S1 2014 Earnings Call

Company Participants

- Andrew Rose, CEO, comparenow.com
- David Stevens, COO
- Geraint Jones, CFO
- Henry Engelhardt, CEO
- Kevin Chidwick, CEO, Elephant Auto
- Lorna Connelly, Head of UK Claims
- Unidentified Speaker, Analyst

Other Participants

- Andrew Crean, Analyst
- Andy Hughes, Analyst
- Dhruv Gahlaut, Analyst
- Greig Paterson, Analyst
- Marcus Barnard, Analyst
- Marcus Rivaldi, Analyst
- Ravi Tanna, Analyst

Presentation

Henry Engelhardt {BIO 3022947 <GO>}

Good morning. And thank you for joining us for Admiral Group's results announcement for the first half 2014. I'm Henry Engelhardt, Chief Executive of Admiral Group. And I'm joined today for the presentation by our newly promoted CFO, Geraint Jones.

Some of you might be wondering what happened to what's his name, the old CFO? Well he's here too. Kevin Chidwick stepped into the role as CEO of our US insurance business, Elephant Auto, a couple of years ago, while simultaneously doing the CFO job. But with the growth in potential of Elephant, he took the decision that it was time to relinquish the CFO position and concentrate solely on Elephant.

I'm very pleased to say that Geraint, who has been with us since 2002, has cleared all the internal and external hurdles and, as of today, is the Group CFO.

In addition to Geraint and Kevin, you'll also hear from David Stevens, our COO and CEO of the UK insurance business. He'll be joined by Lorna Connelly, who runs UK claims. And they'll go into some details on the vagaries of the UK car insurance market and what state it is in today.

Following David and Lorna, Kevin will talk about Elephant and will be joined by the CEO of comparenow.com, our US price-comparison business, Andrew Rose.

Let me just start by summarizing our results. There are a lot of positives to take from our H1 2014 results but, equally, no shortage of challenges ahead.

The positives are the results themselves; a record first half of the year profit and dividend, in particular. And continued progress on the non-UK businesses and UK household.

The big challenge is the UK car insurance market. In the UK car insurance business, it's very simple. We have more customers and less income now, compared to last year. And so, unless there is a noticeable change in claims frequency and/or severity, there will be pressure on margins.

Now let's look at some of the specifics. It was a good half year for profits; in fact, the best first half of the year in Admiral's history.

Geraint Jones {BIO 19738535 <GO>}

It was also a good first half for earnings per share, which increased by 5% to 52.7p; the higher rate of increase there due to a lower rate of corporation tax in the UK.

Henry Engelhardt {BIO 3022947 <GO>}

The dividend will be 49.4p per share; slightly higher than H1 2013 and higher than any other first-half dividend we've ever paid.

Geraint Jones {BIO 19738535 <GO>}

And there was good solid growth in customer numbers, up 9% to just under 4 million; 130,000 additional vehicles in the UK year on year; decent growth in international; and good growth in UK household and Gladiator.

Henry Engelhardt {BIO 3022947 <GO>}

Turnover is down, which is due to falling rate levels in the UK business.

Geraint Jones {BIO 19738535 <GO>}

And finally, on this slide, the Group's return on equity, which is still running in the mid-50s%. A very good result and we think pretty much unmatched elsewhere.

Henry Engelhardt {BIO 3022947 <GO>}

Here's a closer look at the turnover in customer numbers. It's a bit hard to see. But there has been growth in Gladiator and UK household and, compared to H1 last year, non-UK insurance.

Geraint Jones {BIO 19738535 <GO>}

This slide shows the proportion that each of our business segments contributes to the total customer numbers and it shows a similar pattern to Henry's slide on turnover.

You see continued growth in the total. And the mix continues to change. Today, 14% of the 4 million or so customers come from our international insurance operations and 6% come from Gladiator and household.

Henry Engelhardt {BIO 3022947 <GO>}

This is a slide that's very familiar to you, showing the profitability of the Group. And as you can see, it continues to be led by UK car insurance. The reason for the reduction in profit from price comparison is partly Confused and partly the investment we're making in comparenow.com, which Andrew will talk more to in just a few minutes.

This slide is important because it reconciles our statutory results with reality. In this case, reality is represented by the fact that we don't own 100% of all the entities in the Group but we are obliged to report 100% of their profits and losses. In particular, the reality is that we only own 68% of comparenow.com, even though our statutory results will show 100% of any profit or loss.

Now, there's not a big difference between the two results in H1 2014. But the plan is to move compare now’s marketing spend up by some GBP15 million to GBP20 million in H2 2014 and possibly spend in excess of GBP60 million next year.

Previous experience says that if the market is very receptive to price comparison, we might be in profit in 2016. But more likely it will be 2017. And this means we'll be carrying losses for several years.

The compare now losses in H2 2014 are likely to be around GBP10 million for our share and somewhere between GBP10 million and GBP30 million in 2015.

We think the US is right for price comparison and all our consumer research supports this. And so we do this investment.

So if we're so bullish, you might ask, why did we sell off 32%? That we have sold 32% of this venture is testimony to the risk averse nature of the Group. We believe that compare now has great upside potential as it's an Internet disruptor in a very large market. But we know it will sustain losses in its early years and we are happy to sacrifice some of the upside potential this business has for risk mitigation today.

Geraint Jones {BIO 19738535 <GO>}

I'm going to talk a bit about the bond, a bit about capital and then I'm going to finish up talking about the interim dividend.

Firstly, to recap the bond issue. As you know, at the end of July we issued GBP200 million of 10-year subordinated notes, which qualify as lower Tier 2 under the current capital regime and we expect to qualify as Tier 2 under the Solvency II capital regime.

Why do we do it? Well you see the key rationale on the left-hand side of the slide here and there are a number of reasons.

It was, in our view, a good time to strengthen and diversify the capital base. We believe that holding a much larger buffer above capital requirements as we head into Solvency II is a prudent and appropriate thing to do. And more on capital requirements coming up in just a second. And importantly, additional capital now sets us up well for growth we expect in the future from across our operations around the Group.

And it isn't on the slide. But just to reiterate, we haven't raised the debt to do M&A and we haven't raised the debt because we see any immediate or fundamental change in our reinsurance business model.

Just how favorable the conditions were in the market you'll, of course, judge for yourselves but, as you see on the right-hand side of this slide, the net annual costs of the GBP200 million is about GBP4 million a year, or about 2%.

Moving on, let's take a look at the capital position at the end of June. And these charts here show the coverage against our current capital requirements; on the left excluding and on the right including the debt. And you see very strong coverage against the Solvency I requirement; 440% after deducting the interim 2014 dividend.

Now there are a couple of important points to note here.

During 2015 the Group's capital requirement will be based on a Group individual capital assessment, with individual capital guidance applied by the PRA. If that requirement were enforced today, then, after deducting the 2014 interim dividend, we would show a surplus above that requirement in excess of GBP300 million.

And of course, there's Solvency II. As you know, the capital regime in Europe fundamentally changes from January 1, 2016. Our regulatory capital requirements from that date will be set by a standard formula, though the actual capital requirement will be higher and will be derived via our own risk and solvency assessment, or ORSA, process.

Based on what we know now, we expect to hold a substantial surplus above the standard formula capital requirement and a significant surplus above the actual ORSA capital requirement. But to caveat, the capital requirement numbers are to be agreed and so there is uncertainty, hence one of the key reasons for issuing the debt to make sure the Group is well placed to deal with that uncertainty.

On to the dividend and here you see the usual slide that sets out the calculation of it.

Before we get into the numbers here, just to reiterate; our philosophy as regards to dividend is unchanged.

We believe in distributing to shareholders surplus capital we don't need to keep in the company for solvency capital, plus any appropriate margin we feel that's appropriate to withhold. We pay a normal dividend of 45% post-tax profits and then a special dividend, which is based on any remaining surplus at the measurement point.

On to the numbers. Calculations start, as usual, with the capital in the Company, which this time includes the bond; that's GBP674 million. We deduct the solvency capital requirement, which is based on our current capital requirements from around the Group; that's GBP287 million. Then we determine the level of buffer to withhold.

And usually here, of course, you'd see a small margin; GBP30 million it's been recently. This time the margin is materially bigger, at GBP250 million; much of which, of course, is made up of the new capital in the Group.

And that gets us to a dividend of GBP137 million, or 49.4p per share.

Now the specifics of this calculation will, of course, change as the Group ICA requirements come into effect in 2015. But we'd expect to continue holding a significant margin above those requirements, somewhere in the order of what it is today, as we make the prudent transition to Solvency II that we've talked about.

And on dividends, for the near term we'd expect payout ratios to be pretty similar to the current levels, maybe slightly above, maybe slightly below. But somewhere in the current ballpark.

And just to finish on dividends, this slide shows the payout ratios and a little bit of the history. And you can see the current period payout ratio. And it hasn't changed too radically in recent years. Just for a little bit of context, the 2014 interim dividend isn't too far away from being twice as big as it was five years ago.

And the normal/special that you see on the top right-hand side, 23.7p is 45% of post-tax profits, that's the normal element. And the special is 25.7p. And if you've got some shares you'll get paid on October 10.

