S1 2019 Earnings Call

Company Participants

- Cristina Nestares, UK Insurance Chief Executive Officer
- David Stevens, Group Chief Executive Officer
- Duncan Russell, CFO of Admiral Loans
- Geraint Jones, Group Chief Financial Officer
- Milena Mondini, CEO of Europe Insurance
- Scott Cargill, CEO

Other Participants

- Dominic O'Mahony, Analyst
- Edward Morris, Analyst
- Ivan Bokhmat, Analyst
- James Shuck, Analyst
- Phil Ross, Analyst
- Rob Murphy, Analyst
- Unidentified Participant

Presentation

Operator

Ladies and gentlemen, welcome to the Admiral Group 2019 Interim Results Presentation. My name is Haley and I'll be the operator for your call this morning. (Operator Instructions)

David Stevens {BIO 1990356 <GO>}

(Technical Difficulty) in August to hear our presentation. I'm going to move on with this swiftly (inaudible). I know some of you have potential clash with Prudential later on. So we'll launch into it without further ado. Today, we have speaking for us Geraint who will do the key numbers, Cristina who will pick up the core UK business, Milena who we recently promoted to Head of UK and EU Insurance will talk about our international insurance operations, and price comparison operations. Before we do a bit of a deep dive on loans, we've got Duncan respectively CEO and CFO of our loans business tell you more about what we're trying to achieve and what we've achieved so far.

We're not intending to do this level of depth on loans in general, but there has been a fair amount of interest from our shareholders so we thought we'd give you the chance to understand it and ask questions.

As well as the team on the podium today, we've got quite a lot of people in the audience. We've got Annette, our Chair, we've got Rachel, our Chief Actuary, James, our Chief Risk Officer, Constantino, Head of ConTe and Chris, who is the UK Ops Manager. So, if you're short of people to ask questions to afterwards, feel free to ask to those managers as well as that.

Over to you, Geraint

Geraint Jones {BIO 19738535 <GO>}

Thanks David. Morning, everyone. I'll spend some time on the key numbers as David said. Another increase in profits, lots going on and then I'll move on to highlights, another very strong capital position and finish up with news of the increase in record interim dividend.

The usual highlights slide to kick things off, as you can see another slide sets of results for the first half. At the top, we continue to grow, both customer numbers and turnover up, so you'll note that the percentages are a bit lower than the previous year, and that mainly reflects a broadly flat core business which Cristina will talk about.

Our pre-tax profit was up 4%, GBP220 million, it's a record for first half and comes after the adverse Ogden impact, which I'll talk about shortly. EPS was up 2% GPB0.63 slightly lower increase than the pre-tax profit increased due to a higher number of shares in issue. Return on equity also strong, in the high 40s and the reduction over last year was entirely down to Ogden.

The strong capital position means, we've been able to increase our interim dividend despite the 2% growth in EPS by 5% it will be GPB0.63 and after that dividends accounted for, we maintain a very strong solvency position solvency ratio was 190%. I don't normally like to have red arrows highlights slide, but the reason there is almost entirely down to Ogden, so let me talk to you a bit about what's happening there.

I'm sure you'll all know that the writers confirmed a month or so back at minus 0.25% and that rate is firstly, very disappointing and is secondly, a bit below what we previously assumed which you'll recall was 0%. The pre-tax total impact of moving from 0% to minus 0.25% will be GBP50 million to GBP60 million, and as you can see, we've taken GBP33 million of that charge in the first half and the impact on ROE and EPS is also shown there.

And we're retiring our Ogden slides for five years, I'm pleased to know. Let's take a look at the growth that's across the group. It's nice, this time to see a full slate of green arrows again. You can see at the top, as we moved our rates in the UK up ahead of the market over the past 12 months, our rate of growth has slowed and our core business has only marginally ahead where it was 12 months ago.

Our household and international insurers on the other hand, continue to grow very nicely. Household is nearly 20% bigger, moving towards the 1 million policies milestone, and international insurance, in aggregate saw over 20% growth, so those percentages is accelerating in the first half and we're nearly now at 1.4 million customers outside the UK.

Comparison turnover was up 8% helped by a very strong H1 from confused.com and finally, our loans balances reached GBP421 million of 30 June that's double the level a year ago and about 40% higher than at the end of 2018. More detail on all that throughout the presentation.

Let's get into the profits, see what's behind the record first half results. UK Insurance was up around GBP8 billion or 3%. As you can see, that's after the GBP33 million Ogden I mentioned previously. Underlying profit was therefore quite strongly ahead, more like 16% at half year on half year and that bigger than usual underlying move was due to some very strong back year loss ratio development in the first half, which despite keeping our reserve margin flat versus six months ago has led to a more positive back-year booked, loss ratio movement that we would normally expect to see at the half-year period, and we positively surprised if that happened again in the second half.

Household delivered a profit of GBP4 million, decent turnaround on last year's weather impacted loss of GBP2 million and that comes on the back of the continued strong growth. International Insurance was 2 million lower half year on half year, and there are two parts to that. Firstly, the European businesses, which grew very strongly delivered a higher profits GBP4 million versus GBP3 million but a higher loss ratio at Elephant in the US led the result there to be slightly worse.

Comparison profit was at GBP7 million, more than double the H1 2018 results and again, a large part of that is down to a very strong performance in H1 from confused.com where profits were up 50%. Admiral Loans reported a loss of GBP4 million, which has improved half year on half year, despite the strong growth, as the interest income on the portfolio continues to build.

And finally, the other line, which is up a few million pounds since H1 last year, and as you see in the bullet point, the share scheme charge was the main factor there, and just want a bit more color on the share scheme. The accounting cost, and remember, most of it isn't cash is impacted by a number of factors, including the number of shares that we expect the best and of course the share price and between June 30, 2018 at June 30, 2019 the share price increased by GBP3 and also the financial metrics that drive the variable part of the scheme have also delivered strongly, and those two factors lead to the higher cost in H1.

Moving on to talk about the capital position. I don't have too much to say on this slide, it looks pretty consistent with the position six months ago, and it's very satisfactory at this point. The solvency ratio is 190% post dividend, which is a few points down the year-end, and remains elevated in advance of the internal model applications and hopefully approval in due course.

