Q1 2015 Sales and Revenue Call - Interim Management Statement

Company Participants

- John Reizenstein
- Paul Robert Geddes

Other Participants

- Andrew J. Crean
- Ben Cohen
- Dhruv Gahlaut
- Fahad U. Changazi
- Greig N. Paterson
- James A. Shuck
- Ravi Tanna

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Direct Line Group 2015 First Quarter Results. At this time, all participants are in a listen-only mode. There will be a presentation, followed by a question-and-answer session. I must advise you that this conference is being recorded today, Wednesday, the 6th of May, 2015. I will now like to hand the conference over to your first speaker today, Mr. Paul Geddes. Please go ahead, sir.

Paul Robert Geddes {BIO 2474781 <GO>}

Thank you, and good morning, everyone. Welcome to our Q1 update. I'm aware it's a really busy morning for you. So, we are going to keep it quite brief today. In line with the approach back in Q3, there's no formal presentation. I'm going to take you through a brief update on business highlights and run through the headline financials before taking your questions. As usual, I'm joined by John Reizenstein and other members of my team.

So, starting with business highlights. For the full year, we told you about the re-articulation of our strategy and our strategic objectives for 2015. Although it's only been a few weeks since we last spoke, we made a strong start in the first quarter against our mission to make insurance much easier and better value for our customers. Our focus on being a great retailer through making our products easy to buy and getting it right first time continues, and we've delivered further improvements to our trading capabilities.

First, following the rollout of our new quote and buy journey for Motor last year, we briefly overhauled the journey for our Home customers, and this will roll out as we go through the year.

Secondly, we made further enhancements to the Direct Line proposition in the quarter, including removing amendment fees for all Direct Line-branded products, including Direct Lines for Business. We believe this change further differentiates Direct Line as a market-leading brand.

Thirdly, having launched new customer experience programs, I'm pleased to report that we've seen an increase in our net promoter scores and a reduction in the level of our complaints. In addition, we continue to get industry recognition for our approach to social media.

The combination of better customer experience and improved propositions has led to further increase in our market-leading retention rates across both Motor and Home own brands.

We're also busy behind the scenes working on the next generation of customer systems, including Guidewire Policy and Billing, and we expect to be ready to begin deployment in the first half of 2016.

Finally, a quick update on the sale of our international business. Regulatory approval is ongoing, and we hope the transaction will complete sometime during the second quarter. And as a reminder, following completion, we expect to return substantially all of the net proceeds to shareholders and that the return will be conditional on a share consolidation.

So, now, for an update on Q1 trading, and I'm encouraged that we've made a good start to 2015 with a stable trading performance in competitive markets. Gross written premiums in the first quarter totaled £746.5 million, which is less than 1% below the same period last year. Total policy count was also fairly stable with a small 0.8% reduction in the quarter, but more importantly, Motor and Home own brands were flat.

Now, some color on segmental performance, starting with Motor. For the full year results, we said that we've seen some additional market pressure with one major competitor cutting rates significantly at start of the year. But towards the end of the quarter, we did see a modest improvement in the trading environment, but there remains more significant evidence of sustained market premium rates increases in excess of long-term claims inflation.

In terms of our performance versus a year ago, our risk adjusted prices were up around 3.6%. As we said at the full year, we continue to trade the market as we find it and grow where conditions allow, as we did back in Q4, or indeed pull back to protect value.

The combination of the mixed market conditions and our trading discipline meant we were able to hold policy count and premiums relatively flat in the quarter, a better outcome than what I was expecting when we last spoke in early March.

While I'm on the subject of Motor, let me share some observations about claims. In 2014, we highlighted a 2.6 percentage point increase in the Motor current-year loss ratio due to volatility in large bodily injury claims. This 2.6% increase was split roughly two-thirds due to very large claims, those over £1 million, and one-third due to claims falling between £100,000 and £1 million.

For the very largest claims, e.g. those over £1 million, the 2015 accident year-to-date appear to be tracking below the levels we saw in 2014, where the claims between £100,000 and £1 million have remained at elevated levels. These comments relate to 2014 and 2015 accident years only. On the older years, assuming current claim trends continue, we would still expect to see a significant contribution from prior year reserve releases.

