Q1 2016 Earnings Call

Company Participants

- Alain Lessard
- Charles Brindamour
- Louis Marcotte
- Mathieu Lamy
- Patrick Barbeau
- Samantha Cheung

Other Participants

- Brian Robert Meredith
- Doug Young
- Geoffrey Kwan
- Kai Pan
- Mario C. Mendonca
- Meny Grauman
- Paul Holden
- Tom MacKinnon

MANAGEMENT DISCUSSION SECTION

Operator

Good day. My name is Steve and I'll be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp., First Quarter 2016 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

Thank you. Samantha Cheung, Vice President, Investor Relations, please go ahead.

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Steve, and good morning, everyone. Thank you for joining the call today. A link to our live webcast and background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also apply to our discussion on this conference call.

Joining me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Patrick Barbeau, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Mathieu Lamy, SVP of Claims. We'll begin with prepared remarks followed by a Q&A session.

With that, I would like to turn the call to Charles to begin his remarks.

Charles Brindamour {BIO 7012323 <GO>}

Good morning, everyone, and thank you for taking the time to join us this morning. So let me first provide some perspective on the fire events that continue to develop in Northern Alberta. Our thoughts first go out to the people and families at Fort McMurray, including our employees and our customers.

Our first concern is with their safety. So we've been monitoring the situation since last weekend and activated our catastrophic response plan yesterday. Additional resources are ready to mobilize, should the need arise in the coming hours and days. We continue to assess the situation as we talked. But for now, we're focused on bringing our customers back on track. Earlier this morning, we announced first quarter net operating income of $1.46 per share, 7% better than last year on the back of a solid underwriting performance.

Our top-line grew 7% in the quarter with double-digit growth in Personal Lines. Our customer experience innovations and organic growth initiatives have clearly been successful and helped offset the headwinds from the Alberta economy. We improved our combined ratio to 92.5% as our property lines delivered strong results and our auto performance continues to improve, thanks to milder winter conditions and our initiatives to address cost pressure.

Our operating ROE stood at 16.7%, a healthy level particularly in light of our strong capital position. We ended the year with $904 million of excess capital. And our book value per share grew 3% over year to $40.06. In terms of our performance, we beat the industry's ROE by 510 basis points in 2015, driven mainly by our underwriting performance, offset by the effect of weaker capital market.

Let's now look at our first quarter results by line of business. Personal auto grew 10%, including 3 points from CDI, driven by our customer experience improvements, as well as other growth initiatives. The combined ratio improved 4 points to 96.4%, helped by milder winter conditions and profitability actions. We seek further improvements in the combined ratio by taking actions to offset cost pressure. In Alberta specifically, we're increasing rates and optimizing our claims strategy to address pressure in bodily injury claims.

When it comes to the industry in personal auto, we continue to anticipate low single-digit growth in the coming 12 months. Our view on Ontario auto has not changed, as we still expect great reductions from reforms to be largely in line with government cost reduction measures. Given the irrational competitive environment across the land, we anticipate that claims cost inflation will lead to moderate rate increases in the coming 12 months.

In personal property, we grew our premium by 12%, including three points from CDI as rate increases and growth initiatives were deployed in favorable market conditions. Our combined ratio of 82.9% reflects a very strong performance with normal CAT activity and elevated large losses, suggesting that our improvement plan remains quite effective. We continue to see hard market conditions in this line of business leading to upper single-digit growth over 12 months for the industry. With new products on the shelves, including both our Lifestyle Advantage and Enhanced Water Damage Package, we're very well positioned to capture further growth opportunities in this segment.

In commercial P&C, we shrank by 2% year-over-year as headwinds from a slowing Alberta economy offset growth in other regions. This line delivered a solid combined ratio of 92.4%, as the underlying current year loss ratio improved by 2.4 points, demonstrating that our profitability actions continue to pay off. We believe industry conditions should support low single-digit growth in the coming year.

Commercial auto premiums grew 3.4% in the quarter as the impact of corrective measures and rate increases were offset partially by economic conditions in Alberta. The combined ratio remains elevated in our view at 97.5%, but the improvement in the underlying loss ratio is a positive sign further strengthened by milder winter conditions. That said, we're continuing with our corrective measures aiming for a low 90%s combined ratio within 12 months to 18 months. In terms of industry outlook, we believe the market, while still competitive, is firmer, leading to mid-single-digit premium growth in that segment.

While growing and improving our businesses in the quarter, we also deployed a number of strategic initiatives. On April 19, we announced a partnership with Turo Inc., a peer-to-peer car rental company, concurrent with its first expansion outside the U.S. into Canada. This represents another concrete example of our strategy to develop products that meet evolving customer needs. Actively participating in the emerging sharing economy provides potential new growth streams and an opportunity to accelerate our learning, while leveraging our core competencies.

We also introduced our Intact Service Centre in Calgary, the first to be launched in urban areas across Canada. Our customers can now enjoy a simpler, faster and more convenient auto claims experience. I'm also pleased to announce some executive changes enabling us to accelerate our strategic initiatives. Jack Ott, currently Chief Information Officer, will become Senior Vice President of Innovation Partnerships. Jack will bring us knowledge of technology helping our venture team advance a number of partnerships and investments and disruptors.