And as you can see in the bullet, the Ogden impact cost us about 5 percentage points of solvency, and if you exclude that, we are pretty much flat versus half year last year and year end. There's no change at this stage in the basis of the calculation, and there's no new news at this point on internal model, which continues to progress and hopefully, we'll give you a slightly fuller update on the internal model. Let me do our full year results in March.

My final section looks at the interim dividend, another record half year payout. Now, the strong solvency position is met, we were able to pay out all of our H1 post-tax profit and increase our dividend by 5% to GBP0.63 per share. The payout ratio is obviously a bit higher than usual, so don't get used to it. Now, last half-year, we paid over 97% there's no change to the policy. No change in the philosophy and the relevant things to show it on the slide.

That's it from me. So let me try and give you a few key messages from my section. Continued growth, a bit more muted in the UK, but strong elsewhere. Higher profits and materially higher profits on the pre-Ogden basis, so round off higher and record interim dividend with the maintained and strong solvency position. I shall pass you to Cristina to talk about the U.K.

Cristina Nestares {BIO 18674745 <GO>}

Good morning, everybody. I'm going to talk about the results for the UK Insurance operation, focusing mostly on motor, and an excellent good set of results with an increase in profit despite the change in the Ogden rate. This is down to high back year releases, which I think is an indication of the strength of our underwriting capabilities. Relatively flat growth, which is an indication of our approach, very prudent, which tends to prioritize margin over volume and in terms of household results, we have seen good growth and an increase in profit.

Now, let's focus on prices in the market. We have seen premiums coming down during 2018 and the first quarter of 2019, and we have a started to see a change in the trend in the second quarter of this year. You can see in the first graph piece, our market data -- these are indexes that reflect changes in the market, in the red bars you have Confused data, it only focuses on new business and what we have seen in Q2, is an increase of 3% versus Q1.

When you look at the ABI data, that looks at new business and also renewals, what do you see in Q2 is actually prices being flat. So early and there is more signs of possible a change in the trend, and it's very pleasing for us to see the market reacting, and is starting to increase prices. However, there is still a big lag with claims inflation, so we will expect the market to continue to put prices up.

If we move to Admiral prices, you can see in the second graph our Times Top and this chart reflects how we behave in price comparison versus competition, it's indexed to January 2017.

What you see in the graph is we started putting prices up a year ago, and we have continued doing so in the first half of this year, with prices up by about low-to-mid single digit. And recently, due to the change in Ogden, we also have increased prices by at least 1%. Second half of the year, we expect to continue putting prices up, and as I mentioned we hope the market to continue doing this.

Now, let's move on to our Claims results. The graph that you have here, reflects data from the market and the trends that we see in the first half of 2019 are very similar to what we saw in 2018. Basically flat frequency, and an increase in severity. As we're experiencing those similar trends and we also expect the markets and for Admiral to continue seeing similar trends in the second half.

However, there are a number of changes in regulation that might have an impact, I'm going to talk about three. The first one is the change in the Ogden rate. As mentioned, we have increased prices and we expect our competitors to either have increased prices to or to do so very soon. Secondly is the Whiplash reform that we expect that we have about a year. I want to highlight that there is a lot of uncertainty, both in timing but also in the actual impact, that the reform is going to have.

When this was first announced about two years ago, the market estimated the savings in the cost of the claim to be around GBP30 to GBP40 per policy. However, as you can see in the graph on the right, there has been a very strong decrease in the frequency of these type of claims. So, the impact is going to be less than initially anticipated.

But secondly, we don't just know how claimants and how lawyers are going to react to it. There could be an increase in other type of claims that are not covered inside the Whiplash reform. So, with this uncertainty, we don't expect the market to discount price as much, and since there is more clarity in timing, but also in the actual impact.

And the final change that we can see in the market is the results of the FCA Market study on prices. We hope to know more about it in the next two. Moving on to our loss ratios results, you can see in the graph, not very well. But let me highlight, you can definitely see the total movements since the first projection of accident year. You also have in the brackets, you have the movements in the past six months.

In terms of reserve releases, as Geraint has been mentioning, it has been very positive or we have seen very positive prior-year developments in the first half of the year. Our belief is that we are around 22% and 5% has been of Ogden. Overall, we still hold a very prudent and significant margin, which is relatively flat from a year ago on a slightly higher than six months ago.

Now, before I move into the household results, I want to talk about other revenue. We have included a graph that shows the results that we have seen in other revenue for the past 15 years. Two things I want to highlight, lots of movements, up and down, mostly done to changes in our reinsurance agreement, but also changes in products. Second thing I want to highlight is that, overall, there is a very clear decline in trend since 2011 when there was a peak of GBP84 per vehicle.

Today, we are seeing this number to be around mid-60s, and if you make a net of the impact of changes in the reinsurance agreement, it's actually GBP58, down from the previous year. So, what is happening at the moment on this measure? Well, a couple of pressure. First, coming from more sales being closed online, where we sell less ancillaries and secondly, a pressure coming from changes in regulation, I will highlight the IDD, to change the Insurance Distribution Directive.

Going forward, we expect to still see these trends and also the Whiplash reform might have an impact on the margin that we make on the motor legal ancillary product, as the cost of it might go up. So overall, there is a lot of uncertainty. It's hard for us to estimate what is going to be the actual impact. But, I think in the next couple of years, we're going to see a decrease of a few pounds.

Now moving on to Household results. Healthy growth of about 20% both in customers and in turnover, very pleased to see that this growth has been fueled by the growth of our direct channel. We've seen our multi-cover proposition, which is the cross-sell to our motor book to Household policies increasing, and we've also seen our insta quote proposition, which is the direct quote that allows customers to get a price with just four questions, and we see an increase in the take-up. So very good to see the growth, also positive results after a good year in terms of weather. So, in summary, for motor, good growth in profit, despite Ogden. As I say, this is a credit of the strength of our underwriting capabilities. Very pleased to see the development of the prior years. Very flat, very modest growth, as a reflection of our prudent approach, and in terms of household to see a strong growth.

Now, before I move on, I just want to highlight that these results are a credit to the trust of our customers. We focus very much on delivering the best service every year, and we continue to improve. And secondly, our staff, I already highlighted this, we are very proud to see how happy our staff is in Admiral, and all of these results are credit to them.