Moving on to Home, where we said at the full year, the picture was a little more stable, our own brand policy count remains flat for the second successive quarter, and we continue to see strong retention rates across our own brand portfolio. New business pricing in Home was down again in the quarter, although not by as much as we've seen previously. In terms of Home claims, it's been a steady benign quarter with around £5 million of weather-related claims compared to £60 million in Q1 last year.

Rescue and other personal lines GWP was up 8% against prior year. Within that, it was another good quarter for Rescue, which grew by policy count and premiums, with GWP up 6% versus the prior year. Finally, Commercial saw headline GWP down 2.5%, while IFP is up 1% in the quarter. The reduction in GWP was primarily due to the loss of two large regional pieces of business where we continue to see good growth in Direct and eTrade. Direct Line for Business, excluding van (06:16), premiums are up 8.8% versus the prior year. So, I'd sum up the segmental trends overall as stable.

Turning to costs, we continue to make good progress to reduce our cost base with total costs, those including claims handling expenses, of £221 million, a 10% reduction versus the same period last year. It was a particularly good quarter. We don't expect to maintain the size of (06:42) in future quarters, but we'll reiterate our aim to reduce costs in absolute terms for the year as a whole.

Total investment return for the quarter was £51.8 million compared with £55.7 million in Q1 last year. We have income of £41.3 million, which represents a yield of 2.4%, up 10 basis points compared with the prior year.

So, to wrap up before questions, it's been another quarter of stability across Motor and Home own brand IFPs, with Motor premium strapped (07:13) versus the prior year.

The personal lines, Motor and Home markets remain competitive, and against this backdrop, we are still busy improving our propositions and capability. Costs were down 10% in the quarter, and we remain focused on reducing the total cost base in 2015. Taking all this together, we reiterate our core guidance of 94% to 96%, assuming normalized weather and Commercial large (07:39) losses. As we said at the full year, that spread represents uncertainties surrounding claims inflation versus market pricing in Motor.

So, that's all I have to say before questions. Let me hand back to you, operator.

Q&A

Operator

Thank you. And our first question today come from the line of Andrew Crean from Autonomous. Please ask your question.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Hi, Andrew.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Hi. Good morning. Good morning, all. Just a quick question. When you guys talk about stable trading performance, that in my mind, I don't know whether I'm right or wrong, I mean sort of roughly flat profit. We don't get quarterly operating profits, but I mean, roughly speaking, on average, they'd be about £125 million. If you're talking about flat profits, yet there's a sort of £55 million difference in the weather claims, is that how we should read the situation or am I misreading it?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. I mean trading is trading, so it's more a reference to kind of top line than profit. It's not a profit reporting quarter. In terms of the weather, John, do you want to talk about how we take the weather?

A - John Reizenstein {BIO 6786139 <GO>}

Well, obviously, (09:08) said 94% to 96% core for the year excluding weather. And that will be chucked back (09:12) as we always are about that.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Okay. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Thank you.

Operator

The next question comes from the line of Greig Paterson from KBW. Please ask your question.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Good morning, gentlemen. Paul, just can you just remind me, you've got a large partnership and deal in Home that is coming up for renewal and likely to be lost. If you could just remind us what the contribution to the gross written premiums and – versus the contribution to the profit is of that distribution deal.

And in terms of Solvency II, just interested to understand what parts of your model are still being debated with the PRA. I mean, is it the diversification of credit? Is it the matching adjustment? Is it – whatever. I'm just trying to understand what's going on there.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. Thanks, Greig. So, yeah, at the last full year, we updated on Nationwide Building Society, which is under kind of retender, will go through that process. We have no news on that. We said at that time, 22% of our Home premiums but not 22% of our Home profit.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Do you know – I mean, is it 10%, 15%, 20%? What portion of the profit?

A - Paul Robert Geddes {BIO 2474781 <GO>}

We're not going to say, but not 22%. Less than 22%.

Q - Greig N. Paterson {BIO 6587493 <GO>}

(10:40)

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah, it makes contribution to fixed costs, variable costs, but, Greig, we're not going to say any more about that.