Henry, back to you.

Henry Engelhardt {BIO 3022947 <GO>}

Sounds good, Geraint. Thank you. The next couple of slides go into some detail on the non-UK operations. We continue to invest in and grow our operations outside the UK.

There is a slightly bigger loss in H1 2014 than before, which is due to a few items that we don't expect to be repeated in the second half of the year.

These are primarily an advertising campaign in Spain for our Qualitas Auto brand, where the expenditure has been weighted to the first six months of the year; and the implications of some reinsurance caps, where we're taking a conservative view. And there will be more clarity at the end of the full year.

What isn't in these numbers is that we are seeing good loss ratio numbers from the Italian business. But caution investors that this is, like the UK, a long tail market and there is still a large amount of uncertainty in the back years.

The US operation continues to grow. And Kevin will talk more about this.

Meanwhile in France we are busy in-sourcing operations to our new office in Lille, as well as developing a computer system from which to run the business.

We don't expect any growth in this market until sometime in 2015. However, we are keenly waiting for the enactment of a new law in France which will take changing car insurer from a complicated process to a simple free process. The law, which has already been passed, is expected to go into effect later this year.

The price comparison businesses results in sum are pretty good. However, Confused is finding it very tough going and profits are slightly down year on year. It's just the opposite story for Rastreator in Spain and LeLynx in France, where profits are rising.

And now over to David and Lorna for a closer look at the UK.

David Stevens {BIO 6807391 <GO>}

Thank you, Henry and Geraint. So Lorna and I are going to talk about the UK market and we'll start with obviously a key number; the profitability up 8% in the first half versus the previous year, essentially driven by increased reserve releases offsetting the negative impact of reduced current-year profitability.

The size of the business in terms of cars insured has risen slightly. New business volumes actually have been flat in the first half of 2014 versus 2013. But we have seen a very positive evolution on retention ratios and mid-term cancelation ratios. So the persistency level has increased. And that's essentially what's driven the 4% increase in cars on cover.

Turnover down 9%, as obviously the average written premium has fallen substantially.

A little bit of that is because our new business mix has taken us a bit away from the youngest drivers. A little bit of that is because there's more renewal in the mix than new business than there was in the first half of 2013. But most of it is price reductions in the nine months from Quarter One 2013 and in the first three months of 2014.

We started increasing rates in May. And the increases that we put through in the Second Quarter equal the reductions that went through in the First Quarter, such that our rates at the end of the first half were in line with our rates at the end of the full year. And we've subsequently put in some further price increases.

Our view is that there will be price increases in the market in the second half. We're going up. A couple of other major players have announced that they're going up. It's unclear how substantial those increases will be. But we would expect the prices in December to be higher than the prices at the end of June.

Let's look at the key performance measures for the UK car insurance business, starting with the expense ratio.

The earned expense ratio here is shown and it's gone up from 15% to 16.4%; a reflection of the falling average premiums.

Now a little note here. The reported number is actually slightly down. And that's a one-off impact of a change in accountancy convention on levies and fees, which was worth about GBP4.5 million to the profits in the first half, GBP6.5 million in the whole year and won't be repeated in subsequent years.

Another important measure, obviously; other revenue per vehicle. Flat in the first half at GBP67 versus the whole of 2013. Slightly up when you net out expenses that are directly attributable to other revenue, at GBP58 versus GBP57.

But there is continuing regulatory pressure on these revenue sources and obviously we're responding to that. The most obvious pressure that might result in a material impact on the 2015 line is the work that the Competition and Markets Authority is doing on credit hire, which may lead to the end of credit hire referral fee income, or at least a significant reduction. It may not, it's still being consulted on. But it's important to be aware that there's GBP5 a vehicle at risk in 2015.

The claims ratio. Down from 68% to 66%. That's the function of a 3percentage point deterioration in the claims ratio on a current-year basis and a 5percentage point increase in reserve releases.

So let's look at those reserve releases.

In the first half of 2013 we released 14%. This first half we're releasing 19%. That is partly the result of some positive evolution, some surprisingly positive evolution, on the 2011/2012 years, which are demonstrating increasing profitability. And that has allowed us to increase our reserve releases in this manner without actually eating into our buffer over expected ultimate claims.

Obviously in that situation, unless claims develop in some unexpected manner, we would anticipate further material releases going forward.

However, if current-year margins continue to deteriorate, the scope for compensating for deteriorating margins is not infinite and, at some point, we have to see some improvements on current-year margins if we're going to maintain our profitability.

Current-year margins are a function of claims inflation and premium inflation. Lorna will talk about the claims environment.

Lorna Connelly {BIO 19791125 <GO>}

Thanks, David. Good morning, everybody. I am delighted to be here today to talk to you in a little detail about what I think are the claims trends in the UK that you'd be more interested in learning about.

And before I start, because it's my first time presenting the results, I thought I'd just give you a little bit background on myself.

My whole career to date has been in the claims environment. So I clearly enjoy the claims environment, previously working at Aviva and AXA before joining Admiral some 20 years ago now. Roles I've held at Admiral have included Head of Diamond claims with Diamond brand, Deputy Head of UK claims and, for the last 18 months, Head of Claims of the UK.

So today I'm going to talk to you about claims frequency and some bodily injury costs as well, which I may refer to at times as BI costs. And you may recall that, in March, we gave you what we outlined at the time to be mildly optimistic and mildly pessimistic views of how claims frequency could develop. So what's happened since then?

So if I start with small BI. If we take a look at the graph on the left and what it shows you is the volume of the small BI claims that are notified through the Ministry of Justice portal. Now the Ministry of Justice portal, you may remember, is the method that a lawyer uses to submit a small bodily injury claim to an insurer.

And what you can see from here on the red trend line is that, post LASPO, the market did experience some drop in volume but that benefit has now started to erode. And in fact, in June the volume of claims received through the portal was the highest June on record since the portal launched in 2010. So some caution here on small bodily injury claims.

And if you move on to the second graph on the right, what this shows you is the average damages for claims settled through the portal and you can see here there are some inflationary pressures. What's driving that? Well the portal limit was moved from GBP10,000 to GBP25,000 in July last year. But I do think it's still a little early for that to have any significant effect.

The main drivers here are the Simmons case, which effectively added on 10% to damages post LASPO. And also increases in the guides that we use in the industry to value personal injury claims, known as the JCG, the Judicial College Guidelines.

You must remember, of course, that these increased costs are on a backdrop of fall in lawyers' costs from small bodily injury. So the fall in small bodily injury may have been short lived and there are some pressures on costs here.

But it's important to remember that small bodily injury is only part of the picture, although it seems to hog all the headlines.

If we take a look next at the mix between BI and non-BI claims, you can see that over the last seven years it's been increasing all the time. And a department like ours has had to adapt quickly and effectively to be able to handle this well. And I think the ABI have reported a 60% increase in whiplash claims between 2006 and 2012.

But again, I draw your attention to the red graph. It's not all about bodily injury. You can see from this chart, which compares overall claims frequency in the market reported by the ABI, the reduction, which we and the market enjoyed in previous years, has reversed through now since 2013.

In addition, although very small in number compared to the small bodily injury claims, you can see from the final chart on this slide that it is large BI claims that account for the lion's share of total costs. And it's these costs that have and continue to be increasing.

Now when any of you visit us I'm frequently asked: What are the drivers of large bodily inflation? So I thought today would be an ideal opportunity for us to delve into that in a little more detail. So to aid that, what we've done is create for you an illustration, albeit quite a stark one. But an illustration of the increased costs in large BI claims.

So we've taken a claim that was settled in 2007 for a young person with a severe head injury and, given our experience since, we've tried to take a view on what parts of that schedule could look like if we were going to settle that claim today.

And while you digest some of that, I think it's a good time to point out that, at the end of the day, this is what we're here for. This is our role to make sure that claimants receive the right level of compensation. But the figures here are quite striking. So I'm going delve into some of them in a little more detail.

So the drivers, there are many. But for the purposes of today I would put them into three main categories. So the first one is the obvious one, inflation; inflation on the cost of care. That has a significant impact here. So we've moved from a world where there are one or two carers to a world where three are needed to cover all of the hours and that increasingly those three need to be medical specialists as well.

And the drivers of care cost rising are things like working time directive, manhandling regulations, compulsory training for carers, pension primers [ph]; all these types of things have added up into the inflation that we're experiencing.

Next we've got what I would term sophistication. So again there's been a shift; a shift from claims being presented to us by varying lawyers, some of them just high street ones, to a handful of key specialists, experts.

And schedules have become far more sophisticated. So transport costs for wheelchairs and vehicles has moved on somewhat. New technology has become a big thing. So voice-activated televisions, lights and curtains. Prosthetics have advanced considerably. I think new technology is great news for claimants. But, of course, it costs.

And finally we have the lawyer's costs and quite a difference here as well, because in this intervening period success fees have come into play. So in many cases a lawyer can earn a considerable markup on his fees, sometimes 100%; so effectively doubling the fees that he earns.