So that's it from me. And now I'll leave you with Milena, who will talk more about the results of our international operations and price comparison.

Milena Mondini {BIO 18674746 <GO>}

Good morning everybody. So today I will talk to you about International Insurance as usual and price comparison side. Starting with International Insurance, I am delighted to say, that once again, we have seen a very strong growth across all the operation, in Europe and in US. With particularly ConTe and L'olivier growing very fast and celebrating premium milestone GBP150 million respectively. The total International Insurance result reflected profit in Europe, offset by an increase in the current year claims ratio in US, and overall resulted in GBP2.7 million loss.

European operation, while growing very strongly also managed to report a record profit for the first half, and this is particularly thanks to the contribution of ConTe and Admiral Seguros. We've also seen in Europe a positive development of senior underwriting year loss ratio and this is on the back of continuous effort in innovating and pricing, improving anti-fraud capability and exporting best practice in underwriting across the country.

And all of these results are based on an unchanged, if not strengthened level of conservatives in reserves. There are some positives on Elephant as well. Notably, an 11% growth of the current cover and a further two percentage points reduction in the expense ratio. Unfortunately, this was offset by an increase of 5.5 percentage points in the claims ratio for the current year.

The Elephant team responded to this by increasing further pricing in Q2, particularly for the segments that were showing more results. And in the next six months, we will continue to protect the claims ratio, if needed at the expense of growth, and also trying to continue to push the expense ratio further down.

So the -- as I mentioned in the past, and as you can see from this set of results that combined a very strong growth and a relatively flat bottom line.

Our principal aim at this stage of the -- story of international operation is to build economy of scale. That's where we put the most of our effort in the last period. And this is based on a very simple belief. We do have already, an advantage in loss ratio where we are building it in the less mature business, and with more sizable book, we will be able to deliver substantial profit for the Group in the short term --short, medium term.

And this the last slide on International Insurance is the result of these efforts. So, as you can see, all our cost metrics are trending in the right direction, with significant improvements in expense ratio, cost per policy and call per customer, as more of our customers besides, interact with us on our portal online. And we are pushing these efficiencies without renouncing to invest in our people, in our brands, and in our platforms that are evolving continuously. In Italy, for example, we invest more significantly increasing media investments and a new TV campaign, with a very strong testimonial, Mr. ConTe that is probably the best and the more recognized showman in Italy and we had very good return on this media investment.

And L'olivier, as you can see in the table on the right, it pioneer our effort in producing and providing more and more feature lines to our customer, and we continue to release new ones as we speak.

So, moving now to price comparison slide. The first half of the year has seen very pleasing results for us that we are growing both in turnover and in profit, in what remains a challenging markets that are less mature than UK.

Everywhere, we're continuing our crusade and empower customers to do better and easier choice. And this translate in Spain in providing more actual price to the customer in the final part of the quote.

That seems very obvious for us in UK, but it's very far to be market standard in Spain. And customer reaction has been very positive with improved NPS score and more issuers in the panel are embracing this proposition. We are also empowering customers to do a broader range of choice on our site. And this means product diversification with special focus on the finance vertical and mortgage in particular in Spain and energy in France.

Moving now to US. Comparison fell a loss to $3.5 million in the first half of the year. And this is on the back of challenging market condition as we mentioned in the past. The consequence of that, we amended our forecast and our projection for the future, to reflect a more conservative view of the speed of adoption of this new acquisition channels by US consumer.

And consequently, we have written down in a typical conservative Admiral style, the carrying value of Compare.com GBP25.7 million. The most notable change in this period was a substantial cost of overhead costs. This was executed very effectively, we retain all the key personnel, as well as serve our customer and our partners well throughout the period.

As a result of this, cost cut, as well as the improvements in acquisition cost, we expect for the second half of the year, a materially lower loss for Compare. We expect UK now Confuse at a very pleasing half year, growing 14% in turnover and also with the 50% increase in profit. This was in the back of continued effort in improving our proposition for the customer and our product. And beyond also very strong performance in motor, Confuse also increased their share in Household Comparison. We strengthen the B2B relationship, as well as seen an increase in brand awareness, and also an increase in effectiveness of media spending with the new TV app.

To summarize, we've seen a pleasing half year for our Price Comparison side, led by very strong last year for Confuse and the challenging condition in US. We've seen a very strong growth across all international operation and profits from Europe. Once again, thank you very much.

And I now hand over to Duncan and Scott, (inaudible) talk about newer, but already very exciting part of our Admiral business.

Scott Cargill {BIO 20595803 <GO>}

Good morning. Thank you, Milena for the introduction. Some of you know I joined Admiral 3.5 years ago, following a 15 year (inaudible) most recently with Lloyd Banking Group where I was focused on the development of new consumer finance proposition and prior to that at the Royal Bank of Scotland, where I worked across only two products, including CDS and pricing and finance, and as part of the executive team driving the digital and technology focus with our Future Bank Program.

So, why was I tried to join Admiral - why I was tried to join Admiral. Two reasons, the first is the company. As we all know, Admiral is a special and outlier insurance company. So, the opportunity to leverage those capabilities, to create a special and outlier loan business is a huge bill factor. The second was the market, or precisely the opportunity that currently exists in the personal loan and car finance market in the UK, where I believe Admiral can better price risk, be more efficient and drive more consistent customer outcomes. I'll come back to this in a minute.

So, how are we doing? Since launch in 2017, we've had cumulative investment of GBP23 million, we've originated over GBP500 million of loans, to over 60,000 customers under the end of June 19 have a stock position of GBP421 million. Over half of our loans are for the purpose of financing cars and around 28% of those are already to Admiral insurance customers.

During this period, we won multiple awards voted for by our customers, and we have a fantastic team of people, 140 in total, based back in Cardiff, approximately 50% from industry and 50% internally from Admiral.

We play in the prime space, and we currently have a market share of 1.5% and we've also invested heavily in our technology, which allows us to acquire 99% of our loans, fully digitally and of those 85% come through fixed cost channels. So at this point in time, we are already an established lender, but we realize there is a lot to do. So over the next one to two years, the goal is to create a differentiated and special lender for Admirals shareholders.