A - John Reizenstein {BIO 6786139 <GO>}

On Solvency II, Greig. I mean that we're in the process of validation. It's a long process with lots of aspects to it. I wouldn't want to draw any particular element. I can say that the matching adjustment is not something we're going for. But otherwise, we're just (11:04). We're not hit by any particular roadblocks, either in process or in challenge from the regulator.

Q - Greig N. Paterson {BIO 6587493 <GO>}

So, there's no particular parts of the model that is of interest, the run-off versus one year of VAR (11:19) or – I'm just trying to understand the transition from ICAS (11:24) to your Solvency II.

A - Paul Robert Geddes {BIO 2474781 <GO>}

They're after industry issues still out there that hasn't been fully (11:30).

Q - Greig N. Paterson {BIO 6587493 <GO>}

And what - could you just list those (11:31)?

A - Paul Robert Geddes {BIO 2474781 <GO>}

(11:32) one being emergence, which is what allowance you make for the risk to (11:39) as opposed to a year and a half. I mean, that's a sort of industry thing. And there are one or two others like that. But there's nothing specific we want to draw your attention to today.

Q - Greig N. Paterson {BIO 6587493 <GO>}

And the other two? For just our interest, what were the other two?

A - Paul Robert Geddes {BIO 2474781 <GO>}

(11:53) the one I mentioned. I mean, there are other industry issues out there that are - we could go - we could have a whole teaching on it, but they're not particularly specific to us.

Q - Greig N. Paterson {BIO 6587493 <GO>}

All right, Paul, no problem. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Thanks, Greig.

Operator

The next question comes from the line of Fahad Changazi from Nomura. Please ask your question.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Good morning.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Good morning.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Just had a question on claim inflation. You previously said against that 3% to 5% going forward, and you would hope to do better than that given all the sort of changes you've made. First of all, is it 3% to 5% which you're still expecting? And given you increased rate by 3.6%, can we assume that, going forward, you will at least match claims inflation for yourself? Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. I mean, 3% to 5% is our sense of long-term market claims inflation. And we reinvest to try and do better than that, and we think we've got some track record on that. And...

A - John Reizenstein {BIO 6786139 <GO>}

Over the long term.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Over the long term. And we - without - yeah, we will - within the sort of trading range, we will attempt to - we will seek to recover that claims inflation as we see it. And obviously, our trading choice is day-to-day.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Okay. That's fine. Thank you very much.

Operator

The next question comes from Ravi Tanna from Goldman Sachs. Please ask your question.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Hi, Ravi.

Q - Ravi Tanna {BIO 16926941 <GO>}

Hi. Good morning. Morning. Just a couple of questions, please. The first one was around small bodily injury claims. At the year-end, you suggested that you haven't really seen a material pickup in small BI frequency. And clearly, market data is suggesting that across the market, and a number of your peers have been suggesting that they are experiencing that uptick. I was just wondering whether that picture has changed at all.

And the second question is on Rescue and other. Just keen to understand how much of the growth in premiums there is actually kind of underlying growth per se as opposed to the re-pricing of the travel book that you've mentioned in there, which may be one-off, I'm not sure.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. So, listen, we're still pleased with the trends which we're seeing on large BI - small BI frequency, sorry. And again, we think we are - that's looking good versus the market comparatives. John?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. I mean, there was a bit of an uptick in January. I mean, these things are a little bit volatile. But our uptick was less than the market, we think. That's what we have in the data, and since then, we've come down, we think the market's, more or less, steady. So, we think we are doing better preening (14:43) month in, month out.

Q - Ravi Tanna {BIO 16926941 <GO>}

Great.

A - John Reizenstein {BIO 6786139 <GO>}

On the (14:46)

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. And on other ruffles (14:53), yeah, that's possibly what's driving it. The kind of annual price rise, which we put (14:59) on the travel book, which is kind of the nature of those deals that we have with our third parties, which is be able to price off of the (15:06) trends that we've seen.

A - John Reizenstein {BIO 6786139 <GO>}

But don't expect huge impacts on profit on that because a lot of it goes back to them and it's a small profit business (15:16).

Q - Ravi Tanna {BIO 16926941 <GO>}

Perfect. That's very clear. Thank you.