Mathieu Lamy, currently Senior Vice President of Claims, will take on the role of Chief Information Officer. Mathieu's focus will be on continuing our software engineering transformation and advancing our enterprise-wide data strategy. The Intact Lab will also report to Mathieu to bring our research and design unit closer to our development team.

Patrick Barbeau, currently Senior Vice President of Personal Lines, will now bring his depth of experience to the role of Senior Vice President, Claims. And I'm also pleased to introduce Darren Godfrey as our new Senior Vice President, Personal Lines. Darren brings a wealth of experience across actuarial, claims and personal lines since he joined, in fact, 15 years ago. You'll hear from Darren at our next earnings call.

Finally, to accelerate our drive to become the Canadian leader in specialty lines and surety, we're creating a national unit solely focused on excelling in this segment. To make that happen, I'm pleased to announce the appointment of Joe D'Annunzio as Senior Vice President of Specialty Solutions and Surety. Joe's leadership over the years gives me confident that Intact will be second to none in talent, expertise and product in this segment.

I think we really have the privilege of having a world-class team in place and changes like these speak to the depth of our talent pool and our ongoing commitment to people development. So, in conclusion, 2016 is off to a good start with strong momentum in both top-line and bottom-line and a solid balance sheet to support our growth ambition. Our customer-driven strategies such our online experience improvements, new products and service excellence support our strong organic growth momentum.

Our property lines are performing very well in terms of combined ratios. And we're improving our auto results. We're confident that our expanded leadership team, combined with our actions, will continue to help us outperform the industry's ROE by 500 basis points and growing net operating income per share by 10% over time. We believe our focus on the customer experience, our employees and financial performance places us in a very strong position to benefit from the environment in which we compete.

And, with that, I'll turn the call over to our CFO, Louis Marcotte.

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. Good morning, everyone. Q1 2016 has clearly been a strong quarter for Intact, with top-line growth of 7%, a combined ratio of 92.5% and an operating ROE of 16.7%. These results were delivered while maintaining a strong balance sheet with $904 million of total excess capital and an NCT of 215%.

I was pleased to see our underwriting income grow 23% compared to last year, driven by 8% higher earned premiums and a one point improvement in our combined ratio. This is well aligned with our strategic roadmap to grow earnings through organic growth, margin improvements and capital management initiatives.

When looking at our core underwriting results, we see a 4-point improvement in the underlying current year loss ratio with contributions from our auto lines and commercial P&C. In personal property, we incurred non-CAT weather events and large losses which were 5 points higher than year. Despite these losses, the underlying current year loss ratio remains stable at 55% in this line of business.

On a core underwriting basis, our property lines continue to perform well. And we're pleased to see improvements in our auto lines. Favorable prior year development amounted to 8.4 points in the quarter, very much in line with historical levels for Q1, despite being 2 points lower than last year's elevated level.

Finally, the expense ratio was 0.3 points higher than Q1 of last year, essentially due to growth initiatives and premium taxes. Our distribution activities delivered pre-tax earnings of $14 million, in line with expectations, but below last year when we recorded higher variable commissions. This income source should deliver earnings north of $110 million in 2016. With regards to other operating items, we reported stable investment income in the quarter and still expect a mild erosion over the next 12 months as the low yield environment continues to be challenging.

Moving on to non-operating items, we reported non-operating losses at $58 million in the quarter, $44 million more than last year. The year-over-year change relates primarily to weaker capital markets, differences in interest rate movements and gains recorded last year related to brokerage transactions. Despite the recovery of the TSX this quarter, we recorded $22 million in impairments, a similar level to last year.

Our Q1 2016 effective income tax rate of 21.6% is in line with our expectations. It is three points higher than last year essentially due to the tax treatment of non-operating gains recorded last year. In summary, our net operating income per share grew 7% year-over-year, but lower non-operating results led to reduction of earnings per share to $1.11.

Finally a few comments on our financial position. Our MCT increased 12 points this quarter to 215% on the back of strong earnings and 4 points from the phase in of the 2015 and 2016 MCT guidelines. Our total excess capital amounted to $904 million at the end of the quarter, including the proceeds from our $250 million debt issue earlier in March.

We issued this debt to capture low interest rates and optimize our capital structure, bringing us close to our target debt to impact capital ratio of 20%. The notes bear an interest rate of 3.77% and mature in 10 years. Our balance sheet remains strong. During the quarter, our investment portfolio moved into an unrealized gain position of $35 million.

This was driven by a strong recovery in the common share portfolio, offset in part by a decline in the price of rate reset preferred shares. We executed on our buyback during the quarter purchasing some 230,000 shares for a total cash outlay of $20 million. This is aligned with our capital management framework and our stated intention to use the buyback opportunistically preferring to deploy capital on growth initiatives.

In this respect, we invested some $84 million in brokerages and ventures during the quarter. In conclusion, our profitability measures in the property lines continue to be effective. And we have clear action plans to further improve results in auto. We firmly believe consolidation in the domestic P&C industry will continue both in manufacturing and distribution. And we will continue to be active participants.

We are patient and disciplined in our approach and have been rewarded for investing in an organic growth in this environment. With a solid operating position, a strong balance sheet and a deep talent pool, we're well poised to capture emerging opportunities.