The UK loan market is large and established. And as I mentioned earlier, there receives a trends occurring that present an opportunity for Admiral. Firstly with distribution, we are seeing the channels, where Admiral has historically been strong. Notably, price comparison, but also new credit score-based marketplaces like ClearScore. 75% of personal loans in the UK are already now acquired digitally, and over 20% come via these channels.

We expect the share of these channels to continue to grow. Secondly, we are seeing a pull from both distributors and from customers for improved pricing accuracy and expect some certainty. It was a gradual shift from a represented rate model to a pre-approved guaranteed rate model. The chart in the top right gives a real example of a price comparison ranking first on for chance for approval, despite there being lower price represented re-offers available.

We think, we can be a beneficiary from this, given the Group's price and expertise and our new flexible technology in the loans business. Finally, with used-car finance, some of you may have seen the recent media linked to the [ph] ASC review, well due to both these regulatory changes and changes in consumer behavior, where more and more people are shopping online for their cars and subsequently for their finance, we see in time, acquisition gradually moving away from the point of sale traditional channels where there are high cost APRs to subsidize the high cost dealer commissions.

So it is what you can expect from us in the next one to two years. As I said, our focus is to create a truly industry-leading lender. And leading on the Admiral winning formula, we see the following four capabilities as key to achieving this. The first is risk selection and data analytics. This is the single most important capability. The data advantage of traditional players is reducing. So, our focus will be centered around, using established data sources in a more granular way and using new data sources like open banking, the better priced risks. We have an obsession with a little details and our technology allows us to make rapid changes. So, we believe this combination will help us find the pockets of higher pricing returns.

The second is expense efficiency. We wouldn't be an Admiral UK business with an industry leading expense ratio. You can see from the chart, our run rate fixed cost have already raised from 3.7% of stock balance in June, 18, to 2.1 in June 19. As our scale grows, we expect this operational efficiency to continue.

The third is product development. We see an opportunity to create more flexible and convenient products for our customers, in particular by bringing together car insurance and car finance into one interaction, where customers can directly and conveniently arrange all of their car needs. And finally with technology, we started with an end-to-end industry proven system and they are in the process of evolving to a micro services architecture using best of these components. And we have in H1 2019 completed the first phase of this development with our new proprietary pricing system. So, hopefully I have given you an overview of both the market and the business. I'd like to leave you with two points to summarize.

Why will Admiral win? The first is using the latest technology, we will give customers better choices for car finance, and the second, as we hold an obsession on data and pricing to better price risks and finding the pockets of higher pricing returns.

So with that, I'll patch you to Duncan to talk more of our funding and our performance.

Duncan Russell {BIO 15944951 <GO>}

Thank you Scott. Good morning everyone. My name is Duncan Russell, I'm the CFO of Admiral Loans. I joined Admiral about a year and a half ago. Prior to that, I was working the Netherlands with a Dutch Insurance Company where I was responsible for Corporate Finance and Strategy. And before that I was based in London at JPMorgan where I was a Managing Director. I'm going to spend a few minutes talking about the key financial highlights of the loans business and I'll start in that context on the funding position.

As you can see from the slide of the GBP421 million loans outstanding of the half year, roughly 50% of those are funded on a senior secured basis via banking warehouse structure. As a standard facility for lending business like ourselves, and we put in place roughly 12 months ago. The remaining 40% has been funded by money provided to us by Admiral Group, who intern has sourced through a combination of drawing on credit facilities at the holding company and down-streaming it or utilizing the insurance asset base.

We believe these two funding sources should be sufficient for the relevance business to meet our near to medium-term growth ambitions, while in the longer term, we'll naturally diversify further and we'll most likely do that through capital market transactions, such as the public securitization or debt issue.

With respect to the capital position, Admiral Loans is part of a separate legal entity called Admiral Financial Services, and is a consumer credits firm, which means that it does not have any material regulatory capital requirements. However, within the Group Solvency II ratio, we are added in and the way that's done is via a notional solvency capital requirement calculated using banking Basel rules, which is broadly equivalent to 6% of the loans outstanding at any point in time. With respect to asset quality, as Scott mentioned, we are operating in the prime space. As an output, that means we're targeting annualized losses in the range of 1.5% to 2%, and an APR on the book in the mid to high single digits. From an input perspective, it means we're targeting customers who have a good credit history, have a certain minimum level of income, and a certain maximum level of debt.

Now, over the past 12 months to 18 months, we have been optimizing our credit rules and that's been a function, not only of the data and trends we've seen emerging in our own book, but also a realization that we are a new lender in the market, and we have looked to remove any concentrations that may emerge. In addition, we are aware of the macroeconomic background and therefore, generally had a tightening buys from our credit rules over the last 12 months to 18 months.

As Scott mentioned, we have invested in technology, and recently we've put in place, our pricing capability, which allows us to price risk in a very granular manner and in a very rapid manner and utilizing the data sources which Scott got mentioned earlier. From a provisioning perspective, we are utilizing IFRS 9 and the total provision at the half year was GBP15.7 million and some of you are probably aware that does recognize credit losses, slightly earlier than the prior accounting standards.

To put that into context of the GBP15.7 million credit provision as of the half year, approximately GBP5.5 million is related to what is known of Stage 1 loans, which means that they are up-to-date and haven't experienced any credit deterioration.

As you're aware, the half-year result for those business was a loss of GBP4.3 million, which is a slight improvement period-on-period, and we're guiding for that number to be in the high single-digit area for the full year, notwithstanding any significant change in the macroeconomic environment. As you can see from the chart, the loans balances has steadily increased over the past year and a half.

And that's been a function of a stable level of new loan originations, and we anticipate for the coming two years we'll also keep our new loan originations relatively stable, and that means that the total loan balances outstanding in two years' time should be in the range of GBP700 million to GBP900 million.

As Scott mentioned, there is a lot more to do. But as a team, myself, Scott and the team back in Cardiff are reasonably satisfied with the financial performance of business so far, and we look forward to the future with optimism.

And with that, I'll hand back to David to summarize.