Operator

The next question comes from the line of James Shuck from UBS. Please ask your question.

Q - James A. Shuck {BIO 3680082 <GO>}

Good morning. It's James Shuck from UBS.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Hi, James.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi there. I have three quick questions, if I could. Just on the cost cuts. So, I think previously, you've indicated you're going for an absolute reduction in 2015 on the cost, and you're down 10% at Q1. Is that a sort of run rate we can expect through the year or is there sort of any seasonality in that number, I think, we should be considering as the year progresses? That's my first question.

Second question is just on the multi-policy count, in particular, own brands. Obviously, you're doing a lot to become more efficient, more competitive. You've indicated in the past that the signs of you getting better versus the market will be when your market share starts to grow, because you keep your own margins flat, and therefore, you become more competitive. So, I guess, my question is just around when we can expect the most growth to start to come through. (16:36) number there is now just stable. I would be expecting your competitive positioning to be getting better by now.

And then the third quick question was just on – I was interested in your next generation of customer systems, the plans for the first half of 2016. Could you just describe some of the bells and whistles that, that will enable people to do?

A - John Reizenstein {BIO 6786139 <GO>}

Okay. I'll start off on cost, James, John here. Yeah, it's a good start to year with a 10% reduction in Q1. But it's not such a simple story going forward. Quarterly costs are lumpy and can be lumpy, and Q1 2014 was a high-cost first quarter, as you'll remember, some of you, partly due to market, but also partly due to IT costs.

Q1 this year has been – we've had tailwinds on costs. We've had lower marketing costs and also reduced IT costs. So, there's been a very positive improvement in Q1. It will be tough to replicate the Q1 run rate across the year. But as you've said, and we'll repeat, we do aim to reduce costs in absolute terms this year. That's our statement, that's our aim, our target, and it's what setting our core guidance. We don't have any further specific cost target around that, but we'll carry on addressing our costs.

A - Paul Robert Geddes {BIO 2474781 <GO>}

And, I guess, on that, we deliberately didn't want a cost target for reasons we rehearsed, but this should be seen as a signal we don't need one to keep focusing on costs. Our Motor policy count, you stepped straight from us seeing decline in policy count straight to expecting growth. And I'm very happy that we are in this phase of a broadly stable policy count. Obviously, depending on market conditions, it could go down, it could go up a little bit from that. But I wouldn't step over stable being a decent place for us to be right now. And obviously, for the total picture to be stable, there's an awful lot of work, a lot of new policies, a lot of retention going on given the size of our book. So, I'm pleased with where the Motor is, but don't expect it is something to soar away up

(18:38) from my expectations, the market could obviously change that in either direction. But I'm broadly happy we're broadly stable as we have it.

Systems, we are building something fantastic, something pretty ambitious. That's why it's taking a while to do. Some of the headline pieces of that are – we talked about Guidewire, completing what we've got today, which is a claims system, but the full insurance suite. We're also integrating other best-in-breed products to enable us to have fantastic integrated customer experience, digital experience, the next generation of pricing systems. So, we're building something genuinely world-class, best-in-class. It's taking a while to do because we're integrating a lot of best-in-class systems to do that, which we think is the right solution. We will tell you more as we get towards launch, which will be kind of broadly this sort of time next year.

Q - James A. Shuck {BIO 3680082 <GO>}

Are you able just to – I'm just interested in how you sort of interact with the customer. So, it's obviously that the system is allowing you to do certain things today, but the new systems that you're talking about that other people are doing as well. But just how is that customer journey sort of set to change?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. I mean, I don't want to – a year after, I don't want to necessarily spill all the beans on exactly what it enables us to do. But we're building modern systems for a modern world where customers have expectations on how they want to deal in a completely multichannel way they want. Not to have to tell you things you should already know, they except to be able to have much more flexible products around them, not around the strict constraints of current policies. So, we have a number of things up our sleeve, and the business case there, these sort of systems include – should include some benefit to top line, but also to the loss ratio through pricing improvements, and further cost opportunities as we enable customers to do more things for themselves.