With that, I'll return the call back to Samantha.

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Louis. Steve, we're now ready to take your questions. In order to give everyone the chance to participate, kindly limit your questions to two per person. And if there is time, you may login again.

Q&A

Operator

Your first question comes from Tom MacKinnon with BMO Capital. Your line is now open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thank you very much. One quick question and then a follow-up. I guess the quick question would be on the distribution income. I think it was only $14 million in the first quarter, but, Louis, you think it's going to be north of $110 million for 2016. Could you -

A - Louis Marcotte {BIO 18040440 <GO>}

That's right.

Q - Tom MacKinnon {BIO 2430137 <GO>}

So, obviously, we're not in that kind of run rate. What happened in the first quarter that made it lower than that run rate and why would you anticipate it would pick up in the ensuing quarters this year?

A - Louis Marcotte {BIO 18040440 <GO>}

So, these income sources tend to be seasonal. And our expectation, in fact, is to get roughly 15% of the annual income in the first quarter. And that's really driven by the seasonality of the written premiums as well. So, towards it's normal, it's a variation to last year, because last year we actually recorded higher variable commissions in the first quarter, simply because brokerages were recording the benefits of the previous year into Q1, a true-up of the previous year into Q1. But that's a bit of volatility. But when we plan our income throughout the year, it's about 15% of the annual run rate that is booked in the first quarter.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And I think you guided to that number to be $100 million in 2015 and you actually exceeded that a little bit. Is that correct?

A - Louis Marcotte {BIO 18040440 <GO>}

That's right. So, we did $104 million last year and we were guiding towards 10% growth. And I just stated we would expect that to be north of $110 million this year.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And then, Charles, maybe if there is any more context you can give with respect to Fort McMurray. If we look back to Slave Lake, which was one of the second largest in terrible disaster in Canada after the ice storm in Québec, I think that was – you had preannounced then in the area of $45 million to $55 million after tax and that was predominantly personal property, maybe a lesser extent commercial and some auto related coverages. Is there any way that Fort McMurray is similar to Slave Lake with respect to the – maybe not necessarily potential losses because that's certainly something you're trying to assess, but in terms of the breakdown of where those losses could potential be?

A - Charles Brindamour {BIO 7012323 <GO>}

So, Tom, I think it is a bit early to comment. I would say that there are lots of similarities between Fort McMurray and Slave Lake. One big difference is that our market share in Slave Lake was much higher than our market share in Fort McMurray. I think we could get a picture of what the ultimate will look like. And as we did last time, I think, we'll probably inform the market of that once, A, if it's material and, B, once we have a good grasp on what it is. I'll ask Mathieu Lamy, our – as VP of Claims for a few days now or still to give you his perspective on the Fort McMurray.

A - Mathieu Lamy {BIO 15207469 <GO>}

Yeah. So, like you said, Tom, it's very early. So the effort right now or the focus is preparing our response for when we get access to the site – the field operation. At this point, we have beefed up our phone resources to be able to accommodate the calls that we think are coming. So far, in terms of losses reported since last night, we have about 40 losses reported, some are evacuations, some are total losses. Actually, it's reported by the ensured 40 losses reported, probably 25 fires at this point, very early to assess where this is going to end up.

In terms of exposure, it's difficult to know where the damages are at this point. But in the area, we know we ensure about 1,500 houses, 1,300 tenants in condo, some 300 businesses, maybe a bit more. And obviously there is an auto risk that I don't have the numbers, but it's probably similar to those numbers on the other side.

A - Charles Brindamour {BIO 7012323 <GO>}

And that's called the Greater Fort McMurray area.

A - Mathieu Lamy {BIO 15207469 <GO>}

That's it. What we don't know is what is damaged, what proportion of it will be damage. This is way too early to know at this point.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

A - Mathieu Lamy {BIO 15207469 <GO>}

And but like you said, Charles, like focusing on the response right now and in the coming days we'll be able to have an assessment on those.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. No, exactly. Troops, resource, backup plans are in place. We have the people on the ground yesterday actually. And so, it's a matter of getting access and hearing and responding to our customers at this stage.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you for that.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks.

Operator

Your next question comes from the line of Geoff Kwan with RBC Capital Markets.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi. Good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

My first question was just the wording that you guys have been talking about on the auto – the claims inflation. I know that you guys talked about last quarter looking at more Alberta in the bodily injury stuff. It seems like the wording seems a little bit more widespread. I'm just trying to get a sense as to, are there kind of commonalties, specifics that you can talk about? What's driving it? And then I know you've also talked about the pricing increases. Is the implementation of the timing – is that going to be simultaneous method or there might be a delayed impact in terms of when thinking about the combined ratio?

A - Charles Brindamour {BIO 7012323 <GO>}

All right. Jeff, I think, a good observation. I would say that if you go back past few years, we were in a net rate decrease environment in automobile insurance. In fact, if you look at the earned premium in the first quarter, the average earned rate is minus 0.8%. If you look at the written premium in the quarter, you see that it's shifting now in positive territory. And it is a matter of just markets across the land for different reasons moving in a world where you will likely see rate increases, can be normal inflation. It can be a reversal after years of flat rates or slightly decreasing rates in markets like Québec, for instance, or it could be markets like Alberta, whereas we've talked about last quarter, we are in a corrective mode. Bottom-line is we're seeing certainly an environment where rates will pick up across the land as one would expect over time with the inflation naturalizing in the system. I will leave Patrick to provide additional color. And we'll take your next question afterwards.