We need specialist lawyers because of the sophistication I just mentioned and because of their desire to do the best for their client. While they become involved much earlier than before, they use more experts, obtain more medical reports, they do more investigations, they seek more' counsels opinion. And all this additional time adds up. And they add up quite a lot, to some significant figure like this.

So what we're left with is a claim that's presented to us using far greater care, sophistication and expertise than before.

So we've talked through what's happening with frequency. And we've talked in a little detail about some of the pressures on the costs. I wanted to end by reminding you of some of Admiral's key strengths in claims handling. But I talked to Louise and there's not much on the technical front I think I'm able to disclose today. So I'm going to keep it quite general.

For those of you that have visited us and spent time with us, I think you know it's our people that make the big difference, I think. Our people. We've said it before. And it remains true, it's the people that we recruit and nurture and develop into these key specialist roles within our department that make the difference.

Then, of course, it's the culture, the culture that you hear so much about, that's deeply embedded into our organization; the proactive approach to reserving and claims handling, the empowerment and accountability that that culture and staff ownership of the business actually brings on a day-to-day basis.

And you may be surprised at this one. I's not just an expense ratio issue. But I truly believe that having our offices still only 60 miles apart makes a big difference. So despite our size, we don't have the 10, 15, 20 offices that many of our competitors have. Our staff still get to regularly meet people at different offices and to communicate with them to discuss things and to update each other all of the time.

And I think it's factors like this that enable us to maintain that strong culture, strong communication and, I guess this is the toughest one, consistency across all that we do in the organization. And I think that's such a strong advantage.

I finally wanted to show you again my favorite chart, which I think is at the heart of all that we do in claims and underpins our strengths, is what our customers think at the end of the day after their claims experience. And of course, it's my job to make sure that next year there's a tick on there for 2014.

That's all from me. So I'll hand you back to David.

David Stevens {BIO 6807391 <GO>}

Thank you, Lorna. So what we've been hearing then is we're running towards the end of the windfall on frequency that came about through the recession and the erosion of the value of the regulatory reform and continuing structural inflation on large BI.

And that all adds up, in a sense, to a reversion to the situation which we've been familiar with for most of our 20 years of existence of claims inflation running at 3, 4 points above the underlying level of inflation in the economy.

And I think that's something that we'll probably be looking to live with over the next few years as well.

So I mentioned at the beginning that an erosion of margins is about claims inflation and it's about premiums. So let's talk a bit about premiums.

This is a sort of hybrid exhibit that shows, in red, the average earned premium in the market from PRA returns and, in blue, the average written premiums from the ABI Index.

And what you're seeing is written premiums down roughly 5% in the first half of 2014 and you're seeing, interestingly enough, the average premium in the market now at GBP360; below the average premium in 2009. So all the value of the price increases of 2010, 2011 has been eroded.

The change in premiums doesn't just affect the loss ratio, of course. It affects the expense ratio. And what we have seen is an increase in the expense ratio in the market in 2013.

We're showing here market earned expense ratio. The blue line is the Admiral expense ratio on a written basis. Market earned at 29%. Some of you may be more familiar with the 31% number from the returns. The UKI returns tend to be very volatile on expenses and we've taken them out.

But what you're seeing is the impact on the market expense ratio of falling premiums, some impact on our own expense ratio. We're happy to see less of an impact and, therefore, our expense ratio advantage, which has been a constant source of competitive advantage, being slightly widened in 2013.

Now some people look at this exhibit and say it's a little bit unfair that we're choosing ratios because we're a higher average premium company. So we've also shown the number in absolute on the right-hand side there; GBP73 versus GBP113, 35% lower. That doesn't tell the full picture because actually higher premium business is more expensive to manage. They call more, they cancel more, their direct debits bounce more, they claim more.

And to try and quantify that impact, what we're showing here on the bottom is two cohorts of business: a cohort of business GBP350 to GBP400, roughly market average premium; a cohort of business GBP475 to GBP525, roughly our average premium. And we've indexed the cancelation volumes and the claims volumes and you can see that the impact is roughly in the order of just under 20% in terms of the requirement to administer and handle and service the customer.

The last exhibit I'm going to do is on telematics. This is an exhibit that's a reflection of interest from analysts and investors who want to hear more from us on telematics. We've been doing telematics materially for the last two years. We did actually do a test in 2007 and 2008 that led us to believe that it was premature to invest further. But from 2012 we've been testing all the technologies on offer; hard install, self-install and apps.

On the left-hand side at the bottom we've done a schematic of the market. We think that telematics sales represent roughly 2.5% of new business sales at the moment by volume. But that's nearer 6% or 7% by value, because it's a product that is still essentially a high-premium niche product at the moment.

Very, very hard to get hard figures on market share. So the colorful column is indicative. And what it's trying to indicate is A, there are a lot of people doing telematics. Almost all the significant car insurers have some sort of telematic test in the progress. There's also a tail of smaller players and there's some dedicated telematics brands, like Karas [ph] and ingenie and Marmalade, which are players in the market.

And one player which is a dedicated telematics brand, of course, insurethebox, which is represented by the green chunk at the bottom and we believe they probably have somewhere in the order of 125,000 vehicles on cover.

There's then probably a universe of three or four players who have between 40,000 and 60,000 vehicles on cover with a telematics product and we're towards the top end of that range and, therefore, think we're probably. But it's a management guesstimate, second in the market.

Why haven't we made more of a fuss about telematics historically? Well what we did say six months ago is it's a challenge in terms of relative profitability. Yes. We make money on telematics policies but we make more money on non-telematic policies.

And I wouldn't say that's changed in the last six months. It's still work in progress. We are making the investments that's implied by that size of policies in force. But we still need to get better on customer-friendly options, lot of customer resistance still, lower technology costs, squeezing extra value from the data.

It's not clear that risk selection alone will fund the costs. We've got to find a maximum number of uses for the data to offset the costs themselves and the discounting that's required to persuade the customer.

And some of the commentary in this area can be somewhat simplistic. And one of the ones that winds me up is: Oh well, this is going to become a mass market product with apps, because apps are free. Well apps aren't free. If you put an app on an app store, the world does not beat a path to your door. You have to tell the world about it. You have to market that app. And there are a number of ways of doing it. But none of them particularly cheap.

Then you have an interesting funnel. So what I've taken here is actually quite an ambitious cost of GBP5 per person persuaded to take your app. They say they'll take your app; you send them a link to the app store. Some of those never actually activate that link. Some of them don't download your app, therefore. Some of them that download your app, they never register. Some of them register, never actually use it for a single journey.

Some that use it for a single journey only use it for a single journey. And the number that use it for more than a single journey don't use it for enough journeys for you to be able to score. Then, at the end of that process, you offer them a price and the majority of them say no.

And when you've done that, if you're clever enough. And that is clever to do GBP5, you've spent GBP235 to put a policy on cover. That is not free.

So that's where we are on telematics. I have to say, though, I am very excited by the technology and it's one of the most enjoyable things that we're doing and one day it will come good.

Summary then. Competitive market, of course. Encouraging, I think, that premium rates seem to have stopped falling and that we think they will potentially rise in the second half, although the violence or softness of that rise is very hard to assess.

Our margin expectations for the business we're currently writing are lower than our experience on the business we wrote one or two years ago, due to rising claims cost and falling premium.

The nature of the way we book profits; the profits you're seeing today is a lot about the business we wrote in 2011, 2012. The pressure on margins, therefore, that we see currently potentially reflects on our profits in the future.

Offsetting that, we are in a very conservative situation on reserve release and reserves and we do see reserve releases being a continuing material part of our profit. But as I've said before, if current-year margins continue to erode, you cannot defend profitability ad infinitum using reserve releases.

Thank you. I'll now hand over to Kevin and Andrew to talk about the States.

Kevin Chidwick {BIO 15100612 <GO>}

Thank you, Lorna. Thank you, David. Well I guess if you do these presentations long enough eventually you get to see David being excited. That's fantastic. Never thought I'd see the day.

Let me start, though, by adding my congratulations to Geraint. I'm really very pleased that we've been able to promote Geraint on to CFO. He's an excellent addition to the Board and, in my opinion, a big step up in quality from the last guy.

But I'm going to talk about the US market. Particularly I'm going to talk about Elephant. Andrew's going to talk about compare now.

A bit of a reminder really, the US market's a very big market. It's $180 billion of premium. It's over 200 million vehicles. It's a market that shops a bit less than the UK. In the UK about two-thirds of customers will re-shop every year. In the US it's about one-half that number. About one-third will re-shop their car insurance and about one-third of those people will switch; so about 10% or so switching rate.

It's a market that is moving more direct. It's about one-quarter direct right now. But about 40% of all new business is currently being bought direct. So the direct players are growing their share.

It's quite well known for being a high acquisition cost market. It is a high acquisition cost market. GEICO's reported spend of more than $1 billion on marketing each year is probably well known, quite well advertised.

But perhaps less well known is that other players also spend a huge amount as well. Last year Allstate spent $900 million, of which about $200 million was on their Esurance brand. State Farm spent $800 million. Progressive spent $600 million. So there's some very big numbers being spent out there, in what is obviously a very big market, chasing new customers.