David Stevens {BIO 1990356 <GO>}

Thank you very much Duncan and Scott. As everyone dives as deeply as that into loans in future, but I pay your indulgence for one extra page, which is to try and set the loans business a bit in the context of Admiral's aspiration and timeframe. So, I look at the loans business with the goal of creating something Admiral like in a few years' time. What do I mean by Admiral like? I mean, a special business in a difficult market. Loans is a difficult market, the commoditized product with lots of capacity, it's subject to exposure to macroeconomic cycles.

But, if you create a special business, you can still make good return. How is this business going to be special? It's going to be special in risk selection. It's going to find ways of identifying overpriced risks. It took Admiral five years to seven years to beat the industry average loss ratio, through a process of learning and applying those learnings, doesn't happen overnight. It's going to do it through creative product innovation, this appears to be a commoditized market, but there are often opportunities to tweak a product to slightly differentiate. We did it ourselves, with the 10-month products and with multi car and multi cover, just gives the customer an extra reason for coming to us. Again, it takes time to develop those products.

And tight expense control has always been part of the Admiral formula. Low acquisition costs, low administration costs and I'm glad to say that I think the loans business is already demonstrating superior expense economic versus the average competitor in the lending market.

Now, if over time we achieve these three goals, we get a business that establishes a track record of superior returns, and if we do that, we can apply another part of the Admiral formula which is working in partnership with third party capital providers to increase the capital efficiency and the risk mitigation of our capital structure.

And that's something of a goal -- we would do that in the way that Duncan described through securitization. We also might look for more innovative ways of doing that and I'm pleased to say we've done our first relatively small capital efficiency deal with one of our reinsurance partners to provide support for the lending operation.

So, what would I like you to take away from this morning's presentation, I think three things really, the loan business as an option on potentially attractive business for the long term, record European growth. We've got 209,000 more cars on cover, than we had a year ago in Europe, and 125,000 of those came in the last six months.

And lastly and perhaps mostly importantly, I think these results are a further demonstration of the strength and resilience of the core franchise to see the back year loss ratio is evolving as they are, gives us confidence that we continue to beat the market collectively on that key loss ratio metric, and also our conservative approach to reserving that superior -- to recognizing that superior performance means that we can deliver even in difficult times in the market.

So, thank you for your attention, and I'm going to open up for questions and answers.

Questions And Answers

Q - Unidentified Participant

(Inaudible)

A - David Stevens {BIO 1990356 <GO>}

So Cristina, you'll do the UK business and...

A - Cristina Nestares {BIO 18674745 <GO>}

Yes. We believe there is still a gap to reach the claims inflation. So, we will continue putting prices up. In terms of margin, as Geraint has said, in the first half of the year, we have experienced a particularly high back year releases and we don't anticipate to continue with during the second half.

A - Scott Cargill {BIO 20595803 <GO>}

The first probably is to create great lending business as we talked about in the script. In terms of synergy, I think there are possibly two, possibly three ways. The first way is the customer base, there's obviously for 4 million to 5 million insurance customers in the UK, and we estimate there is GBP9 billion of car finance and personal loans. So we would like to talk to them about giving them better solutions and better product.

The second is data, and we already see that in addition to credit data the Admiral data, those quarterly well and there is some insights that we'll take over the next few years with that. And then the third is cultural and Admiral has quite a unique way of driving customer experiences, but also in terms of the granularity and frequency of facing changes and we're already inheriting some of that. So, we see a synergy there as well.

A - Geraint Jones {BIO 19738535 <GO>}

And question was on the financing. As we indicated in the slides, you can expect our balances to be around GBP700 million to GBP900 million in two years' time, and the reason we gave that was to help you frame the financing needs, the capital need and some sort of indication on the P&L as well. I indicated in the presentation that I felt that the current funding capabilities we had, which is the banking warehouse, which funds roughly 60% of those balances and the remaining 40% being funded by a combination of credit lines and insurance, assets should be sufficient to meet those near time needs, particularly the bottom end and at the top end, probably with a small upscaling. And post that, any further growth about that would require I believe a diversification of funding most likely will be in the form of the public securitization.

The main barrier to achieving that will be track record and data and that's also why it coincides nicely with the two years near-term needs and then thereafter when we thought the track record of four to five year period tapping those public markets.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi, it's Ivan Bokhmat from Barclays. My first question would be on the reinsurance profit commissions. Maybe you could provide some outlook considering the creep up in the current year loss ratios, how should it work through the future years? And the second question I had also on loans, just to follow-up, maybe you could provide some kind of bank comparisons in terms of the cost of risk and the cost income that you target for our business, what kind of ROE should we be expecting once you get to the GBP900 million loan balance target? Thank you.

A - Geraint Jones {BIO 19738535 <GO>}

Profit commission, the flow through into the accounts will be predominantly driven by how we release back your loss ratios. So, the current year's, we wouldn't expect those to feed into profits for two or three or four years, so the next couple of years will be largely influenced by 14, 15, 16, 17, which appear to be quite profitable years and are moving into the territory where we recognize profit commission. So, that will influence the next couple of years.

As I mentioned and Cristina mentioned, the first half of this has been particularly positive for those back years, I'd be positively surprised if it happened in the second half. We do have a very strong track record of very strong back year reserve releases and that does lead into profit commission as well.

A - Scott Cargill {BIO 20595803 <GO>}

On loans, and I think it has two parts. So the expense part, I think the way to think about is that the cost income of the banks is in order for 40 to 50, and we're already demonstrating sub 30 cost to income ratios. And I'm unaware of a low cost provider with the parent like Admiral coming into this mark yellow of the challenger banks come in on their own with heavy expense requirements sometime, to -- a bank before they can really get the revenue going. So I think from an expense perspective, we would see us settling into the 20s.

A - Geraint Jones {BIO 19738535 <GO>}

From a return perspective, we -- on the economics which are provided in the presentation, high single-digit APR, an annualized cash loss of around about 2%, and funding cost roughly similar to that and a capital requirement around about 6% within IRRs around 25% on the loans originating today.

Q - Dominic O'Mahony

Hi. Dominic O'Mahony from Exane BNP Paribas. Thank you for the questions and thank you also for the detail on the loans, which were very interesting. If I can ask three questions, if that's all right. Cristina, you mentioned some of the headwinds on the other revenue per customer. I wonder if you might be able to flesh out in a little more detail why you see the IDD has been redundant, also how you see the Whiplash reforms impacting the legal cover?