A - Patrick Barbeau {BIO 18476397 <GO>}

So, exactly Charles. As you might recall, in the past that two years, we've seen a bit of increase in frequency on auto in different parts of the country. Part of it was driven by a couple of tough winters in a row. So, that was part of the inflation overall pretty much as I think mostly the East parts of the country.

We talked about the BI claims pressure. We have a robust action plan on both claims and rates that we have started to implement about a year ago where we're starting to see some benefits from that. And on overall, maybe what I could add on the rate increase or the rate actions we're anticipating from the industry, well, on our side, we have started to already to increase a bit more the rates in different parts of the country, namely the Eastern and obviously Alberta.

On Ontario, obviously, we're now through the reforms. There is the final rate decrease for the industry that's coming up, but there is also normal inflation outside of the reforms that is – as I think that line as well, a bit similar to what I just said for the others. And we're at a point where we are also trying to reflect this inflation in our regional part.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So, I think, the general reasons vary by province, but our perspective is that if you look at the next six months, 12 months, from a written rate point of view, that will look a bit different from the past six months to 12 months in a rational competitive environment. I think we're not behind the curve on any of these things. I think we're trying to be proactive to make sure that we maintain and improve our margins in that environment.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thanks. And then just the other question I had was on the commercial P&C side, the DPW was down 4% year-over-year. I mean units were down 1%. You've talked about some of the price increases in Alberta was weaker. Just wanted to get, I guess, some color on the year-over-year change and then also how you think that year-over-year change trend as we look over the next couple quarters.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Not just for Alberta. I guess, Geoff, you're talking about the line of business and it's holistically, right.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Correct. Yeah. On looking forward, but just generally speaking and what happened with Q1, just maybe a little bit more color on what drove the year-over-year change?

A - Patrick Barbeau {BIO 18476397 <GO>}

Well, Geoff, I think the 4.3% you are quoting is the total duct premium, but there is a bit of two years policy in our portfolio. So we look at it more on a net return if you want basis and the decrease is 2.3% basically. So there is a dip in the number you quote, two year policy effects. So the net decrease is in fact more around 2%. There is a few elements combing into that. The first one is we believe that the impact of the economy in Alberta has been a drag of about a point, okay.

We also saw some elements on the surety side. Surety gets to be very lumpy on a quarter-to-quarter basis, because there is no renewal. And, in fact, surety has affected our growth in the quarter by another point. And, overall, we have a bit of timing issue. And depending on the prices, the account in commercial lines can vary between $2,000 and up to a multi-million dollar account. So there is a lot of variation depending on the number of large account you write or we may lose. And we know that there has been an impact from a handful of large account in the quarter. So overall -

Q - Geoffrey Kwan {BIO 7413168 <GO>}

In fact on that very point, the mix created mid-single-digit drag on the top-line as well.

A - Patrick Barbeau {BIO 18476397 <GO>}

Exactly. Okay. So this explain pretty much the growth in the quarter. I'd look at the historical growth in our quarter and in fact it's been on average for the last nine quarter roughly about 2.5%. But when you look at the standard deviation, it's about three points varying from minus 3% to plus 7%. So that I think illustrates the fact that telling on what happens on the timing in large account. It has a really impact on the growth overall. So, that makes me looking at one quarter not necessarily is the right trend to look at it. In fact, we don't think there is anything structurally right now preventing us to have a growth that would be necessarily different than what we see in the industry, which would be low single-digit growth.

Maybe more on the market, because you are hinting on the rate increase. Basically we think the market is still experiencing some rate increase. In fact, in the last quarter, our rate increase were about 3.7%. And that's like 11 quarter in a row with rate increase above 3%. On top - over the last three year, we've increased by basically 13%. So, we think we're still operating in a market that's conducive to having some rate increase, not everywhere, but mostly targeted on more difficult segments such as condo, realty, restaurant, things like this.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Perfect. Thank you very much.

Operator

Your next question comes from Kai Pan with Morgan Stanley. Your line is now open.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning. Thank you. First question on the underlying current year loss ratio improvement of 4 points. Could you break down between the mild winter as well as the pricing and underwriting action you've taken?

A - Charles Brindamour {BIO 7012323 <GO>}

Patrick will give you his perspective. It's a little bit - I guess there is a bit science and art here in terms of removing the impact of mild winter condition, but we'll share with you our perspective.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. I can share a few comments on the personal lines. When we look at weather, there are single events that can - or not reach the CAT definition - our internal CAT definition. And there's the general winter temperature or accumulation of precipitation that can have access on the different lines. So, it's hard to separate the two. I think if I look in the two personal lines, on the auto side, we've seen 8% decrease in frequency year-on-year when you compare the first quarter to last year. So, a decrease in frequency can be also caused by different things, but we know that a good portion of that was probably driven by milder or better winter conditions.