But if you look at the movers in the market you can see that it's only really, with one or two exceptions, it's only really the direct players that are growing their market share. And that's happening year on year. And that really tells you the nature of the market.

The US market also has an unusual feature, or unusual compared to what we see over here in Europe, which is that it's segmented not by risk, as you might think of things over here. So obviously over here we think about high-risk young drivers likely to be very expensive claims versus low risk drivers. In the US the market is segmented more by retention class.

So it breaks into standard and non-standard, as they call it over there. Standard being customers who will continue with you and stick through renewal typically and pay their premiums regularly. And non-standard, who tend to be much more promiscuous shoppers, often canceling their policies and falling in and out of payments over time.

And that means that the insurers over there have typically ended up focusing on one of those two segments in the market.

And for Elephant, that's meant that we've focused our business very much on being a standard player. We do write the whole market. But we look to build a standard book of business over time, which means building a book of quality customers who will retain a longer period, much more like you would imagine a business over here.

And to that end, that means that we need to build a brand that customers will obviously remember. But also importantly customers will trust.

As I've already said, the acquisition costs in the US are high; very high compared to the European standards. This graph on the left-hand side here plots the average acquisition costs of some of the players; the players are the dots. The vertical axes shows the acquisition costs that range between about $500 and $1,000 per policy; the average being somewhere in the middle of that range.

It also shows the different colors. The blue colors are the direct players; that's actually GEICO, Progressive and USAA. And the green and the purple dots are the traditional players, the incumbent players that have been around for a long time with their captive agents and their independent agents. And there's a clear difference between the two, as you can see.

And there's also a significant difference on the growth rates of the two companies, which is plotted on the horizontal axis at the bottom.

So the direct players are acquiring business much more cheaply and they're also growing faster.

And I'm pleased to say that's true of Elephant. As you can see, the Elephant logo there on the right-hand side of that graph, we are already being able to achieve acquisition costs roughly in line with our direct competitors and significantly lower than the incumbent players. And obviously, growing from a small base, we're growing very fast.

So that's very pleasing and that augers particularly well as we're at this stage only in four states and so our brand is significantly smaller and less well known than the others. So to already be at the same level is, I think, very encouraging.

On the right-hand side is a graph showing loss ratios against growth; the horizontal axis being the same, the vertical axis being the loss ratio. And here you can see Elephant compares less well. There's a similar correlation going on here with the slightly higher loss ratios correlating with higher growth, which is perhaps fairly obvious. And the direct players in the blue there obviously, on average, getting higher loss ratios than the traditional players.

There's a couple of obvious reasons for that. And there's a clear reason why Elephant would be out there a little bit higher as well. All of these older players have got very large books of renewal customers.

And it's true in the US, just like it is here in the UK, even though there's price regulation in the US, which controls your pricing between renewal and new business very much, they can't be different. But even in the US it's very similar to here in the UK. The renewal book will run a loss ratio typically 10 points or 15 points better than the new business book will.

So if you're very much new business biased, which, of course, we are, you're going to be running at a higher loss ratio.

But it's also true in the US that the businesses that focus on trying to build a quality standard book will end up running high loss ratios in the early years, because those customers are more aggressively competed for and, therefore, by nature, you'll end up running a higher loss ratio in the early years when you acquire them.

Somewhat perversely those non-standard risks, the ones that cancel regularly, actually run very good, very low, loss ratios. They just don't stick around very long.

Let me show you a little bit about Elephant's progress so far. We launched it the beginning of 2010 on TV. And that's the story of our growth since then.

We're now in four states, as you can see from that picture. The bars represent our turnover. The line is our customer numbers. And you can see from this graph that we're growing pretty fast. We've gained 50% in the last year. And we're now four times the size we were when I joined the business at the beginning of 2012.

Of course, the right speed to grow at is a tricky one. Clearly, we want to grow as fast as we can to build a big book of business and, therefore, get the business to a point where we've got enough scale to produce profits for our shareholders, assuming, of course, that we can maintain good acquisition economics as we go.

But on the other hand, we don't want to grow too fast that we are not learning from our mistakes as we go along. And we'll make plenty of mistakes and so we want to make sure we don't write too much bad business, particularly in new territories.

So the speed of growth is an important one to try and calibrate correctly. And this is probably about as fast as I want to be growing the business right now. Although, of course, we will take opportunities to grow in different pockets of the territory depending on how things are progressing. But it's unlikely to be much faster than this.

Having said that, I'm absolutely delighted with the success we're making so far. We've grown the business fast and we're also seeing very good economic results, particularly from that core motor book.

But we are, in addition to that, adding additional products. We've added quite a number of additional ancillary products in the last couple of years. And we're now at a point where we think we've got a good competitive range of products for our customers.

And that's an important point in the US context because even, for direct writers, US consumers expect their car insurance company to be able to provide them with other products alongside car insurance; much more so than here in the UK.

In terms of those results, what you can see here is an improving combined ratio on the back of an improving expense ratio. The loss ratio is, as I described earlier, much better on renewals. But with our high growth we've been seeing recently we've got a slightly higher loss ratio.

The expense ratio is coming down, primarily because of the increased scale of the book. Obviously, the fixed costs are now spread over more premium. But the speed of its reduction is somewhat offset by the growth where we're obviously we're spending more money on marketing to grow more quickly.

And that's been particularly the case in Texas, where we've seen our acquisition economics improve quite significantly over the last couple of years. We started in Texas about two years later than we started in Virginia. But it's now pretty close to Virginia in terms of its acquisition economics.

And that's very pleasing, very pleasing, both in terms of the kind of improvement you'd expect to see from any new area you market into, any new space where you start again from zero. But particularly pleasing in the context of Texas which, itself, is a very large state. It's the second largest state for car insurance in the US. It's got 19 million customers. Still plenty of scope for Elephant to grow its business.

We had a combined ratio of about 150%, 152% last year. And I'd expect us to come in this year with a somewhat lower ratio than that. And the result in terms of absolute pound terms is going to look quite similar, I think. We'll have better ratios but obviously on a bigger book.

So the strategy for Elephant is a very simple one. We'll keep trying to offer our customers good prices. And we'll keep growing our business as long as our customers are attracted to our business. So far. So good.

But we keep focused on building a good quality business, which is as Admiral-like as we can make it. And by that I mean keeping our costs low, running a good, efficient, business, focusing on good quality underwriting, focusing on good quality pricing and being prepared to keep testing and learning and changing the business as we grow.

In time we will expand some more states. We're currently in the fourth. But we are, as you can see from the graphic on the right-hand side here, still pretty small in the ones that we're in. Our market share has now grown to the dizzy heights of 0.8% in Virginia. But we're still only 0.2% of Texas, which, as I've said already, is a huge state with about $14 billion of premium just in that one state.

One factor that might influence our decision to want to grow, to move more quickly into other states, would be our belief in the strong future of a UK-style price comparison in the US. If we see that model taking off strongly in states that we're not yet in, then we may well be tempted to get there sooner rather than later.

But let me hand you over now to Andrew Rose, Chief Executive of comparenow.com, who can give you a much better feel for how that business is getting on. Andrew?

Andrew Rose {BIO 18735195 <GO>}

Thank you, Kevin. Good morning, everyone. Pleasure to be here. As Kevin said, my name is Andrew Rose and I've been with Admiral for six very wonderful years; first as CEO of Elephant Insurance. And now as CEO of comparenow.com. Prior to Admiral I was running Country Life's auto insurance business and got my start in the insurance business with Progressive, one of the big four carriers in the US.

So why am I here? I'm here to talk about the US. I'm excited about it. $50 billion to $60 billion of premium is shopped each year. And before we talk about the US market and comparenow.com, it probably makes sense to talk a bit about Admiral's other comparison businesses, all three profit-making enterprises.

It all started more than a decade ago with Confused.com. And I think we would all agree that business has been quite successful, transforming the UK shopping experience. Now between two-thirds and three-quarters of all new business in the UK is shopped on a comparison website.

As great as that sounds, the UK may not be the best proxy for US price comparison. Spain and France, with their stronger tied agent and lower shopping intensity markets, are probably better proxies. Well you can see that each has grown nicely in their early years. And that is a great proxy, we think, for the potential of comparison in the US and, hopefully, comparenow.com.

Why? Well the US consumer is already conditioned to shop online and comparison shop for many products and services. Now our job is to give them the same thing for auto insurance. Consumers are only half the equation however. We need the insurers to embrace this change as well.

Luckily, many insurers are looking for a new way to compete, a new way in the face of the $6 billion of auto insurance advertising that is spent each year, predominantly by those top four carriers that Kevin mentioned earlier.

For carriers five through 200 plus, not being on TV often means out of sight, out of mind. They just don't get considered. That's where comparenow.com can come in and, hopefully, transform the market, giving them the opportunity to compete.

Let's go a bit deeper on the customer side. The US didn't evolve like the other markets for a variety of reasons. As a result, consumers were left with less efficient, less satisfying models that limited choice.

