwriter we've got. In terms of your specific question, I will have to come back to you separately on that sensitivity.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

It's worth noting that we've just gone from one underwriter (01:09:27) to two. I mean, that people want to do that deal and want to be a part of that.

A - Jonathan Stanley Hill {BIO 16892113 <GO>}

And also you'll have seen the names of the two quota share reinsurers in there. I mean, they are absolute two of the top three or four in the world. So, we've got the top guys wanting to be on that ticket, which is absolutely fantastic.

A - Lance Henry Batchelor {BIO 6884486 <GO>}

Anymore? Is there any more? Otherwise, I will thank you all very, very much for coming along and listening this morning. If you have any follow-up questions, please come to us. And we'll see some of you while we're at on the road. Many thanks, everyone.