We have to remember also that the year-on-year comparison is not an easy one because last year was a winter at the other end maybe of the spectrum or was very difficult winter condition in many parts of the country. So, if we compare this year to the average of the past few years or to last year that might make a difference. On the personal property side, not much on the weather. Weather last year or this year, there was about 2 points of CATs in 2016 in Q1 and we had none in the Q1 of 2015. So, that's an indication. So it's not all going in the same direction. But, for personal lines, overall, I think, it's helped our results in auto, not necessarily a part of the equation for our personal property.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. Then my second question, on the capital management side, looks like your excess capital, $900 million, and that's about a 15% of your shareholders' equity. If you take that one out, your ROE could be 2 points higher. So just wonder how - my question really is how big of the excess capital you're willing to hold and for how long before you consider other capital management activities outside investment and acquisitions?

A - Louis Marcotte {BIO 18040440 <GO>}

So, Kai, thanks for the question. At this point, so we raised a debt and that rose the excess capital. Our view that we should raise the debt now because the interest rates were attractive, so we were willing to carry a bit more capital, because we think there's going to be opportunities to deploy them in the short-term to mid-term. So at this point, this is probably a level we're comfortable at but we are obviously looking at deploying it as soon as possible but comfortable to carry it temporarily to deploy it on a growth opportunity.

A - Charles Brindamour {BIO 7012323 <GO>}

I think, Kai, there's visibility of opportunity that goes one way. The other thing that matters to us is the impact of the excess capital on the ROE and our ability to reinvest in the business in relationship with what the industry's ROE is. And with an operating ROE north of 16%, despite the excess capital position, I think, this leads us to be patient holding the capital given we think that there are growth opportunities with some visibility in the market here.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. Well, thank you so much.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

Your next question comes from Meny Grauman with Cormark Securities. Your line is now open.

Q - Meny Grauman {BIO 15238080 <GO>}

Hi. Good morning. The question is on the purchase of brokerages and other ventures, $84 million in Q1, already surpassing what you did last year. So I'm wondering if that's just lumpiness in terms of just opportunities coming to you or are you seeing anything different in the environment that will lead you to believe that you could sustain a robust pace going forward with these kinds of equity investments?

A - Louis Marcotte {BIO 18040440 <GO>}

So this is clearly lumpy. We're off to a good start this year compared to last year, but it is lumpy and difficult to predict. So we're working hard to invest in brokerages, but the timing depends on the brokers and our ability to close those sales. So we expect lumpiness over time. But, again, I think the run rate last year was a bit low. We had higher deployment the year before. I would think in between the two would be a reasonable -

A - Charles Brindamour {BIO 7012323 <GO>}

How much did we deploy last year?

A - Louis Marcotte {BIO 18040440 <GO>}

$77 million.

A - Charles Brindamour {BIO 7012323 <GO>}

$77 million.

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah.

A - Charles Brindamour {BIO 7012323 <GO>}

Clearly, the environment for consolidation and distribution is very healthy. I think in building BrokerLink and helping entrepreneurs in the marketplace, consolidate is a key strategy. And I think more and more people in distribution understand the importance of scale. So if I look at the opportunities in consolidating distribution, I would say very strong at the moment. And given these transactions are meeting our threshold of return as a distributer, clearly, we'll put as much capital as we can find opportunities in that space, so long as we can generate those sorts of returns. And I think the entrepreneurs with whom we partner with and the team at BrokerLink have done a phenomenal job of integrating and rapidly turning double-digit return and margins of EBITDA to revenues in the 20% to 30% range very quickly, so very attractive for us and we'll certainly capture the opportunities that exist in the marketplace.

Q - Meny Grauman {BIO 15238080 <GO>}

Thanks for that. And then if I could just follow-up with a question about the impact of the economy on your business, specifically in Alberta, I wonder if there is any updated thinking on that. I think last time you mentioned specifically for commercial P&C that you expected a reduction in growth of about 0.5 point. Wondering how you see the environment developing a quarter later.

A - Alain Lessard {BIO 21962461 <GO>}

So like I said many – this quarter we estimate that the impact of the economy in Alberta was about a point on commercial P&C. And in fact it's probably deteriorated from what we saw at the last quarter. It's coming basically from the two same area, which is the oil and gas sector and the contractor sector. Last year, we had seen a fairly stable drop in the oil and gas sector to the tone of 10% to 15%. This spiked to about 25% in the first quarter of 2016. Okay. And on the contractor, this was an emerging trend we saw at the last quarter in 2015. And it continued in 2016 and in fact accelerated because we saw a drop of about 17% on the contractor business. So these are the two segments that are really affected by the economy in Alberta. So the impact we were expecting is about 0.5 point in the quarter. It translated to something closer to a point on the overall P&C growth in the market.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks, Alain. Yeah. Those two sectors represent about 27% of our commercialized portfolio in Alberta and, therefore, are influential to our performance. I think if we take higher level perspective, Alberta is an important province for us. We ensure almost one in four Albertans same thing at the business level. This represents about 15%-ish of our portfolio with $1.4 billion of business. So the interesting thing is that the areas that are affected are meaningfully affected. But then when I look at our personal lines performance, this is the market in which we're growing the fastest. It's not to say that the industry is growing the fastest. But this is the market in which shopping is taking place and our value proposition is actually working very well.