Consumers could quote each insurer one by one re-entering their information over and over again, hoping that they're getting an apples-to-apples comparison along the way. Most consumers tired of that process after two or three quotes, barely scratching the surface of the available carriers.

Lead generators developed a proxy. They often look like European-style comparisons on the surface but those consumers that were duped into entering their information into those platforms typically find 50-plus calls and emails greeting them in the coming days and weeks; rarely the process they were looking for.

Comparenow.com is different and follows the model that you're most familiar here with in Europe. Enter your information once, get lots of quotes back, no unrequested contact from the carriers. The customer's in control.

Why do we think this just might work? Well the consumer is ultimately undefeated in their pursuit of simplicity and transparency and we bring both with our site.

Let's talk more about the carriers. As mentioned earlier, insurers face a market of significant spend. This spend, along with the commission structure for agents, results in a very high acquisition cost for insurers.

The first thing that comparenow.com can do is offer them lower acquisition costs. How do we do it? By achieving higher response rates to our ads, a simpler process for consumers and delivering a higher overall conversion on our site. Allow me to explain.

As I said, compare now should have higher response rates to your ads. Think about it, for an average consumer, which sounds like a better value proposition? An ad from British Airways on TV or from one of those travel sites? The travel site offers single entry and many airlines, including British Airways. So more people choose them. The same logic should apply to auto insurance.

The benefits should not stop there, however. Again, as time goes by, the conversion on the comparison site becomes somewhat of an aggregate of the individual insurers' conversions, resulting in a higher overall conversion. Higher response rates of higher conversion yields a lower acquisition cost; something that we can share the benefit of with the carriers.

Beyond just having lower costs, we bring some other benefits. Certainty of acquisition costs; they pay when they make a sale. They only have to quote the risk segments they want. They get to compete on a fair, level playing field, winning on their merits; a combination of price, value proposition and brand.

Lastly, compare now gives access to competitive intelligence in the market that they can get almost nowhere else. They get real data in real time they can react to with rate changes or footprint expansions or contractions.

So with that as background, you might be asking so how's it going? Well we need to start off with a giant caveat. It's still very early. We've only been advertising for seven months but we've been quite pleased by the consumer and carrier response.

We're able to offer our service in 49 of the 51 US markets. But sticking true to our Admiral roots, we're starting small and testing and learning; using the data that we have at our disposal to make good decisions along the way.

First, we have a fully integrated marketing campaign; TV, Internet, etc. We began the year by advertising in six smaller California cities. As those looked good, we expanded into larger California cities, eventually into Virginia and Illinois. And in July we added four large cities in Texas to our portfolio.

We focus our advertising efforts where we have the largest panel, where we can offer the most compelling value propositions to consumers. In some states, we can only offer a couple of carriers and will hold off advertising in those states until the brand proposition can match our expectations.

Naturally, carriers have responded. Six of the top 20 now work with compare now and even more are in discussions. With an offering like ours, we need carriers that cover the entire risk spectrum; from the standard all the way down to the non-standard. As you can see from the graphic, we have been able to attract many of those; names many consumers know in the US.

Will there be competition? Sure. But we feel like we have some advantages entering this market.

First, we've got knowledgeable partners that have the required capital to make this investment.

Second, we've got experience building these businesses, with the technology and processes that already have and can continue to be leveraged. And last but not least, we've got a group of people that have deep insurance knowledge and connections with the carriers; something key to the overall success of the enterprise.

Like I said, it's off to a good start but it's still quite early. I look forward to telling you more about the business as it continues to grow and expand and, hopefully, match the results of our more mature UK siblings.

Now back to Henry to complete today's presentation.

Henry Engelhardt {BIO 3022947 <GO>}

Thank you, Andrew. Thank you, Kevin. In conclusion, we are bullish on our long-term outlook, largely because we continue to have a fundamental economic advantage over the competition in the UK market.

The growth and development of our non-UK businesses are proceeding nicely. And the growth of price comparison and, correspondingly, the Internet, confirms our belief that we are in the infancy of a dramatic change in distribution of car insurance globally for which Admiral Group is well positioned.

However, there are no shortage of challenges, particularly on margins in the UK market for the near term.

Thank you very much for your attention here this morning. And I'll now be joined by David and, obviously, any of the other members of the panel for questions.

Questions And Answers

Operator

(Operator Instructions)

Q - Greig Paterson

Greig Paterson, KBW. Can I just make a suggestion? You give a lot of little bits of guidance all the way through your presentation. And you present quite quickly. Could you maybe on the slides in the future, actually on the right-hand side, where you are giving guidance actually put it down so we can concentrate on what you're actually saying, as opposed to trying to think did I get that statement right or wrong?

And in that regard, could you just reiterate what you said about the timing and size of the advertising costs in the US and also the profit guidance? That was question one.

The second one is you boosted your Group combined ratio with this reinsurance cap story, the reinsurance cap accrual. Could you just explain what's going on there?

And the third thing is a little bit of something that's puzzling me. You've got about GBP280 million of required capital currently. My understanding from speaking to your IR is that that's on a ICA plus regime, which is fully comprehensive not far from Solvency II type regime, even in terms of internal models we eventually get. Yet you're raising GBP200 million of capital? It seems like using a big hammer to crack a nut and raises a whole bunch of questions and thoughts on what are the true motivations for the debt raise.

So you just want to talk about (multiple speakers) --?

A - Henry Engelhardt {BIO 3022947 <GO>}

Andrew, do you want to take the first one, on your spend?

A - Andrew Rose {BIO 18735195 <GO>}

We'll spend as it makes sense. Very much Admiral is test and learn. We'll continue to expand in the market as our value proposition warrants. And as our acquisitions costs demonstrate, it makes sense for us to continue doing so.

It's deliberate. We want to go about this process and make sure that it's a successful, profitable, sustainable business, like Admiral's other startups. And so you'll see us expand as it makes sense.

A - Henry Engelhardt {BIO 3022947 <GO>}

But specifically with GBP10 million to GBP30 million in the second half of this year and potentially GBP60 million or more in next year.

A - Andrew Rose {BIO 18735195 <GO>}

Correct.

Q - Greig Paterson

(Inaudible-audience question)

A - Henry Engelhardt {BIO 3022947 <GO>}

That's the marketing spend.

Q - Greig Paterson

Yes. Then you said something about profit [ph].

A - Henry Engelhardt {BIO 3022947 <GO>}

And it will be GBP5 million to GBP10 million for Admiral's bottom line in the second half and GBP10 million to GBP30 million, somewhere in that range, for 2015.

Q - Greig Paterson

(Inaudible-audience question)

A - Henry Engelhardt {BIO 3022947 <GO>}

Correct. Sorry, we got two more questions of Greig's.

A - David Stevens {BIO 6807391 <GO>}

And I think another element of the specific guidance relates to ancillaries, where we were referring to the car-hire referral income of GBP5 per policy, which we see at risk in 2015. And on top of that, I'd say generally the regulatory context means that there may be pressure on other items of other revenues. So there's a little bit of guidance there.

Then there is guidance in the context of the UK market, which cannot be more specific than just saying if current-year margins continue to deteriorate due to claim inflation and premium reductions, if there isn't a turn, in a sense, then there will be pressure on reported profitability, which cannot be fully compensated by reserve releases ad infinitum.

A - Henry Engelhardt {BIO 3022947 <GO>}

Geraint, I think the last two questions were for you.

A - Geraint Jones {BIO 19738535 <GO>}

So the question was about the Group combined ratio, which I think actually improved to 85% from 87% in the first half of last year.

Q - Greig Paterson

(Inaudible-audience question)

A - Geraint Jones {BIO 19738535 <GO>}

The question was about the caps on the international insurance businesses. It is right to say that some of our contracts internationally have caps. Actually some of the UK contracts have caps too.

And in the first half of 2014 we took additional costs of a couple of million pounds compared to the first half of last year, because the accounted combined ratio in those businesses is higher than those caps, as you might expect. And as those international operations move towards underwriting profit and combined ratios where we'd expect them to get to ultimately, obviously those cap issues go away.

It's an issue in the first half of this year because of the things that Henry referred to: bigger ad spend in Spain; slightly bigger loss ratio in Spain as well. We don't expect those to repeat in the second half of the year is also important to remember.

Then the third question was about (multiple speakers) --

Q - Greig Paterson

So those caps will fall away in the second half?

A - Geraint Jones {BIO 19738535 <GO>}

The impact will be lower in the second half for sure. And we'd expect it gradually to dissipate over time, as you'd expect.

And the final question, I think, was about capital requirements and the bond. So as we saw on the slide earlier, on slide 8, the key rationale for the bond was it was a good time to do it, to build a prudent buffer as we move into Solvency II, to be able to deal with uncertainty in the final level of capital requirements in the Solvency II.

And the risk-based regime under ICAS and the risk-based regime under Solvency II are very similar in principle. But there are valuation differences in capital and there are differences in the calculations of capital requirements, which is a very detailed conversation.