Secondly, you've in the past indicated PID might trend in the long-term average of about 20 points on the combined ratio. Do you still think that's a reasonable number or should we be -- while next half won't be quite as good as this half, it's still going to be above that?

And then finally, apologies for a slightly tactical question, but if I look at the booked loss ratio for the 2018 vintage, it started roughly the same price as 2014, is that good development? But when you committed to 2014 and 2016, it was a little bit of a loss. I think it was GBP30 million odd loss. If 2018 turns out to be similar to 2014 in terms of development, what sort of loss might mean on commutation and would you consider not committing it, if there is a chunky loss? Thank you.

A - David Stevens {BIO 1990356 <GO>}

Do you want to do IDD and Whiplash, and maybe Geraint might do commutation?

A - Cristina Nestares {BIO 18674745 <GO>}

Yes. One thing I wanted to highlight is that despite the decrease that we have been seeing so from the peak of 84 to where we are now around 60, it has not to stopped us from delivering good profits and good return year-on-year. So I think that's important to take into account.

In regards to IDD and Whiplash, Whiplash might increase the cost of delivering legal protection; this is just an ancillary that we offer. It's quite an important one and if the cost increases, it might put pressure on the margin. Yes, so that's the impact of Whiplash.

Second one is in terms of IDD. I would highlight, it's not just the insurance distribution directories, in general these tend to better disclosure and IDD is just an indication. So there is trend constantly, value measures IDD and many other reforms that will lead to different ways of selling product.

A - David Stevens {BIO 1990356 <GO>}

And the question on reserve releases. We used to guide that 15% was our long-term average and as we've updated the chart is selling more towards 20%. I think we commented earlier, the size of our margin is conservative and large and I think if things develop as we would normally expect in the second half, we'd expect H2 to be pretty strong, so not in the 15 territory, probably closer to 20. And in the future will obviously depend on how claims develop and I think 20 is probably a more reasonable the very near term and then 15 for sure.

And commutations, it's a very valid point, 2018 book to loss ratio progression looks like 2014 and we choose to commute it, than you might expect a similar accounting loss. Just to emphasize, it's not a real loss. Obviously 2014 now is -- or 2016, sorry is booked at around about 90%, and so it is a very profitable year.

And so the accounting loss that we recognized at that point of commutation is since unwound in full and we would certainly expect that 2018 will be a profitable year, and we choose to the make a commutation decision based on our expectation of the ultimate profit. And so, if it looks to us like it's going to be a profitable year, then we'll probably do that commutation, and therefore that might recognize a loss at that point. We'll decide that in 2020 or 2021, whenever that point comes.

Q - Unidentified Participant

Hi (inaudible) could you just give us some guide on what led to that sort of extraordinary performance in terms of claims trends? And then secondly on Ogden on the sort of GBP20 million to GBP30 million additional impact you're flagging from that, when should we expect that sort of earn through the P&L? Thank you.

Speaker C-Geraint Jones Prior year, it's more of the same sort of stuff that we normally expect to see. It's positive development, the average cost of injury claims and particularly large injury claims.

And we've seen some different trends in our data over the past couple of years, some more stable development than we'd normally expect to see and we'd normally expect to see continued releases over time.

Those trends have reverted more towards normal, over the past six to nine months. And so our independent and external actuaries have started to take account of that, that's more positive trend. And so you get some, in fact some of that stuff has been stored up, and so you've got a bigger movement in the first half than we might normally see versus the prior year.

Ogden.

A - Geraint Jones {BIO 19738535 <GO>}

Ogden. Yes. So, we reckon the total cost be GBP50 million to GBP60 million. We've recognized GBP33 million in H1 and that's all in the form of lower reserve releases. And the next -- the rest GBP20 million or so will come through in lower profit commission and it will be over the next two or three years. So, the individual six months' impact will be pretty trivial, as I wouldn't expect this to actually it fly at this point. It will just be lower profit commission.

Q - Edward Morris {BIO 16274236 <GO>}

Hello. Edward Morris, JPMorgan. Few questions on loans first, if I may, and then one on solvency. First, just when you talk about pricing and how you approach this, can you just explain how you go about this? Is this something where all of the differentiation on pricing comes through the APR, and can you offer a similar level of granularity that you do for your insurance businesses. Is there an upper limit on what you offer on APR?

Secondly, relating to capital on the loans business. I think you said there's a 6% charge on the capital of the loans books and some of it comes from insurance assets. I was just interested as to -- is that because of the Basel treatment, it seems like quite a low capital charge compared to what you would expect for insurance assets that were in other illiquid type investments?

And then lastly on solvency, I think you mentioned your solvency ratio is subject to regulatory approval on the capital add-on. What's the expected timing on that, please? Thought that might have been expected for the first half? Thank you.

A - Geraint Jones {BIO 19738535 <GO>}

Yes. So, taking it reverse order, the capital, that's a standard banking Basel requirement. So we use a standardized approach to calculate the risk weighted asset, and we take the Pillar I requirement of that, we don't do anything on top of that, not just mathematically works out around about 6% important to note that doesn't diversify. So, if it was within the loans business -- within the insurance business that would have a diversification benefit as well, but because it's an add-on to the Group insurance Solvency II ratio, it doesn't diversify, so it's 6% flat, which I think is something to remember.

On pricing, we do have a maximum APR, which is I think, reflective of the prime space we're operating in. So, we are, as I indicated targeting an overall book APR in high single-digits. So, in that context, there is a maximum which is reflected within that.

And as Scott mentioned, I think on the pricing side, we're trying to develop a couple of competitive advantages. First is cultural which is that both from a -- who we write and the price we charge, we're trying to be quite proactive in managing that, not just because we are an new lender into the market and we are aware of the macroeconomic environment, but just that something we've learnt that Admiral on the insurance side does quite well, and so we've tried to mirror that.

And on the technology side we've built our own proprietary in house pricing capability which means that we could come in any single morning and adapt the price in a very granular manner for a very specific risk and change that frequently as we want. And we believe the combination of those two things should allow us to over time build a competitive advantage in pricing.