In personal lines, you have to keep in mind that there are not necessarily meaningfully less houses or meaningfully less cars on the road. I think what you see, though, is that the value of the insurer car pool is not increasing as fast as it would normally. And it's driven by the fact that new motor vehicle sales are down 10% and, therefore, the average age of the cars on the road in Alberta is increasing. So, overall, a province, which is going through a tough time and we're seeing that very clearly in commercial lines. But I think our value proposition, our product range, service we're providing and the technology solutions we have in place certainly seem to drive growth in that market.

Q - Meny Grauman {BIO 15238080 <GO>}

Thank you very much.

Operator

Your next question comes from Doug Young with Desjardins Capital Markets. Your line is open.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Doug.

Q - Doug Young {BIO 5640851 <GO>}

Good morning. Thank you very much for taking my question. First, Ontario – first, Ontario auto -

A - Charles Brindamour {BIO 7012323 <GO>}

Next question, please.

Q - Doug Young {BIO 5640851 <GO>}

What's that?

A - Charles Brindamour {BIO 7012323 <GO>}

I said next question, please. Just kidding, Doug. Go ahead.

Q - Doug Young {BIO 5640851 <GO>}

I won't take it then. Ontario auto – obviously, there is indication of a cost inflation. And just wondering if there is anything concerning in that for you. And I think there's a new dispute resolution process that's being adopted. And is there any relationship between the two and is there are any concerns you have around that new dispute resolution process?

A - Charles Brindamour {BIO 7012323 <GO>}

Okay. Good. Why don't we start with Mathieu on the dispute resolution and maybe a comment on the upcoming June reforms? And then we'll let Patrick take the rest of your question. Go ahead, Mathieu.

A - Mathieu Lamy {BIO 15207469 <GO>}

Okay. First on the dispute resolution system, the new system has been implemented as of April 1. That followed the Judge Cunningham report about a year-and-a-half ago. And the idea there was to streamline the process, make it more predictable, more cost effective for Ontario. And so far so good. We don't have any decision from the new Tribunal. But it has been implemented and we have every reason to think that this is going to be successful at this point.

In terms of reform, we have some new product effective as of June 1, basically in accident benefit. There's three types of claims in accident benefit: the MIG claims, the basic claims and the CAT claims. On the basic claims and on the CAT claims, basically, what's going into effect is there is a reduction of coverage with an option to buy out. And also, as of June 1, for every effective policy, there will be a new CAT definition, which we think has progressed because it will probably alleviate some of the problems we have with the older definition with the stacking of physical and psychological impairment. So I think, overall, we're positive with those coverage changes.

A - Patrick Barbeau {BIO 18476397 <GO>}

And yeah, I agree. I think our view on the effectiveness of those reforms has not changed. Of course, we'll see when they are all implemented. But the way it's heading is still we think in line with what we expect in terms of the benefits from those reforms. So, when we quote cost pressure for this line of business in Ontario, it's not linked to the reforms, per se. It's more normal inflation. As you might recall, this process of implementing the reforms and the different filing that we had to go through started at the end of 2013 and we're now in beginning of 2016. So over a two-and-a-half year period, there is normal cost inflation in all markets, including Ontario. And we think now that we're through the reforms, it's time to be proactive and reflect that in our rates. Is that clear?

Q - Doug Young {BIO 5640851 <GO>}

That takes me to my second inquiry is that – so you think that post reducing rates, I guess, by roughly 15% come, I guess, mid-June that you'll be able to turn around and start pushing through rate increases. And is that something you've had discussions with the regulator about is there comfort with that?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. We're in that process right now. We've already started. And that's what we expect will happen in the market. It's not necessarily that the trends are concerning. It's just normal inflation. That one point also reflect in our rates.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And then just, secondly - I know, Charles, I've asked this many times and I still get confused by this. But the prior year reserve development is running double what you've historically have run at. And it seems to consistently be up there so much so that I kind of forget what the historical average is. But I think it's 3% to 5%. Is this a renew in a new paradigm? That 6% to 9% is what we should be thinking about on this line item?

A - Charles Brindamour {BIO 7012323 <GO>}

No. I think, Doug, one of the things you need to keep in mind is that the first quarter tends to be higher than other quarters. And the reason is very simple. The prior year is much closer in the first quarter than in the other quarters. And there are a number of elements, some of them structural, some of them not structural and, therefore, not necessarily to be there in the long run that have led us to say that the levels we have seen in the past few years should not necessarily be expected that level going forward. I'll let Mathieu give his perspective on that.

A - Mathieu Lamy {BIO 15207469 <GO>}

Yeah. Well, that's exactly right. The first quarter is normally higher because that development of the short tail claims have closed in the next three months, in Q2, Q3 and Q4. This is current year development if you wish, so, in Q1 of prior year because it's from Q4 the preceding year. We think that the development right now is at the top of the range, 3%, 4%, we expect because of the few factors. First, the AXA acquisition has led to higher prior year development. We think there is still an impact going forward, but that will diminish in time.