Q - Greig Paterson

(Inaudible-audience question)

A - Geraint Jones {BIO 19738535 <GO>}

No, no. (multiple speakers) We're not saying with the GBP200 million that we're going to need all that to fulfill our capital requirements. We're saying that's there to deal with any uncertainty that might arise in the final level of capital requirements. So we don't expect to fully use all that for our capital requirement. We want it to sit there as a buffer.

Q - Greig Paterson

(Inaudible-audience question)

A - Henry Engelhardt {BIO 3022947 <GO>}

It's all the investments in our other businesses, Greig. And for the future investments that we don't even have yet planned out. It was an opportune time to raise money. We felt it was a good moment, because these markets open and close and get expensive and get cheap and you never know. So you take advantage of what you can. We thought this was an appropriate amount at an appropriate time.

Q - Andy Hughes {BIO 15036395 <GO>}

Andy Hughes, Exane BNP Paribas. First question, following on from the reinsurance cap on the international. What's the gross of reinsurance losses on the international business? Because presumably the reinsurers are saying: We don't want to take any more of your international business on the new business side just yet until you've paid back some of the losses in some markets.

So can you tell us which ones are capped and what the benefit has been historically?

The second question is on slide 50, which you don't talk about, which I think is the key thing in your results. I don't really care what your book loss ratio is. I just care what the best ultimate [ph] loss ratio is and how the reserve buffer moves. And the surprise for me was, really, you're showing an unchanged reserve buffer, despite releasing GBP73 million.

So could you talk a bit about how those ultimate loss ratios have moved over the half year? Because it looks like a one-off minus 1% over all the historic years that they've reduced, perhaps the PPO propensity, or something?

But I see that as being -- that top-left slide as being the key numbers in the whole presentation, really. And you haven't said -- perhaps you could break out the GBP73 million and tell me how much of that is been added from H1 2014 underwriting and how much is from this movement in this chart we see here?

And the third question is you've talked a lot about UK motor market, how it's changed, all the bad things that have gone on. But clearly large bodily injury claims is a large component of your business and obviously young drivers is also a large component of your business.

So since 2009 there's been a big drop in serious bodily injury claims involving younger drivers. And that has contributed to the increased competition, presumably, in your key segments and also a large amount of the profit commission we can see coming through now, which, in my mind, is exceptional because you've benefited from this post-2009 drop-off.

So could you talk a bit about that frequency as well, please? Thank you.

A - Henry Engelhardt {BIO 3022947 <GO>}

What was the first one again? .

A - Geraint Jones {BIO 19738535 <GO>}

The first one was the development (inaudible).

A - Henry Engelhardt {BIO 3022947 <GO>}

Sorry?

A - Geraint Jones {BIO 19738535 <GO>}

Development of the ultimate loss ratios in the first half.

A - Unidentified Speaker

The first one was caps (inaudible).

A - Geraint Jones {BIO 19738535 <GO>}

Caps, sorry. For caps, the ratios we present in the international insurance commentary in the pack give the result of the underlying -- give the combined ratios of the underlying business, excluding the impact of the caps. Then you can see in the notes underneath those KPIs what impacts the cap had. And so you can get back to the total loss that those businesses are making.

We're obviously not going to say which contracts have caps and we're not going to say what levels they're at because they're confidential. So we can't give that information. But I think we give enough information in the segment for you to work out what the underlying performance of the business is.

A - David Stevens {BIO 6807391 <GO>}

And on the exhibit top-left, I think it's reasonably straightforward to work out what the earned premiums are for each of the accident years and to use the percentage changes that we're showing there to work out, in a sense, the value of the movement in the loss ratios.

Big picture, what we're saying is that in the first half of 2014. And these changes relate to the first half of 2014. So versus the end of December 2013, whereas the market is December 2013 versus 2012. But in the first half of 2014 we saw some releases across the years, which is gratifying. And a particularly strong outcome on 2012 accident year, which is a mixture of 2011 and 2012 underwriting year.

And because we had that gratifying improvement in the projected best estimates, that let us release more, while maintaining the size of the buffer.

Is there another?

Q - Andy Hughes {BIO 15036395 <GO>}

What was the driver of the change in those charts? What was the drive for the change of those --?

A - David Stevens {BIO 6807391 <GO>}

The driver of the change (multiple speaker) would be more positive development of claims than had been anticipated by Ernst & Young, by our advisors, when they last did the work, which was at the end of December.

Q - Andy Hughes {BIO 15036395 <GO>}

And the final question about large bodily injury claims for young drivers?

A - David Stevens {BIO 6807391 <GO>}

There has been a clear reduction in frequency overall. The number of crashes between 2009 and now has fallen and fell substantially during the recession. There is some reversal of that overall level of crashes.

That doesn't necessarily translate into a lower frequency across the market of big bodily injury claims for two reasons.

One reason is, as Lorna's pointing out, you get a structural level of high inflation on big bodily injury. So claims that might have been smaller are becoming bigger and bigger all the time.

And another reason is there are fewer deaths on the road. But that's partly because medical interventions are more effective and more people survive and that is your very biggest bodily injury claim.

So I don't think it's necessarily true to extrapolate from the overall frequency to say that big bodily injury frequency isn't particularly -- young driver frequencies are down materially.

Q - Andy Hughes {BIO 15036395 <GO>}

Sorry, I was referring to the younger driver KSI stats from the O&S, which shows a 40% drop in younger driver killed and seriously injured and reported to police. And if you knock off -- obviously, there's fewer younger drivers on the road, which wasn't in your 2009 to 2013 comparison of premiums. But if you knock that off, then -- so you don't think that's necessarily a reasonable comparison to make, that there are -- there has been a big windfall from less large bodily injury claims frequency since 2010 for Admiral?

A - David Stevens {BIO 6807391 <GO>}

No. I wouldn't say there has been a large windfall from that. I would say that the prognosis is that bigger bodily injury claims. And you saw in the exhibit that our share of costs from bigger bodily injury claims has increased over time, bigger bodily injury claims will increase materially going forward, as they have over the past few years and as they have over the past 20 years; it's a structural factor.

Q - Andrew Crean {BIO 16513202 <GO>}

Andrew Crean, Autonomous. Three questions also. Firstly, could you say on your Spanish and Italian business, do you have a sense as to when they will approach breakeven? They've been going for some period of time.

Secondly, the comment about ad infinitum, that you can't carry on ad infinitum, obviously begs the question of where infinitum is. During the last soft cycle, you did reduce the conservatism with which you set up current-year reserves during the soft market, which extended that period. Is that something that you will be considering doing this time round?

Then thirdly, the spend on the compare now business could hit the earnings to the degree that the earnings could fall and, mechanically, that would then need the dividend to fall. Is that something which you are prepared to countenance? Or could you use some of the capital? You've already admitted that you've raised excess over your Solvency II requirements to fund that so the dividend remains -- in normal circumstances will remains stable.

A - Henry Engelhardt {BIO 3022947 <GO>}

So let me take Spain and Italy. We've been consistent in saying that these operations should become profitable within six years to 10 years. The Spanish operation hits eight on Halloween and I fully expect it to be profitable within 10 years. The clock is ticking; 2.5 years to go.

The Italian operation is younger. It's, what, six years. So the clock is ticking. But they've got a few years yet and I fully expect it to be profitable as well within the 10-year time frame that we set out.

Infinitum, where is it?

A - David Stevens {BIO 6807391 <GO>}

Yes, I know it must be frustrating in a sense that I'm using a vague term such as ad infinitum. But there are a number of moving parts.

One moving part is how these ultimates evolve. Another moving part is how claims trends and premiums move in the next 12 months to 18 months, two years.

And another one that you mentioned specifically is the size of the buffer versus ultimate and there are a number of factors that we take into account when we're deciding what the appropriate buffer is versus ultimate and there may, at some point, be potential for us.

There may be an argument for us at some point to consider that the buffer is excessively conservative. But that would have to be because of some change in the environment.

And one of the things that's particularly impacting the environment at the moment is actually these quite substantial moves in the ultimates which is implying a degree of uncertainty. So we're responding to this uncertainty because volatility is up and down; it's not just up. This implies a degree of uncertainty, which we feel is appropriate to respond to with a big buffer.

Maybe if these settle down, if they do, that would create a context which is more stable and we might feel it would be appropriate in that context to reduce the size of the buffer.

A - Henry Engelhardt {BIO 3022947 <GO>}

The dividend question. The dividend is formulaic and, therefore, if earnings are impacted, we don't leave cash sloshing about in the Company and we follow the formula for the dividend. And if there is less cash in the Company, then there's less dividend. And if there's more cash in the Company, there's more dividend.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

Marcus Rivaldi, Morgan Stanley. A couple of questions, please. So you mentioned about the reserve release was driven by an E&Y piece of work. Is that a timing issue? So the sort of level of release we saw in 1H, would that be something that you could extrapolate through into the second half of the year?

Just to come back on the point that Andrew made, would you use some of the capital you've raised? You've got more cash on the balance sheet now than you had. Would you use some of that cash to support the dividend going forward, rather than -- or. And, therefore, countenance the payout ratio above 100% on the business?