So, I want to be slightly – I don't want to give everything away, James, in terms of kind of what we're up to, but it's a serious piece of work and we are very excited about what we're building.

A - John Reizenstein {BIO 6786139 <GO>}

And if you don't mind, of course, we will have the cost of running it and the cost of depreciating it as well. Sorry to be the boring (20:54).

Q - James A. Shuck {BIO 3680082 <GO>}

All right. That's great. Thank you.

Operator

The next question comes from the line of Dhruv Gahlaut from HSBC. Please ask your question.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good morning. Just two questions on this amendment fees. Firstly, a clarification as in on Churchill, would you guys still be charging amendment fees? That's one. And secondly, the change you made on the Direct Line brand, how much profits were coming from that last year? If you could just quantify that. Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. I mean, it's just on Direct Line, we are seeking to differentiate our brands. Clearly, depending on what we learn on Direct Line, we'll have to think about it for other brands. But right now, we are seeking to differentiate Direct Line and put it in some space. It's an investment, which I'm not going to break out, but we think is justified for the benefit it gives to the brand, to retention and to other things. So, we are pleased with its initial impact. We will obviously wait and see its longer-term impact.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

And how much was the profit last year from this on contribution revenue?

A - Paul Robert Geddes {BIO 2474781 <GO>}

We don't break that out. No, we don't break that out. It's a – as I say, the investment, we think, is worthwhile in the brand.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Thanks.

Operator

The next question comes from the line of Ben Cohen from Canaccord. Please ask your question.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi, guys. Good morning. Thank you. I just had two questions, I guess, or quite one question on two areas, which is if you could tell a bit more about the competitive environment in Home and also in Commercial. And specifically, in Commercial, have you seen kind of competitive conditions worsen in the quarter? Is it really a continuation of trends that you were seeing in 2014? Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. Thank you. Listen, I'm not dressing up Home as a very competitive marketplace. The ABI data have prices going down about 2% year-on-year and, of course, there's underlying claims inflation in Home, as well as Motor, and probably not of the similar quantums, 84% or 85%. So, at a market level, profitability is still going backwards in Home. We kind of said it probably would. It's not a surprise. It's an attractive market and there's more people competing for it. We continue to do slightly better in terms of the jaws (23:26) we're seeing in the markets. We're pricing down a bit less than that, and we always seek to beat the market levels of claims inflation with all the claims initiatives that we do.

So, we are pleased with our performance and we are pleased that we've been able to spend (23:40) our own brand policy count, but not to dress up as it is a competitive market. We have to work hard through self-help to trade as well as we've traded there. And I'm pleased with our performance.

A - John Reizenstein {BIO 6786139 <GO>}

Commercial market, I think, is a series of slightly discrete separate markets. We think that, for example, the van market is very competitive. It's kind of an out drop or an outreach of many of the dynamics in the UK Motor market, but not to say that we don't have ambitions to do better in it. We slightly under punched our weight in van, but it's very competitive. So, we're working to do a lot of stuff, transfer our knowledge from personal lines Motor into the van market. It's competitive, and we've been somewhat sidestepping that market for a bit. But at some stage, we might choose to reenter that. The regional commercial space, we are very choiceful about the – our underwriting and our pricing there, and that's exemplified by these two pieces of business, one went to captive and one we walked away from.

So, we are – it is a competitive marketplace. I think on the eTrading and Direct markets, whilst they're competitive and a number of people are also interested in them, I think we've got a huge amount of assets in those spaces. I think NIG has got a fantastic reputation on eTrading. And I think Direct Line's business is a unique asset. And we think, therefore, in that part of the market, particularly the real small premium stuff, we think we've got some edges. So, whilst there may be a number of people chasing that market, we think we've got a kind of a right to succeed in it.

Q - Ben Cohen {BIO 1541726 <GO>}

Okay. Thank you very much.

Operator

Thank you. There are no further question at this time. Please continue.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Right, guys. Well, we said it would be short. We look forward to a fuller conversation at the half year. And you know where we are if you've got any follow-ups. But thank you very much for your time and your support. Thanks a lot, guys.

Operator

Thank you. That concludes our conference for today. Thank you for participating, you may all now disconnect. Speaker, please stand by.