We have some assumption for the Ontario reform of 2010. And we executed probably a bit better than the assumption and developed a few points of prior year development because of that. 2015 saw so higher development range because of prior year CAT that were reserved a big higher. So in 2016, that should be lower because there was last year less CAT losses in 2015. And there is the structural effect of the two impact of the discounting and the PfAD, the Provision for Adverse Development. The discounting being lower doesn't completely neutralize the PfAD.

Q - Doug Young {BIO 5640851 <GO>}

Right.

A - Mathieu Lamy {BIO 15207469 <GO>}

Structurally generate the PYD.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And so I mean timing-wise when I think of all these items - and thank you for the detail - do we start to see this kind of revert back to the normal range over the next year or two years or is this kind of a longer-term glide path?

A - Charles Brindamour {BIO 7012323 <GO>}

I wouldn't think about that mid-term.

Q - Doug Young {BIO 5640851 <GO>}

Okay. Great. Thank you.

Operator

Your next question comes from Brian Meredith with UBS. Your line is now open.

A - Charles Brindamour {BIO 7012323 <GO>}

Hey, Brian.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Hey. Good morning. A couple questions here for you. First one, going to the commercial P&C business, wanted to get talk about where is rate relative to loss trend and are you done with your corrective actions in the P&C area or is there still more to come? And I know, Charles, before you have commented about the amount of combined ratio improvement we should continue to expect here going forward as the earned moves in. But could you give us some insight into where that stands right now?

A - Charles Brindamour {BIO 7012323 <GO>}

Sure. We'll let Alain give you his perspective.

A - Alain Lessard {BIO 21962461 <GO>}

Okay. So, basically like I mentioned earlier, last quarter, we saw rate increase at 3.7%. That is probably a bit higher than the loss trends we're doing right now. So, if you look at our corrective action, we think that the corrective action we took – 90% of it right now has been done and earned, okay. We still have some earning coming up in the next 12 months to 18 months. And we're still pushing through rate increase right now. So, this is where we stand. So, on the overall, I think, we said we would operate in, in the low 90%s. I think we're getting very close to operating at that level, currently. We were beyond that in 2015. And we're very close to that level in Q1 2016.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Got you. But that low 90%s also assumes fairly high reserve releases that are going on right now.

A - Alain Lessard {BIO 21962461 <GO>}

Well, if you look at the prior year development like – right now it's a number that's very volatile. We're 3 points lower than that year, which was a ultimate buy. But we're probably a bit higher than our historical average, but not very far from it.

A - Charles Brindamour {BIO 7012323 <GO>}

And the business is priced to generate low 90%s. And when you price, you don't anticipate favorable development from the past. Now, if there is some degree of conservatism in how our folks on the frontline reserve, obviously, that's baked in your current accident year performance. And it all washes out over time. Brian, when I look at commercial P&C right now and I think the first quarter, severity and frequency largely offset each other. And the insured value, so to speak, is up a point. So, when I wash frequency, severity, and the sum insured increases, I get very close to zero. And we're earning 4 points of rates in the system and writing 3.7 point of rate.

So I think if I just look at the average rate increases over the past three quarters, in 2014, we were 4.4-ish, in 2015 we were 4.6-ish and this year 3.7. There has not been 13 points worth of inflation in the system, especially if you take into account that we're also getting a few points of some insured increases to eat that inflation. And so, it's with some degree of confidence that we say that we see this business running in the low 90%s. There is still rate momentum in the system. And, quite frankly, I'm always impressed despite the performance to see the commercial lines team being focused on the corners of the portfolio from coast-to-coast that deserve corrective action. I mean these guys behave as though the combined ratio was 110%, which is what I like to see when the combined is in the low 90%s.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Great. Thanks. And then my second question, I guess, is for Louis. If I look at your cash flow statement, there is a line item that says purchase in brokerages and other equity investments and it was the $84 million in the quarter. That's actually in excess of what the total was in 2015. Is that reflective of actually your activity in the first quarter as far as buying brokerages? Or is there something else going into that number?

A - Louis Marcotte {BIO 18040440 <GO>}

Well, it is reflective of our activities. It does include both brokers and what we put into – invest into ventures. We chose not to specifically disclose the venture part, because we have confidentiality agreements. But we do put the two together there. Now, the activity – this is reflective of what we are doing in the brokerage. It's off to a good start when I look at the run rate compared to last year in terms of brokerages specifically, but it can be lumpy. So -

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think it is fair to say that in Q1 a portion of that lump is venture-driven.

A - Louis Marcotte {BIO 18040440 <GO>}

Yes.

A - Charles Brindamour {BIO 7012323 <GO>}

And venture is much lumpier obviously than brokerage consolidation because there are hundreds of consolidation opportunities right here in Canada. And so we have a pipeline basically that we're working on. Venture given our sandbox is tighter and we're not as comfortable with our skill sets, so to speak, on that front, we're more cautious and it's therefore lumpier.

Q - Brian Robert Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Your next question comes from Paul Holden with CIBC. Your line is now open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning. So, I want to ask a question related to Fort McMurray. And that question is if you can give us a sense around potential commercial lines exposure there, whether that's property or business disruption type insurance?

A - Charles Brindamour {BIO 7012323 <GO>}

Okay. Alain, why don't you give us your perspective?