A - Duncan Russell {BIO 15944951 <GO>}

The second question is capital add-on -- so the -- our capital requirement is based on the standard formula plus the capital add-on. We calculate that internally every quarter and we report that externally every six months. And if it changes materially from the previously approved one, then we'll talk to the regulator about it getting re-approved, I'd expect us to be doing that reasonably shortly, it has gone down a fair bit since the last one. So that's part of the story here. So, I would expect that to be done reasonably shortly.

Q - Unidentified Participant

(Inaudible)

A - Cristina Nestares {BIO 18674745 <GO>}

I'll say that we continue to be very focused on our expense ratio and to be an efficient operator. This year, I will highlight a couple of things, one is the increase in levies, and the other one is just the increasing cost of doing business in the UK, in areas like server, we have done a very important expense to strengthen our server capabilities.

A - Scott Cargill {BIO 20595803 <GO>}

On loans and -- so the product is probably great lending business. And one, we take inspiration from the car insurance business in a few ways. And one is that, they've got dedicated business focus on one product for a very long time and our competitors don't, many of them try to fill lots of different products. So we see the value chain splintering. And a splintering in a way where we think the profit center, which is personal loans and car finance for banks as an opportunity for other people to get involved in, so that's why we're there.

In terms of car insurance and we're talking to millions of customers every year when they are changing their vehicle, and we have a lot of data on those customers that help us give good indications of what type of price they should be going for their loans. So bundling's not really -- we're thinking about talking to our customers about their financing needs at the point they're making the change in the vehicle purchase.

Q - Unidentified Participant

Hi. It's Andrew Crean, Autonomous. Three questions if I can. Could you talk a little bit more about the FCA pricing review and the potential risks that you see there? Secondly, in your appendix you give a sensitivity to changes in the loss ratio, including impacts from changing profit commission tax. But I think the loss ratio is now say high, but there is no sensitivities, it comes down five points. So it's not really helping us to see how, as years progress, they -- you take more of the profit. I wonder whether you could do something about that.

And then second -- finally coming back onto the loans business. As I understand it, you started this operation as a car loans business, now half of it a personal loans business. Why do you think you have pricing -- better pricing insights than the traditional players in that personal loans business? I think you did admit that they have more access to data?

A - Cristina Nestares {BIO 18674745 <GO>}

Yeah. So we start with the FCA pricing review. I'll highlight firstly the uncertainty, we don't know what is going to come out. We see risk and maybe opportunities risk because any change in regulation it could be -- if it's implemented in a way that is similar to every player, I think it could be interesting. But there is always uncertainty when it comes to changes in regulation. Also any change that will limit our ability to price based on risk factors could have an impact.

However, there can also be opportunities. If you look at our motor book, most of it comes from price comparison, where people shop on a very regular basis. About 80% of our customers contact us every single year. And if you look at our household book, actually, it's very recent, we have very old -- sorry, we have very young customers. So you could actually be an opportunity at the end. I will leave it with lots of uncertainty.

A - David Stevens {BIO 1990356 <GO>}

On loans?

A - Geraint Jones {BIO 19738535 <GO>}

Loss ratios and uncertainty. Maybe I'll take up with you afterwards Andrew just to clarify the question. The extent of the sensitivity will clearly depend on where these individual underwriting units is booked at. And so how much profit can be recognized by moving the loss ratios a couple of points and so maybe I'll pick that up afterwards, if that's okay.

A - David Stevens {BIO 1990356 <GO>}

It's a reasonable point. The benefit of five points, is just to say is five times the benefit of one point, whereas a loss ratio is further down, you begin to see the exponential benefit of improving profit commission, so it provides us in a guide, in terms of how to model it.

A - Geraint Jones {BIO 19738535 <GO>}

Well it provides you the guide to model it, if it moves by five points. I'll pick with you later Andrew.

A - Scott Cargill {BIO 20595803 <GO>}

Almost, we were thinking about data and pricing is probably the three areas. So as I said in the script, we're talking about established. And what we think we can do and certainly better than someone established is we are looking at the raw data, the raw credit data at point of acquisition. So let's say 100 of -- 100 of variables. And so there is an opportunity there I think to certainly for a lot of lenders, we only look at consolidated scores our point of acquisition to point an advantage.

The second set on new data sources. And we are one of the first we believe in the market to what with open banking data. So when I say the traditional data sources or the traditional advantages are reducing, open banking data gives you access to fill current account data. And if customers are willing, you're able to assess rest with that information.

So that's the second area we were looking at and we are investing a lot in that in the second half of the year. And the third is with Admiral Data. And the simple example the NOI indicator for our car insurance product and that has a correlation, as you might expect with a but, loan performance. So there is some links there with regard to Admiral Data.

One observation that may Kevin works or at least see where the loans team over the last two or three years as we initially piloted and then decided to get with a loans operation. Is that, the mental process of pricing insurance, the mental process of pricing alone is not as similar as I would have immediately anticipated.

But I've taken away from the view that a combination of a loans pricing culture and Insurance pricing culture is -- is an asset for a lender. And in fact also a combination of lending and then the insurance pricing culture is arguably, potentially an asset for the insurance business as well. There's learning for both sides on how traditionally these sectors have tackled risk.

Q - James Shuck {BIO 3680082 <GO>}

Thank you. It's James Shuck from Citi. I have three quick questions please. Firstly, the best estimate liabilities. I think you previously guided that, you would expect the best estimate not to develop as favorably as it has done in the past. 2017, 2018 still seeing very strong development, and can you just run me through what actually is driving that positive development that would be helpful, please.

And secondly, Whiplash reforms, I think you indicated that it's about a year before you expect those to come in. I was expecting April 2020. Could you just shed some light in, in terms of that potential delay. And thirdly just around the Solvency II sensitivities to low rates. I remember those being far more sensitive to 50 basis point reduction. Could you just clarify what's included in that, is there a reduction in Ogden rate as well? Thank you.