Then thirdly, just maybe some -- get some feel for what bang you're getting for your buck in the US from compare now. If you'd give a sense of -- and I'm trying to think of the best KPIs for this. But number of visits to the website, how that's improving and maybe then the conversion rate through to actually booking a policy. Thank you.

A - David Stevens {BIO 6807391 <GO>}

Shall I do the first one? So I felt there may be a slight misapprehension. We hadn't done an extra special review of the reserves at the end of the half year. Every half year for the last 20 years we've used actuarial advice to take a position on what the right ultimates are.

And those of you who've followed us for a long while will know that those numbers do move around and it's not in a predictable and projectable way where you say: Well that happened in H1. So that's going to happen in H2.

Slight tendency for actuaries to be conservative. So if you do the history of our ultimate projections, there's more of a tendency for them to get better than get worse. But you cannot extrapolate from historical trends to the future to say: This is definitely what's going to happen with the ultimate.

A - Henry Engelhardt {BIO 3022947 <GO>}

The dividend, it's not something we've really discussed at this point. Like I say, our dividend, to this point is formulaic and it pops out the back end. So I'd say we'll have to see when we get there.

Compare now.

A - Andrew Rose {BIO 18735195 <GO>}

If we talk about the specific reserves conversion rate, etc., we don't want to share the details there yet but, as you can imagine with the expansion into States, the growing carrier footprint etc., we've experienced very rapid growth, seeing visitors, in some cases, pass some of the number of visitors that are panel members, see [ph] smaller ones. But we're still miles away from the GEICOs and the Progressives of the world.

But that's the opportunity that's out there. $50 billion of insurance is shopped every year. So the opportunity for us to have millions of visitors as time goes by is certainly there.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

And just (inaudible), you've given quite a wide range on potential impact for next year and you also made the point that it would just depend on how successful you've been. So (inaudible) why the nub of that question is really how we're going to judge --

A - Andrew Rose {BIO 18735195 <GO>}

It's not how you're going to judge, it's how we're going to judge. But we're going to judge it based on the metrics coming through of cost to quote and sales per hit and then click through and so forth, which we look at every day.

And we're seeing very nice steady upward trend in that obviously when we go into a new area we immediately get pickup and the cost per quote slides down the chute. Texas is moving rather quickly, for example.

Not surprising, when we went out to California we went out with seven ad campaigns. We didn't know which one would do well and which wouldn't. We go into Texas and now we've got, what, three ad campaigns and, of course, we've taken the better ones, you'll be pleased to know, from California.

So it's all a matter of continuous learning and continuous refinement. Meanwhile, the campaigns in California are also coming down. As we get more brand awareness and we're out there more frequently, our cost per quote comes down in California.

The key for us now in the next six to 10, 12 months is adding the insurers. We've got a lot more insurers signed up than are on boarded. On boarded is the process between our IT department and their IT department.

In the smaller companies we deal with, one month, two months, three months, we can do this. Some of the bigger ones, I think our record is slightly over one year it took us to onboard and, believe me, it's not us. We can do it very quickly.

So the bigger carriers take a long time to get into their IT departments and get this onboard in process.

And why is that important? Because the consumer -- the real benefit to the consumer is he goes in, he spends his 15 minutes or whatever it is, 10 minutes. And he gets a bunch of quotes rather than one or two. And we've gone from this one or two now up to three or four and we need to get it to five or six and seven or eight. Because when he does get eight quotes, he's going to go: Wow, that was a valuable use of 10 minutes. Whereas when he gets two quotes he says: That wasn't so great.

And when he says that's a valuable use of 10 minutes he's going to tell his friends about it, because he's also probably going to save some money. Because the more quotes he gets the more likelihood you're going to save some money.

So it all works forward in that way and we're watching it on a day-to-day basis.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

And just to be clear, that (inaudible) 30% [ph] is that on boarded or signed up?

A - Andrew Rose {BIO 18735195 <GO>}

Those are live on the platform. There are more signed than that. Those are the live carriers.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Dhruv Gahlaut, HSBC. One, could you quantify what the one-off was for the international operations in the BB US [ph]? You said out of the GBP15 million there were a few one-offs, which you will not get repeated.

Secondly, in terms of Confused.com, I think the revenues have been fairly flat and margins have come down. Do you expect much change in the second half of this year?

And thirdly, in terms of compare now, how has the response been of the bigger players or just still on that [ph] on the bigger names in the market? Do you think those guys will be there in the next 12 months' time?

A - Henry Engelhardt {BIO 3022947 <GO>}

We'll take the latter first. I'll give a little answer and then let Andrew go into detail. He's the one talking to them. To me, it doesn't make sense for them to come on. But Andrew has more detail.

A - Andrew Rose {BIO 18735195 <GO>}

We've talked to everybody. I think we are being watched very, very closely. If you are willing to spend $0.5 billion or more of your own money to advertise you are not the first one to fall.

If you look at how Confused.com started, Rastreator, LeLynx, etc., none of them got the largest players first. But as the opportunity starts to grow, as you start seeing tens of thousands and then hundreds of thousands of quotes per month, it becomes harder and harder to ignore. And when one domino falls, the opportunity for the next one to fall gets greater.

We've got six of the top 20 already on board and there are more in the wings. We think that bodes well for the future.

A - Henry Engelhardt {BIO 3022947 <GO>}

There was a third question. I was going to work my way backwards.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

One was on Confused.com.

A - Henry Engelhardt {BIO 3022947 <GO>}

Confused.com. It's tough going at the moment and it's very tough out there. It's a lot of money being spent and Confuse is fighting perhaps the best UK ad campaign of the decade and it's not easy going.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

The last one was one-offs.

A - Henry Engelhardt {BIO 3022947 <GO>}

The international insurance, the one-offs in the first half of this year. It's tough to be specific because obviously there are lots of moving parts in that number. But I think the first-half loss was about 8% of Group's pre-tax profits and it's usually about 5%, 6%. So you can probably take from that, it's about that effect.

Q - Marcus Barnard {BIO 2103471 <GO>}

Marcus Barnard, Oriel Securities. I've got two questions relating to the quota share reinsurance treaties you've got in AIGL [ph]. And the first question is, I think at the moment you get a 50% reduction in your capital for having quota share reinsurance in AIGL.

Do you anticipate this continuing under Solvency II, or something similar, from having quota share proportional reinsurance, particularly as the way you share the premiums claims and profits doesn't look particularly proportional or sharing to me?

And secondly, also on those treaties, your attritional loss ratio you've reported today, excluding reserve releases, were 85.3% and when I add your expense ratio in at about 15% it looks like your underlying profitability is running towards 100%.

Does it still make sense to use those treaties if your attritionals are rising to that sort of level? And should we expect to see a lower level of quota share reinsurance going forward when you renew?

A - Geraint Jones {BIO 19738535 <GO>}

So going back to the rationale for using quota shares, there are a couple of reasons we use it. Partly from a capital release, it's partly about loss protection and it's partly about the size that the reinsurance grows with the rate of growth of the business. So there are a couple of good reasons why we've used reinsurance in the past and I think we'll continue to use it in the future.

In terms of our Solvency II quota share reinsurance we believe that Solvency II gives appropriate capital relief for quota share reinsurance and co-insurance where that reinsurance provides protection against loss in extreme events. We don't think that changes from the current ICAS regime.

In terms of the actual level of capital relief you get for individual contracts, obviously we won't go into those numbers.

I'll refer you to the comment we made in the presentation on the surplus we show now if the Group ICAS requirement was in effect today that would be in excess of GBP300 million.

And what was the final bit?

Q - Marcus Barnard {BIO 2103471 <GO>}

Will you continue using your (inaudible) and your attritional loss ratio (inaudible)?

A - Geraint Jones {BIO 19738535 <GO>}

So the attritional loss ratio, as you recall, is 85% excluding releases. But don't forget that that includes a buffer above the projected ultimates. So it's not quite fair to say that the underlying level of profitability has hit 100% because obviously we would expect to bring that down over time.

As to whether we will continue to use reinsurance into the future, we think as long as the reinsurance brings the benefits it's brought in the past, capital relief, loss protection, flexibility, then I don't see any fundamental or immediate change in that business model.

Q - Ravi Tanna {BIO 16926941 <GO>}

Ravi Tanna, Goldman Sachs. Three questions, please. So the first one is on the UK claims environment. I'm just curious to know what the impacts from the Ministry of Justice's whiplash report cost cap is likely to be on claims costs and, in particular, whether that might spell a recurrence of what we saw last year in the market following the legal reforms. And if that has any bearing, or if it's sufficiently material to impact UK pricing and the scenario that you've laid out there.

The second one was on administration fees. And there has been some discussion in the press around the level of fees being charged by motor insurers. Just wondering what your level is and whether that's changed materially over time.

And the third one was a question on the investment allocation and the changes that you've made there. Perhaps you could give us a little bit more color as to the likely materiality of the impact on earnings from that. And whether that's -- you make a comment in there about investment risk not being materially greater. Is that something that's within your appetite going forward to increase investment risk further?