A - Alain Lessard {BIO 21962461 <GO>}

Well, I think, Mathieu mentioned that we have basically 350 policies somewhat in the region. And that's the overall region. And we're right now in the midst of looking at all of that. That's the sum of property, building contents as well as business interruption, okay. So, it's the sum of all of the three. What I would like to say is that this is a number, but it ties a lot of variability because we have policy out there in the $20,000 and probably the biggest policy in the bounds of $10 million, $12 million which would be like a building or something like this. So, the exposure is very variable. So depending on where it sits and everything very difficult at this point to call any forecast or anything on that. But that's the color I can give you at this time.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. That's helpful. Thanks. And then second question relates to CDI. I guess it's roughly a year give or take since you acquired CDI. So wonder if you can give us quick update on how that acquisition has progressed, if everything has just fallen in line with your original expectations or if there have been positive or negative deviations relative to expectations?

A - Charles Brindamour {BIO 7012323 <GO>}

So, the business is largely integrated. You have to keep in mind here that there's two things that happened at the same time. First thing is the integration of Grey Power and belairdirect and the second thing is the integration of Canadian Direct Insurance and belairdirect. So, the team has been managing both integration at the same time. And I would say that the integration is largely finished. So, we're pleased with that, because the timing is largely in line with what we anticipated.

The second thing is that the brand of Canadian Direct Insurance has moved in Alberta to belairdirect. And I think there will be further steps in 2017. So, so far so good. I think the direct to consumer platform is now established from coast-to-coast with a fair degree of success. We have in that business unit now well north of $1 billion and very healthy growth taking place. When I look at then the core performance of the direct business in the West, which includes both business that was in belairdirect, Grey Power and the Canadian Direct Insurance, I would say that on the home insurance front, very good. I think on the automobile insurance front, we're seeing the pressure we're seeing in the Alberta automobile book.

I would say the bigger issue for me, Paul, is that there are lots of moving pieces at the moment, new claims seen, new system, the combination of two businesses. And so, I find that it is hard to note we are on plan, better or worse than plan. And the other thing is that from a creditability point of view, it is a little bit thin and early in the process. So there is a lot of efforts to improve our visibility or understanding of the core performance of CDI in Alberta automobile. Overall going very well and then we're trying to establish our brand in the market and testing ways to generate response and transform response into new business. So there is a lot of activity taking place at the moment but the integration is largely done.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. Thank you for your time.

Operator

Your next question comes from Mario Mendonca with TD Securities. Your line is now open.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Good morning. Probably for Louis, could you help me just think through the change in the MCT? The debt issuance, the $250 million, that would have added something. Is that about 13 points? Is that fair?

A - Louis Marcotte {BIO 18040440 <GO>}

So the debt has actually a bigger impact on the excess capital. If you look at the MCT itself, which is up 12 points, it's really 11 points coming from operations and then the 4 points from the phase-in of the guidelines – the guidelines phase-ins. And then part of that is distributed through upstream dividends. So, the MCT, per se, is really driven by the change in – or the gains from operations.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

But why would debt not have added to the MCT?

A - Louis Marcotte {BIO 18040440 <GO>}

Because it's not pushed down. So, it is not pushed down into the operating company.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Oh, you left it at the HoldCo. I'm sorry. Yeah. That's that part I didn't follow.

A - Louis Marcotte {BIO 18040440 <GO>}

We did leave it up. Where it can impact is at the amount of upstream dividends we pull up. And so that would impact it, but this has been left in the HoldCo.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

That makes sense then. Now just a quick question back to Fort McMurray. The reinsurance – is there any extent to which – what is the extent to which reinsurance could limit your exposure there?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, the reinsurance will play its role in this case. Assuming the losses hit or go above our net or our retention, then these are pretty straightforward losses subject to reinsurance. So, I think, reinsurance will kick in the way it has in Slave Lake and in other losses. I mean fire is as straightforward as it get.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Now you couldn't give us a limit there like $100 million, if it exceeds $100 million then the reinsurance kicks in or is it more complex than that?

A - Charles Brindamour {BIO 7012323 <GO>}

No, it's pretty straightforward, Mario. I think that you have the first $100 million for your own account. And then as you move above $100 million, then it goes down from 40% session right up to 95% session. So, the first $50 million above $100 million is 40% ceded and you quickly get close to 90% ceded after that.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

So, why is it that with Slave Lake with the charge, I think, ultimately being about $50 million, why would reinsurance have played a role there at all unless the reinsurance limits were a lot lower then?

A - Charles Brindamour {BIO 7012323 <GO>}

This was, I think, a number of years back where the reinsurance limits and the size of the organization was smaller.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Okay. That makes sense. Thanks again for your help.

Operator

This concludes today's Q&A session. I now turn the call back over to Samantha.

A - Samantha Cheung {BIO 19462616 <GO>}

Thank you all for your participation today. Following this call, a telephone replay will be available for a period of one week, while the webcast will be archived on our website for one year. A transcript will also be available on our website in the Quarterly Financial Archive. We also invite you to listen into our Annual General Meeting of Shareholders, which will take place today at 11:30 AM Eastern Time at the Montreal Museum of Fine Arts. Our second quarter 2016 earnings call is scheduled for July 27. Thanks again for your time today and this concludes our call.

Operator

This concludes today's conference call. You may now disconnect.