A - David Stevens {BIO 1990356 <GO>}

The first one was the development in ultimate loss ratios. So we have commented that we don't expect these projected loss ratio to improve as much as they would have done in the more distant past. I mean, they have insisted in the past where our loss ratio have improved by 20 percentage points or 30 percentage points, we wouldn't expect that to happen anymore. We -- and frequently comment that we expect our more recent years to be on the cautious side for the best estimate range. And see that reflected in the rectangles on slide 14, where some of the US have improved by double digits and 17 and 18 have improved pretty decently already.

And I think I said earlier that the reason for a particularly strong first half was -- some unwind of conservatism that was there six months ago, based on the trends that we've seen on 15, 16, 17 years and starting to be more like normal trends after a period of, quite stubbornly flat average cost development. And so, this half year, I would say, which is a more positive half year than usual.

A - Cristina Nestares {BIO 18674745 <GO>}

In terms of timing of the Whiplash reform, I tried to leave it a bit a vague in the sense that it's about a year because it could be April, it could be October, given the current political climate and some of the priorities. But also the fact that a system needs to be developed, I think there is just certain -- uncertainty, so which we don't know, there could be a delay.

Q - James Shuck {BIO 3680082 <GO>}

Is it mainly the portal, the online portal is the limiting factor in that?

A - Cristina Nestares {BIO 18674745 <GO>}

It's one of them, yes.

A - David Stevens {BIO 1990356 <GO>}

The final bit was about the sensitivity 50 basis points moves in interest rates. The reason it was particularly material historically was twofold. Firstly the much higher expectations for PPO propensity in the positive discount rate environment. And with the minus 0.25 discount rate environment, we don't expect to see that many PPOs. And so the long -- longer-tail duration of the liabilities is not as and material as it once was. And so that sensitivity reflects the new Ogden rate and then a slightly lower propensity of PPOs. The other point is our portfolio is better matched than it was a couple of years ago in terms of asset liability positions.

Q - James Shuck {BIO 3680082 <GO>}

So the sensitivity is -- it does flex the Ogden rate, discount rate as well, on the Solvency proposition?

A - David Stevens {BIO 1990356 <GO>}

It seems that the Ogden discount rate stays the same.

Q - James Shuck {BIO 3680082 <GO>}

Okay.

A - David Stevens {BIO 1990356 <GO>}

And the PPO propensity we've therefore assumed holds.

Q - James Shuck {BIO 3680082 <GO>}

Okay. Thank you.

Q - Unidentified Participant

(inaudible) three questions. Could you talk a bit more in terms of what happened to motor rates since the start of Q3 as in you highlighted a couple of stats on ABI et cetera. But I just want to understand what happen on the competitive landscape, have you seen any increases? Secondly, what is the reinvestment rate at this point of the -- what is the investment yield you're getting on your portfolio? And lastly on Compare.com post the write-down, what's the carrying value there now?

A - David Stevens {BIO 1990356 <GO>}

You want to do Q3?

A - Cristina Nestares {BIO 18674745 <GO>}

Yeah. It's too early to comment. We haven't seen any particular change in trend. Confused index for the month of July that have an increase. The Confused index sometimes changes a bit that we prefer to take it into quarters than month.

A - David Stevens {BIO 1990356 <GO>}

And the other two points, the carrying value in our books now it reflects the net assets of the company which is about $15 million. In total, if it's not our assessment how much the businesses is worth on the balance sheet. And the final point was reinvestment rates are particularly depressing. They started the year pretty good and they moved down very materially since then. And I think we are -- the difficult compare of reinvestment of our bond portfolio is 1.3, 1.4, something around the group.

Q - Rob Murphy {BIO 16621510 <GO>}

Rob Murphy, Edison. On the other income, are you still expecting the installment income to grow strongly? And how should we think about the margin mix and the impact that's going to have on the net figure -- net of internal costs -- internal costs?

A - Cristina Nestares {BIO 18674745 <GO>}

The biggest change in instalment income has been more an accounting change between reinsurance and ourselves. And that's what was mentioned in this slide in green. So if you look at net of the effects of the changes in the reinsurance agreement, there hasn't been any material change in instalment income and we don't expect any material change going forward.

In terms of margin, as I said, when you look at our underwriting, we have one of the best combined ratios in the market. So we tend to get a look at our profitability coming from there. And we tend to see the profitability of the motor book as a whole, both combined ratio and ancillaries, so there may be changes and then we give the margin.

A - David Stevens {BIO 1990356 <GO>}

Probably one more. Sorry if it -- two go for it.

Q - Phil Ross {BIO 20618440 <GO>}

Okay. Hello. Thank you, Phil Ross from Mediobanca. Just a single one from me. You mentioned the pricing increase of 1% in response to the Ogden rate change. Do you have any view on whether you need to revisit that once claims start investing at a new rate or do you think that's fairly final?

A - Cristina Nestares {BIO 18674745 <GO>}

We think that is the final number, but how claims both it's always uncertain. The results is something to consider, which is the possible change in the cost of the reinsurance more or less, that will come for most companies at the beginning of the year. Given that we have a very high retention level, we don't expect a significant impact for us, but you could have a significant impact for the company. So yes, I will assume there might be another change in Ogden, at least in the market.

A - David Stevens {BIO 1990356 <GO>}

Thank you, and a nice quick question. The expense -- the risk of (inaudible) if you have a very short one, I'll take it?

Q - Phil Ross {BIO 20618440 <GO>}

It is short. But just your view, really, I mean we've had from most of the listed peers in the last month or so and since the start of the year and consistently people have been talking about pricing, not keeping pace with claims inflation. I just wonder, what is your view on why the market isn't reacting, and is it because there's something we don't see from the numbers -- thank you.

A - David Stevens {BIO 1990356 <GO>}

I think the conclusion. If you look at all the people who stood up in the last few weeks and talked about how they run their business. They are running them in a disciplined way to -- seeking to offset the impact of the cycle. The implication of that has to be that there are players out there who feels it's an appropriate time to grow. And it's probably fair to say that, they tend to the middle-sized ones.

In our experience there were a number of players who tend to respond a bit too late to market cyclical development. And we anticipate that they will respond and should have done already.

Q - Phil Ross {BIO 20618440 <GO>}

Thank you.

Operator

Ladies and gentlemen, the conference is now concluded and you may disconnect your telephone. Thank you for joining and have a pleasant day. Goodbye.