A - Geraint Jones {BIO 19738535 <GO>}

So in terms of the materiality of the changes on the likely yield, I would say not very at all. I think what we have done effectively is move some money out of money market funds and into fixed income. And that doesn't really result in any material change in the level of market risk capital allocated to investment and so you've got to move out of AAA into single A.

So in theory, there is more risk in the portfolio. But not much and so you don't generate that much additional yield.

As to whether we'll go further, we'll keep on looking at it and if there are opportunities to take additional yield without fundamentally changing the risk, the volatility and so on, then we'll look at them. But I don't see us moving very materially at that risk spectrum.

A - David Stevens {BIO 6807391 <GO>}

I'll do admin charges and Lorna can do medical costs.

On admin charges, I think some of the coverage on it may have shown in our numbers actually, which showed us very middle of the road, certainly not an outlier; actually lower on some of the charges than some of our major competitors. And we're always very careful to be able to set our charges in a way that's justifiable by reference to the costs that underlie the process.

So we don't feel that that's a source of competitive disadvantage at the moment that we're particularly vulnerable on that front.

A - Lorna Connelly {BIO 19791125 <GO>}

On the fees, I think fixing [ph] fees is good news. But on its own it's not material.

I think what really needs to happen is the report in itself to change going forward. So having reports that have got more evidential value and that can be (inaudible) ending cases where you think there's low velocity, that kind of thing. That's the thing that really needs to change.

Q - Andy Hughes {BIO 15036395 <GO>}

A couple of additional questions, if I could. The first one, what is the H1 E&Y loss ratio to compare to the 85%?

The second one is, I guess, on -- a high level question on the debt raising and the dividend. So you don't retain any unnecessary cash at the -- in the business. But you've raised more than the GBP200 million you needed.

More than the -- the GBP200 million is more than you needed. So without the GBP200 million, would you still have been able to pay the dividend? And it sounds like you probably raised GBP100 million more than you actually thought you needed. Is that fair comment?

And the press comment yesterday that you might be interested in buying a telematics provider for GBP150 million, given your commentary about how much excess capital you have, presumably if you were to do that, although it sounds unlikely from your comments, presumably you'd have to raise more capital somewhere else? Thank you.

A - David Stevens {BIO 6807391 <GO>}

I'll do H1 first. Your favorite exhibit on page 50 is an exhibit that's been debated as to whether we give excess disclosure and, on balance, the investors and the analysts like it. But we have decided not. And this is true in 2013, not to give disclosure of best estimates at the half-year level because it is so early in the evolution of the year that it can be just very misleading.

So we've compromised on a disclosure that gives full-year ultimates and so we will be adding that to the projection, to the exhibit, at the full-year results.

Q - Andy Hughes {BIO 15036395 <GO>}

But can I just work it out from the comment for the reserve buffer's the same, take off the earned movement here and then the rest must be the current year, because you said the reserve buffer is the same. So I can work it out, can't I?

A - David Stevens {BIO 6807391 <GO>}

Well then that's something you can go away and do if you feel that's possible.

A - Geraint Jones {BIO 19738535 <GO>}

The question on the debt. So I'd go back to the comment earlier, appropriate amount at the appropriate time, I think.

It's there to deal with uncertainties that come in Solvency II. When Solvency II is in effect and we're live in that environment we've got certainty over the level of capital requirement. We'll have certainty over the level of surplus.

A - Henry Engelhardt {BIO 3022947 <GO>}

In addition, we don't want to starve our businesses. As you can see we've got a lot of businesses that are getting up to speed, Kevin's business growing very quickly, money needed for Andrew's business. We haven't talked much about Spain, Italy or France but they're all moving forward.

So there's a lot of places to soak up capital other than the ones you've mentioned.

Q - Andy Hughes {BIO 15036395 <GO>}

So a clarification question on the guidance about the reserve margin that came out at the time of the trading update. So does it mean -- is your statement really saying that, absent any increase in prices or any surprise positive development (inaudible) loss ratios, that ultimately earnings will be coming down next year as a result of you wanting to keep this buffer the same? Because the natural evolution of this buffer should be that it reduces as you get the impact weighing through of these large reserve releases, unless we have further positive development in that E&Y number, as we've had in this period.

So are you guiding that we shouldn't expect more E&Y positive developments we've had this half year and the earnings are going to be lower in future as a result? Thank you.

A - David Stevens {BIO 6807391 <GO>}

No. We're not taking a position on how the ultimate loss ratios will evolve because we don't know. And nor are we saying that we have a desired level of buffer and that that's fixed over time.

The level of buffer is a reflection of the level of volatility that we're facing and the uncertainties that we're facing and it can vary upwards or downwards. But we're not sitting here today saying there's a long-term aspiration in terms of that buffer that we fix.

All we're saying is, in a sense, an almost obvious point, that if, in a sense, claims inflation has reemerged and premiums don't start to rise, at some stage -- well, progressively the current loss ratio will get worse. And at some stage, it will be impossible to compensate for that through reserve releases.

That's almost mathematically obvious. But I just think it's important that people should be aware of the claims pressures that are out there and the carry-through impact of written premium reduction on earned results and bear that in mind when they think about the future.

You have to take a position on what you think claims inflation and premium patterns are going to be over the next 18 months or two years. We're just, in effect, making a potentially obvious point that, if we see more of what we've seen in the last 18 months in terms of margins, then there is an issue in the medium term.

What we've also said is typically our profits tend -- what we deliver on profits tend to lag two years to roughly the actual experience.

So the big area of uncertainty is two years out rather than necessarily the second half of this year or early 2015.

Q - Greig Paterson

Three questions. One quickly is, when you talk about the buffer, I assume you're talking about 2014. Are you talking relative to earned or written? Because one of them you jump around and one -- I've always struggled. Sometimes one jumps around. And sometimes the other. I think it's earned, if I'm not mistaken. I think you set a stable relative to earned.

A - David Stevens {BIO 6807391 <GO>}

Do you want to do that one, Geraint, as the new finance officer?

A - Geraint Jones {BIO 19738535 <GO>}

When we're assessing the size of the buffer that we want to hold, it's based on the amount of premium that a business has been earned at that point in time.

Q - Greig Paterson

All right. So it was 13 or 10 [ph] first half of last year -- 13 announced -- 10 or 13? Are you talking about it to the end of last year, or relative to the beginning of the year? When you said stable, is it a year-on-year comparison or over the half year?

A - Geraint Jones {BIO 19738535 <GO>}

So the stability comparison is against the end of last year. And we're valuing the buffer on the size of the business that's been cumulatively earned to the end of June 2014.

Q - Greig Paterson

All right. So it's a sterling amount that you're keeping stable.

A - Geraint Jones {BIO 19738535 <GO>}

That's relative.

Q - Greig Paterson

Sterling relative to --?

A - Geraint Jones {BIO 19738535 <GO>}

The margin as a percentage of the best estimate.

Q - Greig Paterson

Is it across the whole book? Or are you talking about --?

A - Geraint Jones {BIO 19738535 <GO>}

Across the whole book.

Q - Greig Paterson

So whole book on an earned basis. All right, cool.

Second question is just on this advertising campaign, are you talking about relative to Direct Line or relative to one of the price comparison websites, that's Confused.com? You said Confused.com is facing serious --

A - Henry Engelhardt {BIO 3022947 <GO>}

The meerkat is the reference.

Q - Greig Paterson

All right. Then the third thing is you talk about -- I don't understand why it doesn't come into thinking. But we've got an election coming up next year. The Tories have invested a lot of time and money in getting premium rates down. They've still got some levers to pull on the portal and various other areas that they've put on hold for the time being.

Isn't it fair to say that if we saw premium rates starting to rise. And they're still pretty unaffordable for young drivers, we're going to see the politicians starting to pull the levers again and then we'll see the whole cycle that we saw in the last 12 months?

A - David Stevens {BIO 6807391 <GO>}

I think what has already happened will result in most of the electorate receiving lower renewal rates than they did 12 months ago, because the impact of these changes takes, on average, six months for the customer to experience them because the average policy length is 12 months. So I'm not sure necessarily if it will get up the political agenda quite as fast as that.

I think also time is very tight now to pull a lever and impact claims experience between now and May 2015.

Q - Greig Paterson

But they're going to make headlines. They can stand up and make a huge headline about it.

A - David Stevens {BIO 6807391 <GO>}

They can, indeed. But often when politicians make headlines it's not necessarily material to the actual outcome at the coal face. (multiple speakers) Having said that, what the Government has done. And the reforms that took place (inaudible) were valuable reforms and are to be applauded.

Q - Greig Paterson

What is the -- if you remember what happened last time, the Government was speaking -- made some announcements and there were six months before they were even coming in to play and hadn't even been clarified and we saw rates starting to drop.

A - David Stevens {BIO 6807391 <GO>}

I think unless they make some very dramatic announcements that are not currently on their agenda, as far as we're aware, there's no likelihood of people dropping rates in anticipation of reform.

A - Henry Engelhardt {BIO 3022947 <GO>}

Are there any questions from outside the room? No questions. Thank you very much for your attendance today and we'll see you again in March. Thank you.

Operator

This concludes today's call, ladies and gentlemen. Thank you for joining. You may now disconnect your lines.